CHINA HGS REAL ESTATE INC.
Form 10-Q
February 07, 2014

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, 2013

¨ 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**
(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 x 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 x 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 x
Non-accelerated filer ¨ (Do not check if a smaller reporting	Smaller reporting company ¨

company)

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

The number of shares outstanding of each of the issuer's classes of common equity, as of January 30, 2014 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. INTERIM FINANCIAL STATEMENTS

CHINA HGS REAL ESTATE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	December 31 2013		September 30 2013	
ASSETS				
Current assets:				
Cash	$	3,233,673	$	5,878,101
Restricted cash		1,302,610		1,332,807
Advances to vendors		198,144		109,134
Cost and earnings in excess of billings		5,391,207		2,178,270
Real estate property development completed		11,413,583		11,607,164
Real estate property under development		1,708,660		1,580,670
Other current assets		459,689		368,377
Total current assets		23,707,566		23,054,523
Property, plant and equipment, net		962,283		977,739
Real estate property development completed, net of current portion		7,330,449		7,619,811
Security deposits for land use right		3,272,144		3,259,240
Real estate property under development, net of current portion		170,227,294		142,916,601
Total Assets	$	205,499,736	$	177,827,914
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Bank loan current portion	$	4,908,216	$	4,888,860
Accounts payable		26,864,280		22,527,686
Other payables		3,639,846		1,863,922
Construction deposits		373,139		357,447
Billings in excess of cost and earnings		6,081,624		5,109,758
Customer deposits		7,051,799		6,130,466
Shareholder loan		6,145,591		1,810,000
Accrued expenses		2,803,811		2,896,539
Taxes payable		5,956,308		6,612,707
Total current liabilities		63,824,614		52,197,385
Long-term bank loan, less current portion		19,632,865		11,407,340
Deferred tax liabilities		958,212		650,067
Customer deposits, net of current portion		17,452,508		13,410,081
Construction deposits, net of current portion		1,017,892		1,013,877
Total liabilities		102,886,091		78,678,750
Commitments and Contingencies				
Stockholders' equity				
		45,050		45,050

Common stock, $0.001 par value, 100,000,000 shares authorized, 45,050,000 shares issued and outstanding December 31, 2013 and September 30, 2013				
Additional paid-in capital		17,759,349		17,759,349
Statutory surplus		8,977,230		8,977,230
Retained earnings		66,315,034		63,257,918
Accumulated other comprehensive income		9,516,982		9,109,617
Total stockholders' equity		102,613,645		99,149,164
Total Liabilities and Stockholders' Equity	$	205,499,736	$	177,827,914

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

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

	Three months ended December 31,			
	2013		2012	
Real estate sales	$	14,140,563	$	11,003,415
Less: Sales tax		(946,688)		(710,717)
Cost of real estate sales		(9,145,841)		(3,830,244)
Gross profit		4,048,034		6,462,454
Operating expenses				
Selling and distribution expenses		114,350		161,094
General and administrative expenses		540,229		560,971
Total operating expenses		654,579		722,065
Operating income		3,393,455		5,740,389
Interest income		4,559		-
Interest expense		(18,100)		(18,100)
Other income - net		-		7,952
Income before income taxes		3,379,914		5,730,241
Provision for income taxes		322,797		221,164
Net income		3,057,117		5,509,077
Other comprehensive income				
Foreign currency translation adjustment		407,365		208,985
Comprehensive income	$	3,464,482	$	5,718,062
Basic and diluted income per common share				
Basic	$	0.07	$	0.12
Diluted	$	0.07	$	0.12
Weighted average common shares outstanding				
Basic		45,050,000		45,050,000
Diluted		45,127,025		45,050,000

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,			
	2013		2012	
Cash flows from operating activities				
Net income	$	3,057,117	$	5,509,077
Adjustments to reconcile net income to net cash used in operating activities:				
Deferred tax provision		304,878		-
Depreciation		19,283		22,404
Stock based compensation		-		3,412
Changes in assets and liabilities:				
Restricted cash		35,394		(77,263)
Accounts receivable		-		(4,664,334)
Advances to vendors		(88,377)		(1,806,155)
Loans to outside parties		-		15,903
Cost and earnings in excess of billings		(3,197,042)		-
Real estate property development completed		557,801		3,830,244
Real estate property under development		(26,805,615)		(6,376,199)
Other current assets		(89,649)		(9,542)
Accounts payables		4,237,763		306,655
Other payables		1,764,531		178,775
Billings in excess of cost and earnings		949,475		-
Customer deposits		4,875,305		3,019,617
Construction deposits		14,245		(731)
Accrued expenses		(103,277)		90,860
Taxes payable		(681,032)		(627,900)
Net cash used in operating activities		(15,149,200)		(585,177)
Cash flow from financing activities				
Proceeds from shareholder loan		4,325,754		-
Proceeds from bank loan		8,161,800		-
Net cash provided by financing activities		12,487,554		-
Effect of changes of foreign exchange rate on cash		17,218		4,359
Net decrease in cash		(2,644,428)		(580,818)
Cash, beginning of period		5,878,101		1,104,686
Cash, end of period	$	3,233,673	$	523,868
Supplemental disclosures of cash flow information:				
Interest paid	$	355,757	$	-
Income taxes paid	$	185,313	$	404,003

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

CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 varial interest entity (“VIE”), engages in real estate development, and the construction and sales of residential apartments, parking space 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, 2013 and 2012 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, 2013.

The Company’s accounts have been prepared in accordance with U.S. GAAP on a going concern basis. As of December 31, 2013, the Company had an approximate deficit of $40,117,048 in working capital because a significant portion of our real estate property under development are classified as a long term asset, although these real estate under developments are under pre-sale contracts. With respect to capital funding requirements, the Company budgeted our capital spending based on our ongoing assessments of needs to maintain adequate cash. Due to the long term relationship with our various construction suppliers, we were able to effectively manage cash spending on construction. We have a limited bank loan of $24,541,081 as of December 31, 2013, representing only 12.9% of total real estate assets including real estate property development completed and real estate property under development, which provides us additional capacity to access new bank loans if needed. Also our major shareholder, Xiaojun Zhu has agreed to provide his personal funds, if necessary, to support our financial needs. In addition, the Company’s cash flows from pre-sales and current sales should provide sufficient financial support for our current developments and operations.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The unaudited 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 U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes, and disclosure of contingent liabilities at the date of the consolidated financial statements. Estimates are used for, but not limited to, the assumptions and estimates used by management in recognizing development revenue under the percentage of completion method, the selection of the useful lives of property and equipment, provision necessary for contingent liabilities, fair values, revenue recognition, taxes, budgeted costs, share-based compensation and other similar charges. Management believes that the estimates utilized in preparing its consolidated financial statements are reasonable and prudent. Actual results could differ from these estimates.

CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Fair value of financial instruments (continued)

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 consolidated balance sheets for cash, restricted cash, advances to vendors, security deposits for land use rights, other current assets, accounts payable, other payables, customer deposits, 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, construction and security deposits approximate their carrying amounts because the deposits are received in cash. The carrying value of the long term bank loan approximates fair value because it has a variable rate of interest.

Revenue recognition

Percentage of Completion method

Real estate sales for the long term real estate projects are recognized under percentage completion method in accordance with the provisions of ASC 360-20-40D “Sale of Condominium Units”. Revenue and profit from the sales of long term development properties is recognized by the percentage of completion method on the sale of individual units when all the following criteria are met:

a. Construction is beyond a preliminary stage.
b. The buyer is committed to the extent of being unable to require a refund except for non-delivery of the unit or interest.
c. Sufficient units have already been sold to assure that the entire property will not revert to rental property.
d. Sales prices are collectible.
e. Aggregate sales proceeds and costs can be reasonably estimated.

If any of the above criteria is not met, proceeds shall be accounted for as deposits until the criteria are met.

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CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition - continued

Percentage of Completion method

Under the percentage of completion method, revenues from condominium units sold and related costs are recognized over the course of the construction period, based on the completion progress of a project. In relation to any project, revenue is determined by calculating the ratio of incurred costs, including land use rights costs and construction costs, to total estimated costs and applying that ratio to the contracted sales amounts. Cost of sales is recognized by determining the ratio of contracted sales during the period to total estimated sales value, and applying that ratio to the incurred costs. Current period amounts are calculated based on the difference between the life-to-date project totals and the previously recognized amounts.

Revenue recognized to date in excess of amounts received from customers is classified as current assets under cost and earnings in excess of billings, whose balance is $5,391,207 as of December 31, 2013 (September 30, 2013-$2,178,270). Amounts received from customers in excess of revenue recognized to date are classified as current liabilities under billings in excess of cost and earnings, whose balance is $6,081,624 as of December 31, 2013 (September 30, 2013-$5,109,758).

Any changes in significant judgments and/or estimates used in determining construction and development revenue could significantly change the timing or amount of construction and development revenue recognized. Changes in total estimated project costs or losses, if any, are recognized in the period in which they are determined.

Full accrual method

Revenue from the sales of short term development properties, where the construction period is expected to be 18 months or less 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 for 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.

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 receives 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, our mortgage-loan based sales contract terminates and there will be 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 Property has been issued by the relevant government authority, our 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.

CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition - continued

Full accrual method

For municipal road construction projects, fees are generally recognized by the full accrual method at the time the projects are completed.

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,
	2013	2012	2013
Period end RMB : USD exchange rate	6.1122	6.3011	6.1364
Three months average RMB : USD exchange rate	6.1261	6.2880	6.2320

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.

Cash

Cash includes cash on hand and demand deposits in accounts maintained with commercial banks within the PRC. The Company considers all highly liquid investments with original maturities of three months or less when purchased to be cash equivalents. The Company maintains bank accounts in the PRC. Cash balances in bank accounts in PRC are not insured.

Restricted Cash

The restricted cash is required by the banks as collateral for mortgage loans given to the home buyers before obtaining the certificates of ownership of the properties as collateral. In order to provide the banks with the certificates of ownership, the Company is required to complete certain procedures with the Chinese government, which normally takes six to twelve months. Because the banks provide the loan proceeds to the Company without obtaining certificates 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. The restricted cash is released by the banks once they receive the certificates of ownership. As of December 31, 2013 and September 30, 2013, restricted cash totaled $1,302,610 and $ 1,332,807, respectively. These deposits are not covered by insurance. The Company has not experienced any losses in such accounts and management believes its restricted cash account is not exposed to any risks.

CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 and commercial 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. As of December 31, 2013 and September 30, 2013, the Company had outstanding advances to vendors in the amount of $198,144 and $ 109,134, respectively.

Security deposits for land use rights

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

Real estate property development completed and under development

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

Real estate property development completed and real estate property under development are reclassified on the balance sheet into current and non-current portions based on the estimated date of construction completion and sales. The real estate property development completed classification is based on the estimated date that each property is expected to be sold within the Company’s normal operating cycle of the business and the Company’s sales plan. Real estate property development completed is classified as a current asset if the property is expected to be sold within the normal operating cycle of the business. Otherwise, it is classified as a non-current asset. Real estate property under development is classified as a current asset, if the property is reasonably expected to be completed within the Company’s normal operating cycle of the business. Otherwise, it is classified as a non-current asset. The majority of real estate projects the Company has completed in the past were multi-layer or sub-high-rise real estate projects. The Company considers its normal operating cycle is 12 months.

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CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Real estate property development completed and under development (continued)

In accordance with ASC 360, "Property, Plant and Equipment" ("ASC 360"), real estate property development completed and under development are subject to valuation adjustments 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. The Company reviewed all of its real estate projects for future losses and impairment by comparing the estimated future undiscounted cash flows for each project to the carrying value of such project. For the three months ended December 31, 2013 and 2012, the Company did not recognize any impairment for real estate property under development and completed.

