

CHINA HGS REAL ESTATE INC.

Form 10-K

December 21, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

☒ ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 2016

☐ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File No. 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)

Securities registered under Section 12(b) of the Exchange Act:

Title of each class registered:	Name of each exchange on which registered:
Common Stock, par value \$0.001	The NASDAQ Stock Market LLC

Securities registered under Section 12(g) of the Exchange Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-K (ss.229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based upon the closing price of the registrant’s common stock on March 31, 2016, the last business day of the Company's second fiscal quarter, as reported by the NASDAQ Stock Market LLC on that date, was approximately \$23,842,132. This calculation does not reflect a determination that certain persons are affiliates of the registrant for any other purpose.

As of December 12, 2016, the number of shares outstanding of the registrant’s common stock was 45,050,000.

DOCUMENTS INCORPORATED BY REFERENCE

None.

CHINA HGS REAL ESTATE INC.

FORM 10-K

For the Fiscal Year Ended September 30, 2016

INDEX

	Page
<u>PART I</u>	
Item 1. <u>Business</u>	2
Item 1A. <u>Risk Factors</u>	13
Item 1B. <u>Unresolved Staff Comments</u>	23
Item 2. <u>Properties</u>	23
Item 3. <u>Legal Proceedings</u>	23
Item 4. <u>Mine and Safety Disclosure</u>	24
<u>PART II</u>	
Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	24
Item 6. <u>Selected Financial Data</u>	25
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	26
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	40
Item 8. <u>Financial Statements and Supplementary Data</u>	41
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	74
Item 9A. <u>Controls and Procedures</u>	74
Item 9B. <u>Other Information</u>	76
<u>PART III</u>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	76
Item 11. <u>Executive Compensation</u>	79
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	83
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	84
Item 14. <u>Principal Accountant Fees and Services</u>	86

PART IV

Item 15. <u>Exhibits and Financial Statement Schedules</u>	87
<u>SIGNATURES</u>	89

FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K (the “Report”) and other reports (collectively the “Filings”) filed by the registrant from time to time with the Securities and Exchange Commission (the “SEC”) contain or may contain forward looking statements and information that are based upon beliefs of, and information currently available to, the registrant’s management as well as estimates and assumptions made by the registrant’s management. When used in the filings the words “anticipate,” “believe,” “estimate,” “expect,” “future,” “intend,” “plan” or the negative of these terms and similar expressions as they relate to the registrant or the registrant’s management identify forward looking statements. Such statements reflect the current view of the registrant with respect to future events and are subject to risks, uncertainties, assumptions and other factors (including the risks contained in the section of this Report entitled “Risk Factors”) relating to the registrant’s industry, the registrant’s operations and results of operations and any businesses that may be acquired by the registrant. Should one or more of these risks or uncertainties materialize, or should the underlying assumptions prove incorrect, actual results may differ significantly from those anticipated, believed, estimated, expected, intended or planned.

Although the registrant believes that the expectations reflected in the forward looking statements are reasonable, the registrant cannot guarantee future results, levels of activity, performance or achievements. Except as required by applicable law, including the securities laws of the United States, the registrant does not intend to update any of the forward-looking statements to conform these statements to actual results. The following discussion should be read in conjunction with the registrant’s financial statements and the related notes thereto included in this Report.

In this Report, “we,” “our,” “us,” “China HGS Real Estate Inc. or the “Company” sometimes refers collectively to China HGS and its subsidiaries and affiliated companies.

PART I

ITEM 1. BUSINESS

Our Organization

China HGS Real Estate Inc. (the “Company” or “China HGS,” “we”, “our”, “us”), formerly known as China Agro Sciences Corp., is a corporation organized under the laws of the State of Florida.

HGS Investment is a Delaware corporation and owns 100% of the equity interest in Shaanxi HGS Management and Consulting Co., Ltd. (“Shaanxi HGS”), a wholly owned foreign entity incorporated under the laws of the People’s Republic of China (“PRC” or “China”).