Capitalization of Interest

Interest incurred during and directly related to real estate development projects is capitalized to the related real estate property under development during the active development period, which generally commences when borrowings are used to acquire real estate assets and ends when the properties are substantially complete or the property becomes inactive. Interest is capitalized based on the interest rate applicable to specific borrowings or the weighted average of the rates applicable to other borrowings during the period. Interest capitalized to real estate property under development is expensed as a component of cost of real estate sales when related units are sold. All other interest is expensed as incurred.

Impairment of long-lived assets

In accordance with ASC 360, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company is required to review its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable through the estimated undiscounted cash flows expected to result from the use and eventual disposition of the assets. Whenever any such impairment exists, an impairment loss will be recognized for the amount by which the carrying value exceeds the fair value.

Assets are grouped and evaluated at the lowest level for their identifiable cash flows that are largely independent of the cash flows of other groups of assets. The Company considers historical performance and future estimated results in its evaluation of potential impairment and then compares the carrying amount of the asset to the future estimated cash flows expected to result from the use of the asset. If the carrying amount of the asset exceeds estimated expected undiscounted future cash flows, the Company measures the amount of impairment by comparing the carrying amount of the asset to its fair value. The estimation of fair value is generally determined by using the asset's expected future discounted cash flows or market value. The Company estimates fair value of the assets based on certain assumptions such as budgets, internal projections, and other available information as considered necessary. There is no impairment of long-lived assets during the three months ended December 31, 2013 and 2012, respectively.

CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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.

Property warranty

The Company provides its customers with warranties which cover major defects of building structure and certain fittings and facilities of properties sold. The warranty period varies from two years to five years, depending on different property components the warranty covers. The Company continually estimates potential costs for materials and labor with regard to warranty-type claims expected to be incurred subsequent to the delivery of a property. Reserves are determined based on historical data and trends with respect to similar property types and geographical areas. The Company continually monitors the warranty reserve and makes adjustments to its pre-existing warranties, if any, in order to reflect changes in trends and historical data as information becomes available. The Company may seek further recourse against its contractors or any related third parties if it can be proved that the faults are caused by them. In addition, the Company also withholds up to 2% of the contract cost from sub-contractors for periods of two to five years. These amounts are included in construction deposits, and are only paid to the extent that there has been no warranty claim against the Company relating to the work performed or materials supplied by the subcontractors. For the periods ended December 31, 2013 and September 30, 2013, the Company had not recognized any warranty liability or incurred any warranty costs in excess of the amount retained from subcontractors.

Construction Deposits

Construction deposits are the warranty deposits the real estate contractors provide to the Company upon signing the construction contracts. The Company can use such deposits to reimburse customers in the event of customer claims due to construction defects. The remaining balance of the deposits are returned to the contractors when the terms of the after-sale property warranty expires, which normally occurs within two to five years after the date of the deposit.

Share-based compensation

The Company accounts 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.

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CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, 2013 and September 30, 2013.

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, 2013, and 2012, respectively.

As of December 31, 2013, the tax years ended September 30, 2006 through December 31, 2013 for the Company’s PRC entities remain open for statutory examination by PRC tax authorities. The parent Company China HGS Real Estate Inc.’s tax years ended September 30, 2010 through December 31, 2013 remains open for statutory examination by U.S. tax authorities.

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%. Yang County, where the project Yangzhou Pearl Garden and Yangzhou Palace are located, requires a tax rate of 0.5%.

CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Comprehensive income

In accordance with ASC 220-10-55, comprehensive income is defined as all changes in equity except those resulting from investments by owners and distributions to owners. The Company's only components of comprehensive income during the three months ended December 31, 2013 and 2012 were net income and foreign currency translation adjustments.

Basic and diluted earnings per share

The Company computes earnings per share ("EPS") in accordance with the ASC 260, "Earnings per share", which requires companies to present basic and diluted EPS. Basic EPS is measured as net income divided by the weighted average common shares outstanding for the period. Diluted EPS is similar to basic EPS but presents the dilutive effect on a per share basis of potential common shares (e.g., convertible securities, options and warrants) as if they had been converted at the beginning of the periods presented, or issuance date, if later. Potential common shares that have an anti-dilutive effect (i.e., those that increase income per share or decrease loss per share) are excluded from the calculation of diluted EPS. For the three months ended December 31, 2013, the dilutive effect of common shares from stock options was 77,025 (2012 Nil).

Advertising expenses

Advertising costs are expensed as incurred. For the three months ended December 31, 2013 and 2012, the Company recorded advertising expenses of $48,743 and $51,115, respectively.

Concentration risk

The Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environment in the PRC, and by the general state of the PRC's economy. The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in North America. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things. Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and trade accounts receivable. All of the Company's cash is maintained with state-owned banks within the People's Republic of China of which no deposits are covered by insurance. The Company has not experienced any losses in such accounts and believes it is not exposed to any risks on its cash in bank accounts.

The Company is dependent on third-party sub-contractors, manufacturers, and distributors for all construction services and supply of construction materials. For the three months ended December 31, 2013, none of the suppliers accounted for over 10% of project expenditures. One supplier accounted for 10.9% of project expenditures for the three months ended December 31, 2012.

CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 3. 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, 2013 and September 30, 2013:

	December 31, 2013		September 30, 2013	
Development completed				
Hanzhong City Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)	$	4,938,409	$	5,031,358
Hanzhong City Nan Dajie (Mingzhu Xinju)		1,645,264		1,638,775
Yang County Yangzhou Pearl Garden		11,543,824		11,941,367
Hanzhong City Central Plaza		616,535		615,475
Real estate property development completed		18,744,032		19,226,975
Less: Real estate property completed short-term		11,413,583		11,607,164
Real estate property completed long-term	$	7,330,449	$	7,619,811
Under development:				
Hanzhong City Oriental Pearl Garden	$	66,502,917	$	53,467,802
Hanzhong City Mingzhu Garden-Mingzhu Beiyuan (a)		59,155,010		54,727,543
Yang County Yangzhou Pearl Garden (b)		7,822,202		7,637,133
Yang County Yangzhou Palace		20,350,277		19,190,615
Hanzhong City Shijin Project		7,924,775		7,893,522
Hanzhong City Mingzhu Road West (c)		1,400,421		1,280,332
Hanzhong City Liuhou Road (c)		308,239		300,323
Hanzhong City Liangzhou Road (d)		8,472,113		-
Real estate property under development		171,935,954		144,497,271
Less: Short-term portion		1,708,660		1,580,670
Real estate property under development long-term	$	170,227,294	$	142,916,601

(a) The Company recognized $7,524,150 of development cost in cost of real estate sales under the percentage of completion method for the three months ended December 31, 2013 (2012- $Nil)

(b) The Company recognized $1,063,902 of development cost in cost of real estate sales under the percentage of completion method for the three months ended December 31, 2013 (2012- $Nil)

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CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 3. REAL ESTATE PROPERTY DEVELOPMENT COMPLETED AND UNDER DEVELOPMENT

(c) In June 2012, the Company was approved by Hanzhong local government to construct two municipal roads with total length of 1,064.09 meters. The budgeted price for these two municipal roads is approximately $3.0 million (RMB 18,716,489) which was approved by the Hanzhong Ministry of Finance. The related construction was substantially completed as of December 31, 2013. A further extension on this road construction was under discussion between the Company and the Hanzhong local government and therefore, these two roads have not been delivered to the local government as of December 31, 2013. For these construction projects, the Company recognizes the fee as other revenue using the full accrual method when the project is completed.

(d) In September 2013, the Company entered into a framework agreement (“Liangzhou Agreement”) with Hanzhong local government on Liangzhou Road reformation and expansion project (Liangzhou Road Project”). Pursuing to the agreement, the Company is contracted to reform and expand Liangzhou Road, a commercial street at downtown of Hanzhong City, with a total length of 2,080 meters and width of 30 meters and resettle the existing residence in Liangzhou road area. The total of construction and residence’s resettlement cost (“Investment”) is approximately $33 million (RMB 202,265,310) in accordance with Liangzhou Agreement. The Company, in return, is compensated by local government to have an exclusive right on acquiring at least 394.5 Mu land use right in a specified location of Hanzhong City. The Company’s Investment on Liangzhou Road Project is treated as the Company’s deposit on purchasing the related land use right. The Company is also authorized by local government to develop and manage the commercial units surrounding the Lianzhou Road. The Liangzhou Road Project just started in the end of 2013 and is expected to be completed by the end of 2014. The Company determines that this is a barter transaction with commercial substance and that the conditions for revenue recognition has not met until the completion of Liangzhou Road Project.

As of December 31, 2013 and September 30, 2013, land use rights included in real estate property under development totaled $59,941,143 and $52,896,558, respectively.

NOTE 4. 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 approximately of $19.6 million (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, 2013, a deposit of $3,272,144 (RMB20,000,000) (September 30, 2013 - $3,259,240 or RMB 20,000,000) was paid by the Company. The Company currently expects to make payment of the remaining development cost based on the government’s current work progress. The Company has classified the security deposits for land use rights to long term assets based on the Company’s development plan

NOTE 5. BANK LOAN

On August 23, 2013, the Company entered into a project finance loan agreement (the "Loan Agreement") with China Construction Bank, Hanzhong Branch (the “Bank") for a working capital loan (the “Loan”). The Loan has a three-year term in the principal amount of $24,541,081 (RMB150,000,000) at an interest rate (6.46% at December 31, 2013), which is 5% over the benchmark interest rate and is adjustable every twelve months from the date of the loan. The loan is for the development of the Company’s Mingzhu Beiyuan project. As of December 31, 2013, the Company received loan proceeds of $24,541,081 or RMB 150,000,000. (September 30, 2013-$16,296,200 or RMB 100,000,000) from the bank.

	December 31, 2013	September 30, 2013
China Construction Bank Loan	$ 24,541,081	$ 16,296,200
Less: current maturities of long-term bank loan	4,908,216	4,888,860
Bank loan long term	$ 19,632,865	$ 11,407,340

The weighted average interest rate of the loan was 6.46% as of December 31, 2013 (September 30, 2013 6.46%). For the three months ended December 31, 2013, total loan interest was $356,567, which was capitalized in to the development cost of Mingzhu Garden Mingzhu Beiyuan project.

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CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 5. BANK LOAN (continued)

The Company pledged its real estate properties in the Mingzhu Beiyuan project with carrying value of $59,155,010 as of December 31, 2013 (September 30, 2013 - $54,727,543). The Loan is also subject to certain covenants including current ratio not less than 2 and quick ratio not less than 0.8. The bank treated all the Company's real estate property including real estate property completed and real estate property under development as current assets. As a result, the Company met the current ratio requirement as of December 31, 2013 and September 30, 2013, respectively. The bank waived the quick ratio requirement under the loan agreement as the Mingzhu Beiyuan project was still under construction.

The repayment of the loan is due and payable based on sales progress on the Mingzhu Beiyuan project and fixed milestone dates as follows:

	Repayment in USD	Repayment in RMB
May 20, 2014	1,636,072	10,000,000
August 20, 2014	3,272,144	20,000,000
February 20, 2015	6,544,288	40,000,000
August 20, 2015	6,544,288	40,000,000
February 10, 2016	4,908,216	30,000,000
August 20, 2016	1,636,073	10,000,000
Total	24,541,081	150,000,000

NOTE 6. 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, 2013	September 30, 2013
Customer deposits by real estate projects		
Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)	$ 11,592,390	$ 11,013,061
Hanzhong City Oriental Pearl Garden	10,224,172	6,617,245
Yangzhou Pearl Garden	2,687,745	1,910,241
Total	24,504,307	19,540,547
Including: Customer deposits -short-term	7,051,799	6,130,466
Customer deposits - long-term	$ 17,452,508	$ 13,410,081

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. The 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.

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CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 7. SHAREHOLDER LOANS

		December 31, 2013	September 30, 2013
Shareholder loan	USD loan (a)	$ 1,810,000	$ 1,810,000
Shareholder loan	RMB loan (b)	4,335,591	-
Total		$ 6,145,591	$ 1,810,000

(a) The Company entered into a one year loan agreement ("USD Loan Agreement") with Mr. Xiaojun Zhu, our Chairman, CEO and major shareholder, pursuant to which the Company borrowed $1,810,000 to make a capital injection into Shaanxi HGS, the Company's subsidiary. The interest rate for the loan is 4% per annum. On July 19, 2012, the term of the loan was extended to June 28, 2013. On July 19, 2013, the Company entered into the second amendment to the USD Loan Agreement to extend the term until June 28, 2014. The Company recorded interest expense of $18,100 for the three months ended December 31, 2013 and 2012, respectively. The Company has not paid this interest and it is recorded in accrued expenses in the balance sheets as of December 31, 2013 and September 30, 2013.

(b) On December 31, 2013, Shaanxi Guangsha Investment and Development Group Co., Ltd. (the "Guangsha"), the Company's PRC operating subsidiary, entered into a loan agreement with Mr. Xiaojun Zhu, our Chairman, CEO and major shareholder (the "Shareholder RMB Loan Agreement"), pursuant to which Guangsha shall from time to time borrow up to RMB 50 million (approximately US$8.2 million) from Mr. Zhu in order to support the Company's Liang Shan Road construction project development and the Company's working capital needs. The Loan Agreement has a one-year term at an interest rate, which is equal to the China RMB loan annual benchmark rate of 6.15% as of December 31, 2013. As of December 31, 2013, the shareholder RMB loan balance was $4,335,591 (September 30, 2013-$Nil).,

NOTE 8. 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.

On August 22, 2012, the Company's Board of Directors granted stock options to two new independent directors to repurchase up to an aggregate of 120,000 shares of the Company's common stock ("2013 Stock Options). The shares underlying the options become excisable during the following 36 months period at the end of each quarter. The exercise price of the options is $2.37 per share. As of December 31, 2013 and September 30, 2013, 41.6% and 33.3% of the option awards have vested, respectively.

The assumptions used in calculating the fair value of options granted using the Black-Scholes option pricing model are as follows:	Options granted in August 2012	
Risk-free interest rate	0.19	%
Expected life of the options	3 year	
Expected volatility	148	%
Expected dividend yield	0	%

Fair value	$	8,400

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CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 8. STOCK OPTIONS (continued)

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:

	Number of options	Weighted Average Exercise Price	Weighted Average Remaining Life in Years	Grant Date Fair Value
Outstanding, September 30, 2013	140,000	$ 2.39	1.89	$ 44,207
Granted	-	-	-	-
Forfeited	-	-	-	-
Exercised	-	-	-	-
Outstanding, December 31, 2013	140,000	$ 2.39	1.63	$ 44,207
Exercisable, December 31, 2013	70,000	$ 2.39	1.63	$ 39,308

Total stock-based compensation expense recognized in the three months ended December 31, 2013 and 2012, was $Nil and $3,412 respectively.

NOTE 9. 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 the 5% business sales tax based on revenue as a cost of sales as the revenue is recognized. As of December 31, 2013, the Company had business sales tax payable of $4,712,664 (September 30, 2013- $5,257,194), which is expected to be paid when the projects are completed and assessed by the local tax authority.

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 the privately 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 Yang County is 1.25% on revenue. For the three months ended December 31, 2013 and 2012, the Company's assessed income taxes were $17,919 and $221,164, respectively.

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.

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CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 9. TAXES (continued)

B) Corporate income taxes ("CIT")

The following table reconciles the statutory rates to the Company's effective tax rate for the three months ended December 31, 2013 and 2012:

	For the three months ended December 31, 2013		2012	
Chinese statutory tax rate	25.0	%	25.0	%
Exemption rendered by local tax authorities	(15.4)	%	(21.1)	%
Effective tax rate	9.6	%	3.9	%

Income tax expense for the three months ended December 31, 2013 and 2012 is summarized as follows:

	For the three months ended December 31, 2013		2012	
Current tax provision	$	17,919	$	221,164
Deferred tax provision		304,878		-
Income tax provision	$	322,797	$	221,164

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 $269,492 and $251,392 as of December 31, 2013 and September 30, 2013, respectively, which are available to reduce future years' taxable income. These carry forwards will expire in 2033. 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, 2013 and September 30, 2013. The components of deferred taxes as of December 31, 2013 and September 30, 2013 consist of the following:

	December 31, 2013		September 30, 2013
Deferred tax assets			
Deferred tax assets from net operating loss carry-forwards for parent company	$	91,627	$ 85,473
Valuation allowance		(91,627)	(85,473)
Deferred tax assets:		-	-
Deferred tax liability			
Revenue recognized based on percentage of completion		958,212	650,067
Deferred tax liability- long term	$	958,212	$ 650,067

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CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 9. TAXES (continued)

B) Corporate income taxes ("CIT")

The valuation allowance increased $6,154 and $7,314 for the three months end December 31, 2013 and 2012, respectively.

(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 0.5% in Yang County and 1.0% in Hanzhong against total cash receipts from sales of real estate properties, rather than according to the progressive rates. As at December 31, 2013, the Company made a prepayment on LAT of $50,831 with respect to completed real estate properties sold up to December 31, 2013. As at September 30, 2013, the prepayment on LAT was $96,232 with respect to completed real estate properties sold up to September 30, 2013.

(D) Taxes payable consisted of the following:

	December 31, 2013	September 30, 2013
CIT	$ 600,090	$ 764,836
Business tax	4,712,664	5,257,194
Other tax and fees	643,554	590,677
Total taxes payable	$ 5,956,308	$ 6,612,707

NOTE 10. 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.

CHINA HGS REAL ESTATE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 10. CONTINGENCY AND COMMITMENTS (continued)

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 approximately of $19.6 million (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, 2013, a deposit of $3,272,144 or RMB20,000,000 (September 30, 2013 - $3,259,240 or RMB 20,000,000) was paid by the Company. The Company currently expects to make payment of the remaining development cost based on the government's current work progress.

NOTE 11. SUBSEQUENT EVENTS

During January 2014, the Company borrowed an additional 3,844,769 (RMB 23,500,000) from Mr. Xiaojun Zhu, in accordance with the Shareholder RMB Loan Agreement signed on December 31, 2013 (Note 7). The Company further borrowed $1,881,483 (RMB 11,500,000) from Mr. Xiaojun Zhu with the same loan terms to support the Company's Liang Zhou Road construction project development and the Company's working capital needs. As of January 31, 2014, the shareholder's RMB loan balance was $10,061,843(RMB 61,500,000).

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 unaudited condensed consolidated financial statements of China HGS Real Estate, Inc. for the three months ended December 31, 2013 and 2012 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 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 "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 sustain our project development
- 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

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.

During 2013, the introduction of the cooling measures such as the "National Five" regulations has by far caused a temporary halt in land and property price appreciation. With uncertainties in the PRC government's credit tightening policies, the market for real estate sales in 2013 remained challenging. Developers generally have been reducing inventory by adopting more aggressive sales tactics. On the other hand, real estate housing demands and sales remained stable. In general, property developers in the market, including the Company, recorded satisfactory sales growth.

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China's urbanization, rising incomes and growing demand for a higher standard of living continues to create a strong housing need in the market. The Company believes that the demand from first-time buyers amid ongoing urbanization is expected to remain robust. The PRC government's continuous efforts to increase housing and land supply should be conducive to long-term healthy development of the property market.

For the three months ended December 31, 2013, our sales, gross profit and net income for the three months ended December 31, 2013 were $14,140,563, $4,048,034 and $3,057,117, respectively, representing an approximately 28.5% increase in sales from three months ended December 31, 2012 and 37.4% and 44.5% decrease in gross profit and net income from three months ended December 31, 2012, respectively. The decrease in gross profit and net income mainly resulted from a decrease in high margin commercial properties sold in the three month ended December 31, 2013.

The Company adopted the percentage of completion method in fiscal 2013 to account for real estate sales from large high rise residential projects with construction periods over 18 -24 months. Total revenue recognized under the percentage of completion method for the three months ended December 31, 2013 was $12,948,596 (2012- $Nil), representing 91.6% of total revenue for the quarter, with the related costs of these real estate sales was $8,588,040 (2012-$Nil), representing 93.9% of the real estate costs in the quarter. The gross profit from the percentage of completion method was $3,479,668 (2012-$Nil), representing 86.0% of the total gross profit for the quarter. The adoption of the percentage of completion method does not have any impact on the Company's interim consolidated financial statements for the three months ended December 31 2012, because the related conditions for revenue recognition under percentage of completion method was not met for the three months ended December 31 2012.

For the three months ended December 31, 2013, our average selling price ("ASP") for real estate projects (excluding sales of parking spaces) located in Yang County was approximately $425.7 per square meter, a decrease of 30.8% from the ASP of $615.2 per square meter for the three months ended December 31, 2012, due to less commercial units sold in this quarter. But the current quarter's ASP is consistent with the annual ASP of $441 per square meter in Yang County for fiscal 2013. The ASP of our Hanzhong real estate projects (excluding sales of parking spaces) was approximately $580.5 per square meter, a decrease from the ASP of $1,008.3 per square meter for the three months ended December 31, 2012. The higher ASP of Hanzhong real esteate projects in the first quarter of last year was a result of a sale of a large commercial floor located in Mingzhu Xinju project. For the three months ended December 31, 2012, the ASP for residential units in Hanzhong was $532.6 per square meter, which is consistent with the current quarter results.

Market Outlook

The Company expects the purchase restrictions and price ceiling policies to continue, which, however, should have less impact on the Company's products comparing to the premium real estate market in Tier 1 and Tier 2 cities. Our customers have a constant growth in their disposable income. With a lower housing price to family disposable income ratio and an increasing urbanization level, there is a growing demand for high quality residential housing. The Company expects to continuously focus on developing real estate properties in prime locations of Tier 3 and Tier 4 cities and counties. In this perspective, the Company is positive about the outlook for the local real estate market, as end-user demand stemming from rising disposable income and ongoing urbanization stays robust.

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. In this respect, in late fiscal 2012, we began the construction of the following large high rise residential projects in Hanzhong City and Yang County:

Oriental Pearl Garden

The project is located in downtown of Hanzhong City. It consists of 1 multi-layer residential building and 12 high-rise residential buildings with commercial shops on the first and second floors with an estimated GFA of 273,693 square meters. The Company started construction in the third quarter of fiscal 2012 and expects to complete the whole construction in 1-1.5 years. The pre-sale license was obtained in November 2013.

Mingzhu Beiyuan

The project is located in the south west part of Hanzhong City. It includes 17 high-rise residential buildings with an estimated GFA of 355,321 square meters. The Company started construction in the third quarter of fiscal 2012 and expects to complete the whole construction in 1-1.5 years. The pre-sale license was obtained in April 2013.