China HGS does not conduct any substantive operations of its own. Instead, through its subsidiary, Shaanxi HGS, it entered into certain exclusive contractual agreements with Shaanxi Guangsha Investment and Development Group Co., Ltd. (“Guangsha”). Pursuant to these agreements, Shaanxi HGS is obligated to absorb a majority of the risk of loss from Guangsha’s activities and entitles Shaanxi HGS to receive a majority of Guangsha’s expected residual returns. In addition, Guangsha’s shareholders have pledged their equity interest in Guangsha to Shaanxi HGS, irrevocably granted Shaanxi HGS an exclusive option to purchase, to the extent permitted under PRC Law, all or part of the equity interests in Guangsha and agreed to entrust all the rights to exercise their voting power to the person(s) appointed by Shaanxi HGS.

Based on these contractual arrangements, we believe that Guangsha should be considered a “Variable Interest Entity” (“VIE”) under ASC 810 “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51”, because the equity investors in Guangsha no longer have the characteristics of a controlling financial interest, and the Company, through Shaanxi HGS, is the primary beneficiary of Guangsha and its operations.

Our Company, along with our subsidiaries and VIE, engages in real estate development, primarily in the construction and sale of residential apartments, car parks and commercial properties.

Guangsha was organized in August 1995 as a limited liability company under the laws of the PRC. Guangsha is headquartered in the city of Hanzhong, Shaanxi Province. Guangsha is engaged in developing large scale and high quality commercial and residential projects, including multi-layer apartment buildings, sub-high-rise apartment

buildings, high-rise apartment buildings, and office buildings.

Our corporate structure is set forth below:

Business Overview

We conduct substantially all of our business through our subsidiary and VIE in China. All of our business is conducted in mainland China. Guangsha was founded by Mr. Xiaojun Zhu, our Chairman and Chief Executive Officer and commenced operations in 1995 in Hanzhong, a prefecture-level city in Shaanxi Province.

Since Guangsha was founded, management has been focused on expanding our business in Tier 3 and Tier 4 cities and counties in China that we strategically select based on population and urbanization growth rates, general economic conditions and growth rates, income and purchasing power of resident consumers, anticipated demand for private residential properties, availability of future land supply and land prices, and governmental urban planning and development policies. We utilize a standardized and scalable model that emphasizes rapid asset turnover, efficient capital management and strict cost control. We plan to expand into strategically selected Tier 3 and Tier 4 cities and counties with real estate development potential in Shaanxi Province, and expect to benefit from rising demand for residential housing as a result of increasing income levels of consumers and growing populations in these cities and counties due to urbanization.

In fiscal 2017, we are going to start the construction of our Liangzhou road and related projects, which consist of residential buildings, office buildings and commercial plaza, which will become a new city center of Hanzhong city.

Real Estate Industry Overview

During the first nine months of 2016, the economy of the PRC is facing the challenge of consolidation amidst uncertainties in the global market. In response to the sluggish economic outlook, the Central Government has taken measures to release more liquidity into the market and has made positive adjustments to the policies so as to maintain a stable development of the property market. Furthermore, with the continuation of implementation of the urbanization policy by the Central Government and the continual growth in gross domestic product, it is expected that the real estate industry in the PRC will be heading into a healthy direction.

During the volatile real estate market, the Company has been capitalizing on its inherent strengths and market opportunities in Tier 3 and Tier 4 cities and counties to deliver value for our shareholders. We feel confident and also competent to take on every challenge and grasp every opportunity during market consolidation. We expect to provide rapid response to the market on the basis of our projected business plans together with a flexible approach in seizing market opportunities; strict investment standard and prudent attitude towards investment opportunities, and appropriate replenishment of quality land resources in existing regions to realize value within the Tier 3 and Tier 4 cities and counties in Western China.

Company Positioning

The Company is headquartered in Hanzhong in the southwestern part of the Shaanxi province, in the center of the Hanzhong Basin, on the Han River, near the Sichuan border. According to the China City Statistical Yearbook, Hanzhong had a population of about 3.86 million.

Hanzhong is a key transportation hub connecting China's Middle Economic zone and Western Economic Zone. The travel time from Xi'an, the provincial capital of Shaanxi province, to Hanzhong takes only about 3 hours. The new airport in Hanzhong was completed and put into service in 2014. The airport is expected to handle 300,000 passengers and 1,300 tons of cargo by 2020. Xicheng, a high-speed railway between Chengdu, the provincial capital of Sichuan province, and Xi'an with a major stop in Hanzhong is under-construction and expected to be completed by the end of 2017. After its completion, it will take 1 hour from Hanzhong to both Xi'an and Chengdu. The railway passenger's volume is expected to increase from 1.5 million to 6 million by 2020.