Yangzhou Pearl Garden

The Company is currently constructing 5 high-rise residential buildings and 1 multi-layer residential building with total GFA of 64,854 square meters in Yangzhou Pearl Garden located in Yang County. The related pre-sales licenses were obtained in February 2013. The construction is expected to be completed in 1-1.5 years.

Yangzhou Palace

The Company is currently constructing 9 high-rise residential buildings and 16 sub-high-rise residential and multi-layer residential buildings with total GFA of 285,244 square meters in Yangzhou Palace located in Yang County. The construction started in the fourth quarter of fiscal 2013. The related pre-sales license is expected to be obtained in later half of fiscal 2014. The construction is expected to be completed in 2-3 years.

Road Construction

In addition to the above residential projects, the Company was approved by the Hanzhong local government to construct two municipal roads with a total length of 1,064.09 meters. The budget for these two municipal roads was approximately $3 million and was approved by Hanzhong Ministry of Finance. The related construction was substantially completed as of September 30, 2013. A further extension on these road construction projects was under discussion between the Company and the Hanzhong local government, and therefore, these two roads have not been delivered to the local government as of December 31, 2013. For these construction projects, the Company recognizes the fee as other revenue using the full accrual method when the project is completed.

The Company also entered into a framework agreement (“Liangzhou Agreement”) with Hanzhong local government on Liangzhou Road reformation and expansion project (Liangzhou Road Project”). Pursuing to the agreement, the Company is engaged to reform and expand Liangzhou Road, a commercial street at downtown of Hanzhong City, with total length of 2,080 meters and width of 30 meters and resettle the existing residence in Liangzhou road area. The total of construction and residence’s resettlement cost (“Deemed Investment”) is approximately $33 million (RMB 202,265,310) in accordance with Liangzhou Agreement. The Company, in return, is compensated by local government to have an exclusive right on acquiring at least 394.5 Mu land use right in a specified location of Hanzhong City. The Company’s Deemed Investment on Liangzhou Road Project is treated as the Company’s deposit on purchasing the related land use right. The Company is also authorized by local government to develop and manage the commercial units surrounding the Lianzhou Road. The Liangzhou Road Project just started at the end of 2013 and is expected to be completed by the end of 2014. The Company determines that this is a barter transactions with commercial substance and that the conditions for revenue recognition has not met until the Company completes Liangzhou Road Project.

We expect these initiatives will help us during 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 unaudited condensed consolidated financial statements.

Revenue recognition

Percentage of Completion method

Real estate sales for the long term real estate projects are recognized under percentage completion method in accordance with the provisions of ASC 360-20-40D “Sale of Condominium Units”. Revenue and profit from the sales of long term development properties is recognized by the percentage of completion method on the sale of individual units when all the following criteria are met:

a. Construction is beyond a preliminary stage.
b. The buyer is committed to the extent of being unable to require a refund except for non-delivery of the unit or interest.
c. Sufficient units have already been sold to assure that the entire property will not revert to rental property.
d. Sales prices are collectible.
e. Aggregate sales proceeds and costs can be reasonably estimated.

If any of the above criteria is not met, proceeds shall be accounted for as deposits until the criteria are met.

Under the percentage of completion method, revenues from condominium units sold and related costs are recognized over the course of the construction period, based on the completion progress of a project. In relation to any project, revenue is determined by calculating the ratio of incurred costs, including land use rights costs and construction costs, to total estimated costs and applying that ratio to the contracted sales amounts. Cost of sales is recognized by determining the ratio of contracted sales during the period to total estimated sales value, and applying that ratio to the incurred costs. Current period amounts are calculated based on the difference between the life-to-date project totals and the previously recognized amounts.

Revenue recognized to date in excess of amounts received from customers is classified as current assets under cost and earnings in excess of billings. Amounts received from customers in excess of revenue recognized to date are classified as current liabilities under billings in excess of cost and earnings.

Any changes in significant judgments and/or estimates used in determining construction and development revenue could significantly change the timing or amount of construction and development revenue recognized. Changes in total estimated project costs or losses, if any, are recognized in the period in which they are determined.

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Full accrual method

Revenue from the sales of short term development properties, where the construction period is expected to 18 months or less 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 for 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.

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 receives 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, our mortgage-loan based sales contract terminates and there will be 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 Property has been issued by the relevant government authority, our 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.

For municipal road construction projects, fees are generally recognized by the full accrual method at the time of the projects are completed.

Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes, and disclosure of contingent liabilities at the date of the consolidated financial statements. Estimates are used for, but not limited to, the assumptions and estimates used by management in recognizing development revenue under the percentage of completion method, the selection of the useful lives of property and equipment, provision necessary for contingent liabilities, fair values, revenue recognition, taxes, budgeted costs, share-based compensation and other similar charges. Management believes that the estimates utilized in preparing its 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 on 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 consolidated balance sheets for cash, restricted cash, advances to vendors, security deposits for land use rights, other current assets, accounts payable, other payables, customer deposits, 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, construction and security deposits approximate their carrying amounts because the deposits are received in cash. The carrying value of the long term bank loan approximates fair value because it has a variable rate of interest.

Real estate property development completed and under development

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

Real estate property development completed and real estate property under development are reclassified on the balance sheet into current and non-current portions based on the estimated date of construction completion and sales. The real estate property development completed classification is based on the estimated date that each property is expected to be sold within the Company’s normal operating cycle of the business and the Company’s sales plan. Real estate property development completed is classified as a current asset if the property is expected to be sold within the normal operating cycle of the business. Otherwise, it is classified as a non-current asset. Real estate property under development is classified as a current asset, if the property is reasonably expected to be completed within the Company’s normal operating cycle of the business. Otherwise, it is classified as a non-current asset. The majority of real estate projects the Company has completed in the past were multi-layer or sub-high-rise real estate projects. The Company considers its normal operating cycle is 12 months.

In accordance with ASC 360, “Property, Plant and Equipment” (“ASC 360”), real estate property development completed and under development are subject to valuation adjustments 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. The Company reviewed all of its real estate projects for future losses and impairment by comparing the estimated future undiscounted cash flows for each project to the carrying value of such project. For the periods ended December 31, 2013 and September 30, 2013, the Company did not recognize any impairment for real estate property under development and completed.

RESULTS OF OPERATIONS

<u>Three Months Ended December 31, 2013 compared to Three Months Ended December 31, 2012</u>

Revenues

The following is a breakdown of revenue:

	For Three Months Ended December 31, 2013		2012	
Revenue recognized under full accrual method	$	1,191,967	$	11,003,415
Revenue recognized under percentage of completion method		12,948,596		-
Total	$	14,140,563	$	11,003,415

Revenues recognized under full accrual method

The following table summarizes our revenue generated by different projects:

	For Three Months Ended December 31, 2013 Revenue		%		2012 Revenue		%		Variance Amount		%	
Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)	$	241,539	20.3	%	$	1,272,786	11.6	%	$	(1,031,247)	(81.0)	%
Yangzhou Pearl Garden		950,428	79.7	%		4,313,737	39.2	%		(3,363,309)	(78.0)	%
NanDajie (Mingzhu Xinju)		-				5,416,892	49.2	%		(5,416,892)	(100)	%
Total Real Estate Sales before Sales Tax	$	1,191,967	100	%	$	11,003,415	100	%	$	(9,811,448)	(89.2)	%
Sales Tax		(299,258)				(710,717)				411,459	(57.9)	%
Revenue net of sales tax	$	892,709			$	10,292,698			$	(9,399,980)	(91.3)	%

Our revenues are derived from the sale of residential buildings, commercial front-stores and parking space in projects that we have developed. Our sales of completed real estate projects were slow during our first quarter ended December 31, 2013, because most of our completed real estate projects are in a later sales phase and only limited units are left for customer selection. Revenues before sales tax decreased by 89.2% to approximately $1.2 million for the three months ended December 31, 2013 from approximately $11.0 million for the same period last year. The total GFA sold during the three months ended December 31, 2013 was 2,649 square meters, representing a significant decrease from 13,028 square meters completed and sold for the three months ended December 2012. A significant portion of revenue for the first quarter last year was from the sales of commercial units in NanDajie Project (Mingzhu Xinju). On October 23, 2012, the Company entered into a sales agreement to sell the remaining commercial units in Nan Dajie (Mingzhu Xinju) project with a total GFA of 4,545.88 square meters located in Hanzhong City for a total contract amount of $5,393,038.

Sales tax for the three months ended December 31, 2013 and 2012 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, 2013 and 2012 was assessed at the rate of 0.5% of the customer deposits in Yang County and 1% of the customer deposits in Hanzhong. The sales tax for the three months ended December 31, 2013 decreased by 57.9% from the same period last year, primarily as a result of the decrease in our revenue.

Revenue recognized under percentage completion method

	For the three months ended December 31, 2013								
	Total GFA	Average Percentage of Completion(1)		Qualified Contract Sales(2)		Revenue Recognized under Percentage of Completion		Accumulated Revenue recognized under Percentage of completion	
Real estate properties under development located in Hanzhong									
Mingzhu Garden Mingzhu Beiyuan	355,321	69	%	$	52,069,959	$	11,441,649	$	35,113,394
Real estate properties under development located in Yang County									
Yangzhou Pearl Garden	64,854	62	%	$	8,642,278	$	1,506,947		5,371,036
Total	420,175				60,712,237		12,948,596		40,484,430

(1) Percentage of Completion is calculated by dividing total costs incurred by total estimated costs for the relevant buildings in the each real estate building , estimated as of the time of preparation of our financial statements as of and for the year indicated.

(2) Qualified contract sales only include all contract sales with customer deposits balance as of December 31, 2013 equal or greater than 30% of contract sales amount and related individual of buildings were sold over 20%.

For Mingzhu Garden Mingzhu Beiyua real estate property under development, the total contract sales as of December 31, 2013 was $63,207,604. Total GFA sold under the contract sales was 105,164 square meters. The average unit price was $591.5 per square meters. For the purpose of percentage of completion calculation, the qualified contract sales amount was approximately $52.1 million for the three month ended December 31, 2013 (2012- $Nil).

For Yangzhou Pearl Garden real estate property under development, the total contract sales as of December 31, 2013 was $8,691,899. Total GFA sold under the contract sales was 20,764 square meters. The average unit price was $417.5 per square meters. For the purpose of percentage of completion calculation, the qualified contract sales amount was approximately $8.6 million for the three month ended December 31, 2013 (2012- $Nil).

Cost of Sales

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

	For Three Months Ended December 31,											
	2013				2012				Variance			
	Cost		%		Cost		%		Amount		%	
Land use rights	$	1,139,115	12.5	%	$	645,018	14	%	$	494,097	76.6	%
Construction cost		8,006,726	87.5	%		3,185,226	86	%		4,821,500	151.4	%
Total cost	$	9,145,841	100	%	$	3,830,244	100	%	$	5,315,597	138.8	%

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 $9.1 million for the three months ended December 31, 2013 compared to $3.8 million for the three months ended December 31, 2012. The $5.3 million increase in cost of sales was mainly attributable to the increase in revenue during this quarter.

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, 2013 were $1,139,115, as compared to $645,018 for the three months ended December 31, 2012, representing an increase of $494,097 from the same quarter last year. The increase was consistent with the fact that the total revenue for the three months ended December 31, 2013 was higher than the same quarter of last year.

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, 2013 were approximately $8.0 million as compared to approximately $3.2 million for the three months ended December 31, 2012, representing an increase of $4.8 million. The increase in construction cost was due to the additional 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, 2013 increased to 67.4% from 34.8% for the three months ended December 31, 2012, which was mainly attributable to the fact the majority of revenue from this quarter were derived from sales of lower margin residential properties.

Gross Profit

Gross profit was approximately $4.0 million for the three months ended December 31, 2013 as compared to approximately $6.5 million for the three months ended December 31, 2012, representing a decrease of 2.4 million, which was mainly attributable to the sales of lower margin residential properties. The overall gross profit as a percentage of real estate sales before sales tax decreased to 28.6% during the three months ended December 31, 2013 from 58.7% for the same quarter last year, mainly due to the fact that more commercial units with higher margins in Hanzhong City and Yang County were sold during the same quarter last year.

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

	For Three Months Ended December 31,							
	2013				2012			
	Gross Profit		Percentage of Revenue		Gross Profit		Percentage of Revenue	
Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)	$	4,046,437	34.6	%	$	774,858	60.9	%
Yangzhou Pearl Garden		948,285	38.6	%		2,764,202	64.1	%
NanDajie (Mingzhu Xinju)		-	-			3,634,111	67.1	%
Sales Tax		(946,688)				(710,717)		
Total Gross Profit	$	4,048,034	28.6	%	$	6,462,454	58.7	%
Total Real Estate Sales before Sales Tax	$	14,140,563			$	11,003,415		

Operating Expenses

Total operating expenses decreased by 9.3% or $67,486 to $654,579 for the three months ended December 31, 2013 from $722,065 for the three months ended December 31, 2012 as a result of a 29.0% decrease in selling expense of $46,744 and a 3.7% decrease in general and administration expenses of $20,742.

The decrease in selling expenses for three months ended December 31, 2013 was primarily attributed to reduced promotions, sales and marketing activities and lower sale commission expense. The decrease in general administration expense for the three months ended December 31, 2013 was attributed to lower taxes and office expense.

	For Three Months Ended December 31,					
	2013			2012		
Selling expenses	$	114,350		$	161,094	
General and administrative expenses		540,229			560,971	
Total operating expenses	$	654,579		$	722,065	
Percentage of Real Estate Sales before Sales Tax		4.6	%		6.6	%

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, 2013.

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 statutory rate of 25% on income reported in the statutory financial statements after appropriate tax adjustments.

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However, the local tax 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 tax 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% on the income before income tax. Income tax provision for the three months ended December 31, 2013 were $322,797 compared to $221,164 for the three months ended December 31, 2012 as a result of the increase in our 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. 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 have 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.

Net Income

We reported net income of $3,057,117 for the three months ended December 31, 2013, as compared to net income of $5,509,077 for the three months ended December 31, 2012. The decrease of $2.5 million in our net income was primarily due to the lower gross profit as discussed above under Revenues and Gross Profit.

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 $407,365 and $208,985 for the three months ended December 31, 2013 and 2012, respectively. The balance sheet amounts with the exception of equity at December 31, 2013 were translated at 6.1122 RMB to 1.00 USD as compared to 6.1364 RMB to 1.00 USD at September 30, 2013. 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, 2013 and 2012 were 6.1261 RMB and 6.2880 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. In the past, we mainly financed our operations primarily through cash flows from operations and borrowings from our principal shareholder.

During the fourth quarter of fiscal 2013, the Company entered into a project finance loan agreement (the "Loan Agreement") with China Construction Bank, Hanzhong Branch (the “Bank") for a working capital loan (the “Loan”). The Loan has a three-year term in the principal amount approximately of $24 million (RMB150,000,000) at an interest rate which is 5% over the benchmark interest rate and adjustable every twelve months from the date of the loan. The purpose of the loan is for the development of the Company’s Mingzhu Beiyuan project.

During the three month ended December 31, 2013, the Company also entered into a loan agreement with its principal shareholder - Mr. Xiaojun Zhu. Pursuant to the agreement, the Company shall from time to time borrow up to approximately $8.2 million (RMB 50 million) from Mr. Zhu in order to support the Company's Liang Shan Road construction project development and the Company's working capital needs. The agreement has a one-year term at an interest rate equal to the China RMB loan annual benchmark rate of 6.15% as of December 31, 2013. As of December 31, 2013, the shareholder loan balance was $4,335,591.

In January 2014, the Company borrowed an additional 3,844,769 (RMB 23,500,000) from Mr. Xiaojun Zhu, our Chairman, CEO and major shareholder in accordance with the Shareholder RMB Loan Agreement signed on December 31, 2013. The Company further borrowed $1,881,483 (RMB 11,500,000) from Mr. Xiaojun Zhu with the same loan terms to support the Company's Liang Shan Road construction project development and the Company's working capital needs. As of January 31, 2014, the shareholder's RMB loan balance was $10,061,843(RMB 61,500,000).

As of December 31, 2013, the Company had an approximate deficit of $40.1 million in working capital, an increase of $11 million as compared to $29.1 million as of September 30, 2013. It was mainly due to the fact that most of our real estate projects under construction are high-rise buildings which generally take over 1- 1.5 years for construction, so they are included in non-current assets. Our accounts payable balance significantly increased based on the construction in progress.

Our total cash and restricted cash balance decreased to approximately $4.5 million as of December 31, 2013, a decrease of $2.7 million as compared to approximately $7.2 million as of September 30, 2013. The decrease in cash and restricted cash balance mainly resulted from the ongoing spending on real estate construction and the new investment in the Liangzhou Road reformation and expansion project during the three months ended December 31, 2013. 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 improving during fiscal 2014.

With respect to capital funding requirements, the Company budgeted our capital spending based on ongoing assessments of needs to maintain adequate cash. Due to the long term relationship with our construction suppliers, we were able to effectively manage cash spending on construction. Also, our major shareholder, Mr Xiaojun Zhu has agreed to provide his personal funds, if necessary, to support as on a as needed basis. In addition, the Company's cash flows from pre-sales and current sales should provide financial support for our current developments and operations.

In order to fully implement our business plan and sustain continued growth, we may also need to raise capital from outside investors. Our expectation, therefore, is that we will seek to access the capital markets in both the U.S. and China to obtain the funds as needed. 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,			
	2013		2012	
Net cash used in operating activities	$	(15,149,200)	$	(585,177)
Net cash provided by financing activities		12,487,554		-
Effect of change of foreign exchange rate on cash		17,218		4,359
Net cash decrease in cash		(2,644,428)		(580,818)
Cash, beginning of period		5,878,101		1,104,686
Cash, end of period	$	3,233,673	$	523,868

Operating Activities

Net cash used in operating activities during the three months ended December 31, 2013 was $15.1 million, consisting of net income of $3.1 million, noncash adjustments of $0.3 million and net changes in our operating assets and liabilities, which mainly included an increase in real estate property under development of $26.8 million due to the ongoing construction on Oriental Garden, Mingzhu Beiyuan and Yangzhou Pearl Garden and Yangzhou Palace real estate projects, an increase in cost and earnings in excess of billings of $3.2 million offset by the increase of billings in excess of cost and earnings of $0.9 million resulted from using the percentage of completion method of revenue recognition, increases in accounts payable of $4.2 million and other payable of $1.8 million due to more progress payables on our real estate construction and an increase in customer deposits of $4.9 million resulted from real estate projects under presales. The negative cash provided by operating activities is mainly attributable to our significant spending on our new real estate properties under development.

Net cash used in operating activities during the three months ended December 31, 2012 was $0.6 million, consisting of net income of $5.5 million, noncash adjustments of $0.03 million and net changes in our operating assets and liabilities, which mainly included an increase in advances to venders of $1.8 million due to the more construction prepayments made on the projects under construction, an increase in account receivable of $4.7 million as we extended payment term for one major customer who made bulk purchase of commercial units in our Nan Dajie (Mingzhu Xinju) project located in Hanzhong City, an increase in real estate property under development of $6.4 million resulting from more progress on our real estate projects under development, a decrease in real estate property completed of $3.8 million due to sales and an increase in customer deposits of $3.0 million resulted from our pre-sale efforts. The negative cash provided by operating activities is mainly attributable to our significant spending on our new real estate properties under development.

Financing Activities

Net cash flows provided by financing activities amounted to approximately $12.5 million for the three months ended December 31, 2013, which included bank loan of approximately $8.2 million and $4.3 million of shareholder loans from our principle shareholder.

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

Foreign Exchange Risk

All of our net sales, and a majority of our costs and expenses are denominated in RMB. Although the conversion of the RMB is highly regulated in China, the value of the RMB against the value of the U.S. dollar or any other currency nonetheless may fluctuate and be affected by, among other things, changes in China's political and economic conditions. Under current policy, the value of the RMB is permitted to fluctuate within a narrow band against a basket of certain foreign currencies. China is currently under significant international pressures to liberalize this government currency policy, and if such liberalization were to occur, the value of the RMB could appreciate or depreciate against the U.S. dollar.

Because substantially all of our earnings and majority of our cash assets are denominated in RMB, other than certain cash deposits we keep in a bank in Hong Kong and the U.S., appreciation or depreciation in the value of the RMB relative to the U.S. dollar would affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business or results of operations. Fluctuations in the exchange rate will also affect the relative value of any dividends we may issue in future that will be exchanged into U.S. dollars and earnings from, and the value of, any U.S. dollar-denominated investments we make in the future.

Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedging transactions may be limited and we may not be able to successfully hedge our exposure at all. In addition, our currency exchange losses may be magnified by the PRC exchange control regulations that restrict our ability to convert RMB into foreign currency.

Interest Rate Risk

We have not been, nor do we anticipate being exposed to material risks due to changes in interest rates. Our risk exposure to changes in interest rates relates primarily to the interest income generated by cash deposited in interest-bearing savings accounts and interest expense on variable rate bank loan. We have not used, and do not expect to use in the future any derivative financial instruments to hedge our interest risk exposure. However, fluctuations in interest rates can lead to significant changes in our interest income and interest expense.

Credit Risk

We are exposed to credit risk from our cash in banks and accounts receivable. The credit risk on cash in bank and fixed deposits is limited because the counterparties are recognized financial institutions. Accounts receivable are subjected to credit evaluations. An allowance would be made, if necessary, for estimated unrecoverable amounts by reference to past default experience, if any, and by reference to the current economic environment.

Inflation

Inflationary factors, such as increases in the cost of our products and overhead costs, could impair our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of sales revenue if the selling prices of our products do not increase with these increased costs.

Our Company's Operations are Substantially in Foreign Countries

Substantially all of our operations are conducted in China and are subject to various political, economic, and other risks and uncertainties inherent in conducting business in China. Among other risks, our Company and our subsidiaries' operations are subject to the risks of restrictions on transfer of funds; export duties, quotas, and embargoes; domestic and international customs and tariffs; changing taxation policies; foreign exchange restrictions; and political conditions and governmental regulations.

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.

Management conducted its evaluation of disclosure controls and procedures under the supervision of our chief executive officer and our chief financial officer. Based upon this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective as of December 31, 2013.

Management is committed to improving the internal controls over financial reporting and will undertake the consistent improvements or enhancements on an ongoing basis.

To remediate the material weakness and significant deficiencies and to prevent similar deficiencies in the future, we are currently evaluating additional controls and procedures, which may include:

Engage a third party IT consulting firm to help formalize the Company's policies and procedures on information technology, analyze the capability and reliability of existing systems, and establish an integrated information technology development plan.

Provide more U.S. GAAP knowledge and SEC reporting requirement training for the internal audit department and establish formal policies and procedures in internal audit function.

Recruit qualified professionals with appropriately level of knowledge, experience and training in the application of U.S GAAP standard to prepare adjusting entries and to assist CFO in the financial reporting process.

Establish written policies and procedures to ensure appropriate and timely review and approval in all transaction process level.