In accordance with Hanzhong Government's 2015 annual report, Hanzhong's GDP reached RMB 106.5 billion (approximately \$16.0 billion) by 2015, representing a 7.4% increase from 2014. Residents' annual disposable income for 2015 was RMB 23,625 (equivalent to \$3,542) in 2015, consistent from 2014.

Many Tier 3 and Tier 4 cities and counties in China provide a major source of migration workers for the Tier 1 and Tier 2 cities in China. The income from migration workers also is becoming a significant factor in supporting the hometown economy. Based on Hanzhong Government's 2015 annual report, the number of Hanzhong's migration workers reached approximately 840,000 as of December 31, 2015 (2014 - 906,600). Total income of migration workers was about RMB 16.8 billion (equivalent to \$2.5 billion) in 2015 (2014 - RMB 17.65 billion or \$2.8 billion).

The target market of the Company is in Western China. The Company continues to focus on Tier 3 and Tier 4 cities and counties in acquiring sizable quality land reserves at low cost in a flexible and diversified manner. There has been an increasing demand for high quality residential housing, largely driven by the "Go West" policy and accelerated urbanization. Many buyers in Tier 3 and Tier 4 cities and counties are first time home buyers. In order to mitigate default risk, the Company generally requires from its homebuyer customers a deposit in the range of 30%-50% of the purchase price, which is higher than the percentage required by the government for the mortgage down payment.

The Company received the National Grade-I real-estate development qualification granted by the Ministry of Housing and Urban-Rural Development of the People's Republic of China ("MOHURD") on October 12, 2011. The Grade-I real-estate development qualification is the highest qualification for real-estate developers in China and requires meeting several strict criteria, including:

- a. Registered capital of at least RMB 50 million (approximately \$7.9 million);
- b. At least five years of experience in real estate development and operation;
- c. The completion of construction of a total over 300,000 square meters of ground floor area (GFA) within the last three years and, in the most recent year, developed real estate projects of at least 150,000 square meters; and
- d. The completed real estate projects have no quality issues in each of the past five years; and an established, comprehensive quality control and guarantee system.

The National Grade-I real-estate development qualification provides significant opportunities for the Company to expand its operations beyond Shaanxi province into new regional real estate markets in China.

Looking ahead, the Company will continue to focus on developing high quality and large scale real estate projects in the suburban areas of Tier 3 and Tier 4 cities and counties with promising economic growth potential. Leveraging on its unique competitive strengths, and under the direction and guidance of the government's macro policies, the Company expects to further replicate its successful business model into new high growth regions through strategic selection of project locations, a short project development schedule characterized by fast asset turnover and excellent execution ability, as well as innovative product offering closely in line with market demand. The Company aims at becoming a leading large-scale residential property developer in Western China and a well-recognized brand name.

Pre-Sales and Sales

In the PRC, real estate developers are allowed to begin to market properties before construction is completed. Like other developers, we pre-sell properties prior to completion of construction. Under PRC pre-sales regulations, property developers must satisfy specific conditions before properties under construction can be pre-sold. These mandatory conditions include:

- the land premium must have been paid in full;
- the land use rights certificate, the construction site planning permit, the construction work planning permit and the construction permit must have been obtained;
- at least 25% of the total project development cost must have been incurred;
- the progress and the expected completion and delivery date of the construction must be fixed;
- the pre-sale permit must have been obtained; and
- the completion of certain milestones in the construction processes must be specified by the local government authorities.

These mandatory conditions are designed to require a certain level of capital expenditure and substantial progress in project construction before the commencement of pre-sales. Generally, the local governments also require developers and property purchasers to have standard pre-sale contracts prepared under the auspices of the government. Developers are required to file all pre-sale contracts with local land bureaus and real estate administrations after entering into such contracts.

After-Sale Services and Delivery

We assist customers in arranging for and providing information related to financing. We also assist our customers in various title registration procedures related to their properties, and we have set up an ownership certificate team to assist purchasers to obtain their property ownership certificates. We offer various communication channels to customers to facilitate customer feedback collection. We also cooperate with property management companies that

manage our properties and ancillary facilities, to handle customer feedback.