Implementation of an ongoing initiative and training in the Company to ensure the importance of internal controls and compliance with established policies and procedures are fully understood throughout the organization and plan to provide continuous U.S. GAAP knowledge training to relevant employees involved to ensure the performance of and compliance with those procedures and policies.

The Company continued to engage the existing independent professional consulting firm to assist the Company's Internal Control Evaluation Committee in evaluating the internal control effectiveness in fiscal 2014.

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, 2013 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

Investing in our securities involves risk. Before making an investment decision, you should carefully consider the following risk factors as well as the risks described in our most recent Annual Report on Form 10-K, or any updates to our risk factors in our Quarterly Reports on Form 10- Q, together with all of the other information appearing in or incorporated by reference into this Quarterly Report, in light of your particular investment objectives and financial circumstances. Our business, financial condition or results of operations could be materially adversely affected by any of these risks. The trading price of our securities could decline due to any of these risks, and you may lose all or part of your investment.

Risks Relating to Our Business

Our business is sensitive to China economy and China real estate policies. A downturn in China economy and restrictive real estate polices could materially and adversely affect our revenues and results of operations.

Any slowdown in China's economic development might lead to tighter credit markets, increased market volatility, sudden drops in business and consumer confidence and dramatic changes in business and consumer behaviors. As exports slowed, China's reported GDP growth dropped to 7.7% year on year in the third quarter ended September 30, 2013 from 8.1% in the first quarter of 2012, prompting the government to loosen economic policy to support growth. The current package of economic support policies is designed to stabilize the economy against slowing exports and to ensure the full-year official target of 7.7% GDP growth is met. Ongoing government regulatory measures, including the "Ten National Notices" announced in 2010, the "Eight National Notices" and property tax approved in January 2011, have brought the PRC property market further down to the bottom in 2012 and the recovery of real market is shown in the first nine months of 2013. In response to their perceived uncertainty in economic conditions, consumers might delay, reduce or cancel purchases of homes, and our homebuyers may also defer, reduce or cancel purchases of our units and our results of operations may be materially and adversely affected.

If we are unable to successfully manage our expansion into other Tier 3 and Tier 4 cities, we will not be able to execute our business plan.

Historically, our business and operations have been concentrated in Hanzhong City and other surrounding counties. If we are unable to successfully develop and sell projects outside Hanzhong City, our future growth may be limited and we may not generate adequate returns to cover our investments in these Tier 3 and Tier 4 cities. In addition, as we expand our operations to Tier 3 and Tier 4 cities with higher land prices, our costs may increase, which may lead to a decrease in our profit margin.

We require substantial capital resources to fund our land use rights acquisition and property developments, which may not be available.

Property development is capital intensive. Our ability to secure sufficient financing for land use rights acquisition and property development depends on a number of factors that are beyond our control, including market conditions in the capital markets, the PRC economy and the PRC government regulations that affect the availability and cost of financing for real estate companies.

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In order to strengthen liquidity management and regulate money and credit supply, the People's Bank of China raised the RMB reserve requirement ratio for depository financial institutions from 13.5% as of September 30, 2009 to 18.5%, effective on December 20, 2010. Prior to December 2011, the People's Bank of China raised the reserve requirement ratio by an additional 1.5%. Effective on December 5, 2011, the People's Bank of China reduced the RMB reserve requirement ratio by 0.5%. Effective on February 24, 2012 and May 18, 2012, People's Bank of China decided to further cut the RMB reserve requirement ratio by 0.5% twice. The reserve requirement ratio refers to the amount of funds that banks must hold in reserve against deposits made by their customers. These increases in the reserve requirement ratio have reduced the amount of commercial bank credit available to businesses in China, including us.

We may be unable to acquire desired development sites at commercially reasonable costs.

Our revenue depends on the completion and sale of our projects, which in turn depends on our ability to acquire development sites. Our land use rights costs are a major component of our cost of real estate sales and increases in such costs could diminish our gross margin. In China, the PRC government controls the supply of land and regulates land sales and transfers in the secondary market. As a result, the policies of the PRC government, including those related to land supply and urban planning, affect our ability to acquire, and our costs of acquiring, land use rights for our projects. In recent years, the PRC government has introduced various measures attempting to moderate investment in the property market in China.

Although we believe that these measures are generally targeted at the luxury property market and speculative purchases of land and properties, the PRC government could introduce other measures in the future that may adversely affect our ability to obtain land for development. We currently acquire our development sites primarily by bidding for government land. Under current regulations, land use rights acquired from government authorities for commercial and residential development purposes must be purchased through a public tender, auction or listing-for-sale. Competition in these bidding processes has resulted in higher land use rights costs for us. We may also need to acquire land use rights through acquisition, which could increase our costs. Moreover, the supply of potential development sites in any given city will diminish over time and we may find it increasingly difficult to identify and acquire attractive development sites at commercially reasonable costs in the future.

We provide guarantees for the mortgage loans of our customers which expose us to risks of default by our customers.

We pre-sell properties before actual completion and, in accordance with industry practice, our customers' mortgage banks require us to guarantee our customers' mortgage loans. Typically, we provide guarantees to PRC banks with respect to loans procured by the purchasers of our properties for the total mortgage loan amount until the completion of the registration of the mortgage with the relevant mortgage registration authorities, which generally occurs within six to twelve months after the purchasers take possession of the relevant properties. In line with what we believe to be industry practice, we rely on the credit evaluation conducted by mortgagee banks and do not conduct our own independent credit checks on our customers. The mortgagee banks typically require us to maintain, as restricted cash, 5% to 10% of the mortgage proceeds paid to us as security for our obligations under such guarantees (the security deposit).

If a purchaser defaults on its payment obligations during the term of our guarantee, the mortgagee bank may deduct the delinquent mortgage payment from the security deposit. If the delinquent mortgage payments exceed the security deposit, the banks may require us to pay the excess amount. If multiple purchasers default on their payment obligations at around the same time, we will be required to make significant payments to the banks to satisfy our guarantee obligations. If we are unable to resell the properties underlying defaulted mortgages on a timely basis or at prices higher than the amounts of our guarantees and related expenses, we will suffer financial losses.

We rely on third-party contractors.

Substantially all of our project construction and related work are outsourced to third-party contractors. We are exposed to risks that the performance of our contractors may not meet our standards or specifications. Negligence or poor work quality by any contractors may result in defects in our buildings or residential units, which could in turn cause us to suffer financial losses, harm our reputation or expose us to third-party claims. We work with multiple contractors on different projects and we cannot guarantee that we can effectively monitor their work at all times.

Although our construction and other contracts contain provisions designed to protect us, we may be unable to successfully enforce these rights and, even if we are able to successfully enforce these rights, the third-party contractor may not have sufficient financial resources to compensate us. Moreover, the contractors may undertake projects from other property developers, engage in risky undertakings or encounter financial or other difficulties, such as supply shortages, labor disputes or work accidents, which may cause delays in the completion of our property projects or increases in our costs.

We may be unable to complete our property developments on time or at all.

The progress and costs for a development project can be adversely affected by many factors, including, without limitation:

delays in obtaining necessary licenses, permits or approvals from government agencies or authorities;

shortages of materials, equipment, contractors and skilled labor;

disputes with our third-party contractors;

failure by our third-party contractors to comply with our designs, specifications or standards;

difficult geological situations or other geotechnical issues;

onsite labor disputes or work accidents; and natural catastrophes or adverse weather conditions.

Any construction delays, or failure to complete a project according to our planned specifications or budget, may delay our property sales, which could harm our revenues, cash flows and our reputation.

Changes of laws and regulations with respect to pre-sales may adversely affect our cash flow position and performance.

We depend on cash flows from pre-sale of properties as an important source of funding for our property projects and servicing our indebtedness. Under current PRC laws and regulations, property developers must fulfill certain conditions before they can commence pre-sale of the relevant properties and may only use pre-sale proceeds to finance the construction of specific developments.

Our results of operations may fluctuate from period to period.

Our results of operations tend to fluctuate from period to period. The number of properties that we can develop or complete during any particular period is limited due to the substantial capital required for land acquisition and construction, as well as the lengthy development periods required before positive cash flows may be generated. In addition, several properties that we have developed or that are under development are large scale and are developed in multiple phases over the course of one to several years. The selling prices of the residential units in larger scale property developments tend to change over time, which may impact our sales proceeds and, accordingly, our revenues for any given period.

We rely on our key management members.

We depend on the services provided by key management members. Competition for management talent is intense in the property development sector. In particular, we are highly dependent on Mr. Xiaojun Zhu, our founder, Chairman and Chief Executive Officer. We do not maintain key employee insurance. In the event that we lose the services of any key management member, we may be unable to identify and recruit suitable successors in a timely manner or at all, which will adversely affect our business and operations. Moreover, we need to employ and retain more management personnel to support our expansion into other Tier 3 and Tier 4 cities and counties. If we cannot attract and retain suitable human resources, especially at the management level, our business and future growth will be adversely affected.

Increases in the price of raw materials may increase our cost of sales and reduce our earnings.

Our third-party contractors are responsible for procuring almost all of the raw materials used in our project developments. Our construction contracts typically provide for fixed or capped payments, but the payments are subject to changes in government-suggested steel prices. The increase in steel prices could result in an increase in our construction cost. In addition, the increases in the price of raw materials, such as cement, concrete blocks and bricks, in the long run could be passed on to us by our contractors, which will increase our construction cost. Any such cost increase could reduce our earnings to the extent we are unable to pass these increased costs to our customers.

Any unauthorized use of our brand or trademark may adversely affect our business.

We own trademarks for " ", in the form of Chinese characters and our company logo. We rely on the PRC intellectual property and anti-unfair competition laws and contractual restrictions to protect brand name and trademarks. We believe our brand, trademarks and other intellectual property rights are important to our success. Any unauthorized use of our brand, trademarks and other intellectual property rights could harm our competitive advantages and business. Historically, China has not protected intellectual property rights to the same extent as the United States, and infringement of intellectual property rights continues to pose a serious risk of doing business in China. Monitoring and preventing unauthorized use is difficult. The measures we take to protect our intellectual property rights may not be adequate. Furthermore, the application of laws governing intellectual property rights in China and abroad is uncertain and evolving, and could involve substantial risks to us. If we are unable to adequately protect our brand, trademarks and other intellectual property rights, our reputation may be harmed and our business may be adversely affected.

We may fail to obtain, or may experience material delays in obtaining necessary government approvals for any major property development, which will adversely affect our business.

The real estate industry is strictly regulated by the PRC government. Property developers in China must abide by various laws and regulations, including implementation rules promulgated by local governments to enforce these laws and regulations. Before commencing, and during the course of, development of a property project, we need to apply for various licenses, permits, certificates and approvals, including land use rights certificates, construction site planning permits, construction work planning permits, construction permits, pre-sale permits and completion acceptance certificates. We need to satisfy various requirements to obtain these certificates and permits. To date, we have not encountered serious delays or difficulties in the process of applying for these certificates and permits, but we cannot guarantee that we will not encounter serious delays or difficulties in the future. In the event that we fail to obtain the necessary governmental approvals for any of our major property projects, or a serious delay occurs in the government's examination and approval progress, we may not be able to maintain our development schedule and our business and cash flows may be adversely affected.

We may forfeit land to the PRC government if we fail to comply with procedural requirements applicable to land grants from the government or the terms of the land use rights grant contracts.

According to the relevant PRC regulations, if we fail to develop a property project according to the terms of the land use rights grant contract, including those relating to the payment of land premiums, specified use of the land and the time for commencement and completion of the property development, the PRC government may issue a warning, may impose a penalty or may order us to forfeit the land. Specifically, under current PRC law, if we fail to commence development within one year after the commencement date stipulated in the land use rights grant contract, the relevant PRC land bureau may issue a warning notice to us and impose an idle land fee on the land of up to 20% of the land premium. If we fail to commence development within two years, the land will be subject to forfeiture to the PRC government, unless the delay in development is caused by government actions or force majeure. Even if the commencement of the land development is compliant with the land use rights grant contract, if the developed GFA on the land is less than one-third of the total GFA of the project or the total capital invested is less than one-fourth of the total investment of the project and the suspension of the development of the land continues for more than one year without government approval, the land will also be treated as idle land and be subject to penalty or forfeiture. We cannot assure you that circumstances leading to significant delays in our development schedule or forfeiture of land will not arise in the future. If we forfeit land, we will not only lose the opportunity to develop the property projects on such land, but may also lose all past investments in such land, including land premiums paid and development costs incurred.

Any non-compliant GFA of our uncompleted and future property developments will be subject to governmental approval and additional payments.

The local government authorities inspect property developments after their completion and issue the completion acceptance certificates if the developments are in compliance with the relevant laws and regulations. If the total constructed GFA of a property development exceeds the GFA originally authorized in the relevant land grant contracts or construction permit, or if the completed property contains built-up areas that do not conform with the plan authorized by the construction permit, the property developer may be required to pay additional amounts or take corrective actions with respect to such non-compliant GFA before a completion acceptance certificate can be issued to the property development.

Our failure to assist our customers in applying for property ownership certificates in a timely manner may lead to compensatory liabilities to our customers.

We are required to meet various requirements within 90 days after delivery of property, or such other period contracted with our customers, in order for our customers to apply for their property ownership certificates, including passing various governmental clearances, formalities and procedures. Under our sales contract, we are liable for any delay in the submission of the required documents as a result of our failure to meet such requirements, and are required to compensate our customers for delays. In the case of serious delays on one or more property projects, we may be required to pay significant compensation to our customers and our reputation may be adversely affected.

We are subject to potential environmental liability.

We are subject to a variety of laws and regulations concerning the protection of health and the environment. The particular environmental laws and regulations that apply to any given development site vary significantly according to the site’s location and environmental condition, the present and former uses of the site and the nature of the adjoining properties. Environmental laws and conditions may result in delays, may cause us to incur substantial compliance and other costs and can prohibit or severely restrict project development activity in environmentally-sensitive regions or areas. Although the environmental investigations conducted by local environmental authorities have not revealed any environmental liability that we believe would have a material adverse effect on our business, financial condition or results of operations to date, it is possible that these investigations did not reveal all environmental liabilities and that there are material environmental liabilities of which we are unaware. We cannot assure you that future environmental investigations will not reveal material environmental liability. Also, we cannot assure you that the PRC government will not change the existing laws and regulations or impose additional or stricter laws or regulations, the compliance with which may cause us to incur significant capital expenditure.

We have never paid cash dividends and are not likely to do so in the foreseeable future.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings for use in the operation and expansion of our business. We do not expect to pay any cash dividends in the foreseeable future but will review this policy as circumstances dictate.

We need to improve our internal financial reporting controls. If we are unable to establish appropriate internal financial reporting controls and procedures, it could cause us to fail to meet our reporting obligations, subject us to regulatory scrutiny and sanction, cause investors to lose confidence in our reported financial information and have a negative effect on the market price for shares of our common stock.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. We maintain a system of internal control over financial reporting, which is defined as a process designed by, or under the supervision of, our principal executive officer and principal financial officer, or persons performing similar functions, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

We cannot assure you that we will not, in the future, identify areas requiring improvement in our internal control over financial reporting. We cannot assure you that the measures we will take to remediate any areas in need of improvement will be successful or that we will implement and maintain adequate controls over our financial processes and reporting in the future as we continue our growth.

As a public company, we are required to comply with the reporting obligations of the Exchange Act and Section 404 of the Sarbanes-Oxley Act of 2002. If we fail to comply with the reporting obligations of the Exchange Act and Section 404 of the Sarbanes-Oxley Act or if we fail to maintain adequate internal controls over financial reporting, our business, results of operations and financial condition could be materially adversely affected.

As a public company, we are required to comply with the periodic reporting obligations of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including preparing annual reports and quarterly reports. Our failure to prepare and disclose this information in a timely manner could subject us to penalties under U.S. federal securities laws, expose us to lawsuits and restrict our ability to access financing. In addition, we are required under applicable law and regulations to design and implement internal controls over financial reporting, and evaluate our existing internal controls with respect to the standards adopted by the U.S. Public Company Accounting Oversight Board.

This Annual Report includes our Independent Registered Public Accounting Firm's first audit report on internal control over financial reporting. We received a qualified opinion on our internal control over financial reporting from such accounting firm for the fiscal year ended September 30, 2013. The Company's remediation plan is listed in Item 9A. However, we cannot assure you that our current remediation plan can resolve all the significant deficiencies and material weakness in the internal control over financial reporting. As a result, we may be required to implement further remedial measures and to design enhanced processes and controls to address issues identified through future reviews. This could result in significant delays and costs to us and require us to divert substantial resources, including management time, from other activities.

If we do not fully remediate the material weaknesses identified by management or fail to maintain the adequacy of our internal controls in the future, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal controls are necessary for us to produce reliable financial reports and are important to help prevent fraud. As a result, any failure to satisfy the requirements of Section 404 on a timely basis could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business and negatively impact the trading price of our common stock.

Risk Relating to the Residential Property Industry in China

The PRC government may adopt further restrictive measures to slow the increase in prices of real property and real property development.

Along with the economic growth in China, investments in the property sectors have increased significantly in the past few years. In response to concerns over the scale of the increase in property investments, the PRC government has introduced policies to curtail property development. We believe those regulations, among others, significantly affect the property industry in China.

These restrictive regulations and measures could increase our operating costs in adapting to these regulations and measures, limit our access to capital resources or even restrict our business operations. We cannot be certain that the PRC government will not issue additional and more stringent regulations or measures, which could further slowdown property development in China and adversely affect our business and prospects.

We are heavily dependent on the performance of the residential property market in China, which is at a relatively early development stage.

The residential property industry in the PRC is still in a relatively early stage of development. Although demand for residential property in the PRC has been growing rapidly in recent years, such growth is often coupled with volatility in market conditions and fluctuation in property prices. It is extremely difficult to predict how much and when demand will develop, as many social, political, economic, legal and other factors, most of which are beyond our control, may affect the development of the market. The level of uncertainty is increased by the limited availability of accurate financial and market information as well as the overall low level of transparency in the PRC, especially in Tier 3 and 4 cities which have lagged in progress in these aspects when compared to Tier 1 cities.

The lack of a liquid secondary market for residential property may discourage investors from acquiring new properties. The limited amount of property mortgage financing available to PRC individuals may further inhibit demand for residential developments.

We face intense competition from other real estate developers.

The property industry in the PRC is highly competitive. In the Tier 3 and Tier 4 cities we focus on, local and regional property developers are our major competitors, and an increasing number of large state-owned and private national property developers have started entering these markets. Many of our competitors, especially the state-owned and private national property developers, are well capitalized and have greater financial, marketing and other resources than we have. Some also have larger land banks, greater economies of scale, broader name recognition, a longer track record and more established relationships in certain markets. In addition, the PRC government’s recent measures designed to reduce land supply further increased competition for land among property developers.

Competition among property developers may result in increased costs for the acquisition of land for development, increased costs for raw materials, shortages of skilled contractors, oversupply of properties, decrease in property prices in certain parts of the PRC, a slowdown in the rate at which new property developments will be approved and/or reviewed by the relevant government authorities and an increase in administrative costs for hiring or retaining qualified personnel, any of which may adversely affect our business and financial condition. Furthermore, property developers that are better capitalized than we are may be more competitive in acquiring land through the auction process. If we cannot respond to changes in market conditions as promptly and effectively as our competitors, or effectively compete for land acquisition through the auction systems and acquire other factors of production, our business and financial condition will be adversely affected.

In addition, risk of property over-supply is increasing in parts of China, where property investment, trading and speculation have become overly active. We are exposed to the risk that in the event of actual or perceived over-supply, property prices may fall drastically, and our revenue and profitability will be adversely affected.

We may be deemed a PRC resident enterprise for PRC tax purposes under the new Enterprise Income Tax Law, which could result in the imposition of a 25% enterprise income tax payable on our taxable global income.

On March 16, 2007, the National People’s Congress of the PRC passed the Enterprise Income Tax Law of the PRC (‘‘New Income Tax Law’’), which took effect on January 1, 2008. On December 6, 2007, the Implementation Rules of Enterprise Income Tax Law of the PRC (‘‘Implementation Rules’’) were also enacted, and took effect on January 1, 2008. In accordance with the new laws and regulations, a unified enterprise income tax rate of 25% and unified tax deduction standards will be applied equally to both domestic enterprises and foreign-invested enterprises.

Under the New Income Tax Law and the Implementation Rules, enterprises established under the laws of foreign jurisdictions other than the PRC may nevertheless be considered as PRC-resident enterprises for tax purposes if these enterprises have their ‘‘de facto management body’’ within the PRC. Under the Implementation Rules, ‘‘de facto management body’’ is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and treasury, and acquisition and disposition of properties and other assets of an enterprise. At present, it is unclear what factors will be used by the PRC tax authorities to determine whether we are a ‘‘de facto management body’’ in China. All of our management personnel are located in the PRC, and all of our revenues arise from our operations in China. If the PRC tax authorities determine that we are a PRC resident enterprise, we will be subject to PRC tax on our worldwide income at the 25% uniform tax rate, which may have a material adverse effect on our financial condition and results of operations. Notwithstanding the foregoing provision, the New Income Tax Law also provides that, if a PRC resident enterprise already invests in another PRC resident enterprise, the dividends received by the investing resident enterprise from the invested resident enterprise are exempt from income tax, subject to certain qualifications. Therefore, if we are classified as a PRC resident enterprise, the dividends received from our PRC subsidiaries may be exempt from income tax. However, due to the limited history of the New Income Tax Law, it is unclear as to (i) the detailed qualification requirements for such exemption and (ii) whether dividend payments by our PRC subsidiaries to us will meet such qualification requirements, even if we are considered a PRC resident enterprise for tax purposes.

In addition, the local tax 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. In 2013 and 2012, the Hanzhong City tax authority assessed the Company for income taxes at the rate of 1.25% to 2.5% on revenue, instead of the statutory rate of 25%. As a result, income tax expenses for the year ended September 30, 2013 were significantly different than they would have been had the Company been assessed at the statutory rate. If the Company were assessed at the statutory rate of 25%, the Company's tax expenses would increase significantly which could significantly reduce the Company's net income.

We face uncertainty from the Circular on Strengthening the Administration of Enterprise Income Tax on Non-resident Enterprises' Share Transfer ("Circular 698") released in December 2009 by China's State Administration of Taxation (SAT), effective as of January 1, 2008.

Where a foreign investor indirectly transfers equity interests in a Chinese resident enterprise by selling the shares in an offshore holding company, and the latter is located in a country (jurisdiction) where the effective tax burden is less than 12.5% or where the offshore income of her residents is not taxable, the foreign investor is required to provide the tax authority in charge of that Chinese resident enterprise with the relevant information within 30 days of the transfers.

Where a foreign investor indirectly transfers equity interests in a Chinese resident enterprise through the abuse of form of organization and there are no reasonable commercial purposes such that the corporate income tax liability is avoided, the tax authority has the power to re-assess the nature of the equity transfer in accordance with the "substance-over-form" principle and deny the existence of the offshore holding company that is used for tax planning purposes.

"Income derived from equity transfers" as mentioned in this circular refers to income derived by non-resident enterprises from direct or indirect transfers of equity interest in China resident enterprises, excluding share in Chinese resident enterprises that are bought and sold openly on the stock exchange.

While the term "indirectly transfer" is not defined, we understand that the relevant PRC tax authorities have jurisdiction regarding requests for information over a wide range of foreign entities having no direct contact with China. The relevant authority has not yet promulgated any formal provisions or formally declared or stated how to calculate the effective tax in the country (jurisdiction) and the process of the disclosure to the tax authority in charge of that Chinese resident enterprise. Meanwhile, there are no formal declarations with regard to how to decide "abuse of form of organization" and "reasonable commercial purpose," which can be utilized by us to determine if our company complies with the Circular 698.

Failure to comply with PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may materially adversely affect us.

In October 2005, the PRC State Administration of Foreign Exchange, or SAFE, issued the Notice on Relevant Issues in the Foreign Exchange Control over Financing and Return Investment Through Special Purpose Companies by Residents Inside China, generally referred to as Circular 75. The policy announced in this notice required PRC residents to register with the relevant SAFE branch before establishing or acquiring control over an offshore special purpose company, or SPV, for the purpose of engaging in an equity financing outside of China on the strength of domestic PRC assets originally held by those residents. Internal implementing guidelines issued by SAFE, which became public in May 2007 (known as Circular 106), expanded the reach of Circular 75. In the case of an SPV which was established, and which acquired a related domestic company or assets, before the implementation date of Circular 75, a retroactive SAFE registration was required to have been completed before March 31, 2006; this date was subsequently extended indefinitely by Circular 106, which also required that the registrant establish that all foreign exchange transactions undertaken by the SPV and its affiliates were in compliance with applicable laws and regulations. Failure to comply with the requirements of Circular 75, as applied by SAFE in accordance with Circular

106, may result in fines and other penalties under PRC laws for evasion of applicable foreign exchange restrictions. Any such failure could also result in the SPV's affiliates being impeded or prevented from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation to the SPV, or from engaging in other transfers of funds into or out of China.

We have requested our shareholders who are PRC residents to make the necessary applications, filings and amendments as required under Circular 75 and other related rules. We attempt to comply, and attempt to ensure that our shareholders who are subject to these rules comply, with the relevant requirements. However, we cannot provide any assurances that our shareholders who are PRC residents will comply with our request to make or obtain any applicable registrations or comply with other requirements required by Circular 75 or other related rules or that, if challenged by government agencies, the structure of our organization fully complies with all applicable registrations or approvals required by Circular 75. Moreover, because of uncertainty over how Circular 75 will be interpreted and implemented, and how or whether SAFE will apply it to us, we cannot predict how it will affect our business operations or future strategies. A failure by such PRC resident shareholders or future PRC resident shareholders to comply with Circular 75 or other related rules, if SAFE requires it, could subject these PRC resident shareholders to fines or legal sanctions, restrict our overseas or cross-border investment activities, limit our subsidiaries' ability to make distributions or pay dividends or affect our ownership structure, which could adversely affect our business and prospects.

PRC economic, political and social conditions as well as government policies can affect our business.

The PRC economy differs from the economies of most developed countries in many aspects, including:

- political structure;
- degree of government involvement;
- degree of development;
- level and control of capital reinvestment;
- control of foreign exchange; and
- allocation of resources.

The PRC economy has been transitioning from a centrally planned economy to a more market-oriented economy. For more than two decades, the PRC government has implemented economic reform measures emphasizing utilization of market forces in the development of the PRC economy. Although we believe these reforms will have a positive effect on China's overall and long-term development, we cannot predict whether changes in the PRC economic, political and social conditions, laws, regulations and policies will have any adverse effect on our current or future business, financial condition or results of operations.

Changes in foreign exchange regulations may adversely affect our results of operations.

We currently receive all of our revenues in RMB. The PRC government regulates the conversion between RMB and foreign currencies. Over the years, the government has significantly reduced its control over routine foreign exchange transactions under current accounts, including trade and service related foreign exchange transactions, payment of dividends and service of foreign debt. However, foreign exchange transactions by our PRC subsidiaries under capital accounts continue to be subject to significant foreign exchange controls and require the approval of, or registration with, PRC governmental authorities. There can be no assurance that these PRC laws and regulations on foreign investment will not cast uncertainties on our financing and operating plans in China. Under current foreign exchange regulations in China, subject to the relevant registration at SAFE, we will be able to pay dividends in foreign currencies, without prior approval from SAFE, by complying with certain procedural requirements. However, there can be no assurance that the current PRC foreign exchange policies regarding debt service and payment of dividends in foreign currencies will continue in the future. Changes in PRC foreign exchange policies might have a negative impact on our ability to service our foreign currency-denominated indebtedness and to distribute dividends to our shareholders in foreign currencies.

Interpretation of PRC laws and regulations involves uncertainty.

Our core business is conducted within China and is governed by PRC laws and regulations. The PRC legal system is based on written statutes, and prior court decisions can only be used as a reference. Since 1979, the PRC government has promulgated laws and regulations in relation to economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade, with a view to developing a comprehensive system of commercial law, including laws relating to property ownership and development. However, due to the fact that these laws and regulations have not been fully developed, and because of the limited volume of published cases and the non-binding nature of prior court decisions, interpretation of PRC laws and regulations involves a degree of uncertainty. Some of these laws may be changed without being immediately published or may be amended with retroactive effect. Depending on the government agency or how an application or case is presented to such agency, we may receive less favorable interpretations of laws and regulations than our competitors, particularly if a competitor has long been established in the locality of, and has developed a relationship with, such agency. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. All these uncertainties may cause difficulties in the enforcement of our land use rights, entitlements under its permits, and other statutory and contractual rights and interests.

The Chinese government exerts substantial influence over the manner in which we must conduct our business activities.

China only recently has permitted provincial and local economic autonomy and private economic activities, and, as a result, we are dependent on our relationship with the local government in the province in which we operate our business. Chinese government has exercised and continues to exercise substantial control over virtually every sector of the Chinese economy through regulation and state ownership. Our ability to operate in China may be harmed by changes in its laws and regulations, including those relating to taxation, environmental regulations, land use rights, property and other matters. We believe that our operations in China are in material compliance with all applicable legal and regulatory requirements. However, the central or local governments of these jurisdictions may impose new, stricter regulations or interpretations of existing regulations that would require additional expenditures and efforts on our part to ensure our compliance with such regulations or interpretations. Accordingly, government actions in the future, including any decision not to continue to support recent economic reforms and to return to a more centrally planned economy or regional or local variations in the implementation of economic policies, could have a significant effect on economic conditions in China or particular regions thereof, and could require us to divest ourselves of any interest we then hold in Chinese properties.

Future inflation in China may inhibit our activity to conduct business in China.

In recent years, the Chinese economy has experienced periods of rapid expansion and high rates of inflation. During the past ten years, the rate of inflation in China has been as high as 20.7% and as low as -2.2%. These factors have led to the adoption by the Chinese government, from time to time, of various corrective measures designed to restrict the availability of credit or regulate growth and contain inflation. While inflation has been more moderate since 1995, high inflation may in the future cause Chinese government to impose controls on credit and/or prices, or to take other action, which could inhibit economic activity in China, and thereby harm the market for our products.

Because Chinese law governs almost all of our material agreements, we may not be able to enforce our legal rights within China or elsewhere, which could result in a significant loss of business, business opportunities, or capital.

Chinese law governs almost all of our material agreements. We cannot assure you that we will be able to enforce any of our material agreements or that remedies will be available outside of China. The system of laws and the enforcement of existing laws in China may not be as certain in implementation and interpretation as in the United States. The inability to enforce or obtain a remedy under any of our current or future agreements could result in a significant loss of business, business opportunities or capital. It will be extremely difficult to acquire jurisdiction and enforce liabilities against our officers, directors and assets based in China.

Substantially all of our assets are located in the PRC and all of our officers and most of our present directors reside outside of the United States. As a result, it may not be possible for United States investors to enforce their legal rights, to effect service of process upon our directors or officers or to enforce judgments of United States courts predicated upon civil liabilities and criminal penalties of our directors and officers under Federal securities laws. Moreover, we have been advised that China does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts with the United States. Further, it is unclear if extradition treaties now in effect between the United States and China would permit effective enforcement of criminal penalties of the Federal securities laws.

Failure to comply with the United States Foreign Corrupt Practices Act could subject us to penalties and other adverse consequences.

We are subject to the United States Foreign Corrupt Practices Act, which generally prohibits United States companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Foreign companies, including some that may compete with us, are not subject to these prohibitions. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices occur from time-to-time in the PRC. We can make no assurance, however, that our employees or other agents will not engage in such conduct for which we might be held responsible. If our employees or other agents are found to have engaged in such practices, we could suffer severe penalties and other consequences that may have a material adverse effect on our business, financial condition and results of operations.

We may have difficulty establishing adequate management, legal and financial controls in the PRC.

The PRC historically has been deficient in Western style management and financial reporting concepts and practices, as well as in modern banking, computer and other control systems. We may have difficulty in hiring and retaining a sufficient number of qualified employees to work in the PRC. As a result of these factors, we may experience difficulty in establishing management, legal and financial controls, collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices that meet Western standards. We may have difficulty establishing adequate management, legal and financial controls in the PRC.

Risks Relating to our Securities

We may be subject to the penny stock rules which will make the shares of our common stock more difficult to sell.

We may be subject now and in the future to the SEC’s “penny stock” rules if our shares of common stock sell below $1.00 per share. Penny stocks generally are equity securities with a price of less than $1.00. The penny stock rules require broker-dealers to deliver a standardized risk disclosure document prepared by the SEC which provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer must also provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson, and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations, and the broker-dealer and salesperson compensation information must be given to the customer orally or in writing prior to completing the transaction and must be given to the customer in writing before or with the customer's confirmation.

In addition, the penny stock rules require that prior to a transaction, the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. The penny stock rules are burdensome and may reduce purchases of any offerings and reduce the trading activity for shares of our common stock. As long as our shares of common stock are subject to the penny stock rules, the holders of such shares of common stock may find it more difficult to sell their securities.

Our shares of common stock are very thinly traded, and the price if traded may not reflect our value. There can be no assurance that there will be an active market for our shares of common stock either now or in the future.

Our shares of common stock are very thinly traded, and the price if traded may not reflect our value. There can be no assurance that there will be an active market for our shares of common stock either now or in the future. The market liquidity will be dependent on the perception of our operating business and any steps that our management might take to bring us to the awareness of investors. There can be no assurance given that there will be any awareness generated. Consequently, investors may not be able to liquidate their investment or liquidate it at a price that reflects the value of the business. If a more active market should develop, the price may be highly volatile. Because there may be a low price for our shares of common stock, many brokerage firms may not be willing to effect transactions in the securities. Even if an investor finds a broker willing to effect a transaction in the shares of our common stock, the combination of brokerage commissions, transfer fees, taxes, if any, and any other selling costs may exceed the selling price. Further, many lending institutions will not permit the use of such shares of common stock as collateral for any loans.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

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
31.2	Rule 13a-14(a) Certification of 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 7, 2014	By:	/s/ Xiaojun Zhu Xiaojun Zhu Chief Executive Officer

By:/s/ Wei Shen
Wei Shen