We endeavor to deliver the units to our customers on a timely basis. We closely monitor the progress of construction of our property projects and conduct pre-delivery property inspections to ensure timely delivery. The time frame for delivery is set out in the sale and purchase agreements entered into with our customers, and we are subject to penalty payments to the purchasers for any delay in delivery caused by us. The Company has never incurred any delay penalties. Once a property development has been completed, has passed the requisite government inspections and is ready for delivery, we will notify our customers and hand over keys and possession of the properties.

Marketing and Distribution Channel

We maintain a marketing and sales force for our development projects, which at September 30, 2016 consisted of 69 employees specializing in marketing and sales. We also train and use outside real estate agents to market and increase the public awareness of our projects, and spread the acceptance and influence of our brand. However, our marketing and sales are primarily conducted by our own sales force because we believe our own dedicated sales representatives are better motivated to serve our customers as well as to control our property pricing and selling expenses.

Our marketing and sales team develops the appropriate advertising and selling plan for each project. We develop public awareness through marketing and advertising as well as referrals from customers. We utilize a customer relationship management system to track customer profiles, which helps us to forecast future customer requirements and general demand for our projects. This allows us to have real-time information on the status of individual customer transactions as well as available inventory by project, which enables us to better anticipate the preferences of current and future customers.

We use various advertising media to market our developments and enhance our brand name, including newspapers, magazines, television, radio, e-marketing and outdoor billboards. We also participate in real estate exhibitions.

We have also developed a strong relationship with local institutional purchasers and governments. - The Company has entered into various significant residential-apartment bulk-purchase agreements with local government and institutional purchasers.

A typical real estate property sales transaction usually consists of three steps. First, the customer pays a deposit to the Company. Within a week, after paying the deposit, the customer will sign a purchase contract with us and make a down payment to us in cash. After making the down payment, the customer arranges for a mortgage loan for the balance of the purchase price. Once the loan is approved, the mortgage loan proceeds are paid to us directly by the bank. Finally, we deliver the property to the customer. Legal title, as evidenced by a property ownership certificate issued by local land and construction bureaus, will be delivered to the customer in 12 months from the property delivery date.

For customers purchasing properties with mortgage financing, under current PRC laws, their minimum down payment is 30% of the total purchase price for the purchase of the first self-use residential unit with total GFA of 90 square meters (about 970 square feet) or more on all existing units and those yet to be completed, and a down payment of 20% on the first residential units for self-use with total GFA of under 90 square meters. In order to mitigate the default risk, the Company requires from its homebuyer customers deposits ranging from 30% - 50% of the purchase price, which is higher than the percentage required by the government for the mortgage down payment.

Like most real estate companies in China, we generally provide guarantees to mortgagee banks in respect of the mortgage loans provided to the purchasers of our properties up until completion of the registration of the mortgage with the relevant mortgage registration authorities. As of September 30, 2016, the Company had security deposits for these guarantees amounted to approximately \$1.5 million. Guarantees for mortgages on residential properties are typically discharged when the individual property ownership certificates are issued. In our experience, the issuance of the individual property ownership certificates typically takes six to twelve months, so our mortgage guarantees typically remain outstanding for up to twelve months after we deliver the underlying property.

Our Property Development Operations

We have a systematic and standardized process of project development, which we implement through several well-defined phases. One critically significant portion of our process is the land acquisition process, which is segmented into three stages: (i) opportunity identification, (ii) initial planning and budgeting, and (iii) land use rights

acquisition. The following diagram sets forth the key stages of our property development process.

Our Projects

Overview

We develop the following three types of real estate projects, which may be developed in one or more phases:

- multi-layer apartment buildings, which are typically six stories or less;
- sub-high-rise apartment buildings, which are typically seven to 11 stories; and
- high-rise apartment buildings, which are typically 12 to 33 stories.

At any one time, our projects (or phases of our projects) are in one of the following three stages:

- completed projects, meaning properties for which construction has been completed;
- properties under construction, meaning properties for which construction permits have been obtained but construction has not been completed; and
- properties under planning, meaning properties for which we have entered into land grant contracts and are in the process of obtaining the required permits to begin construction.

Our main projects located in Hanzhong City are: Mingzhu Garden -Mingzhu Nanyuan, Mingzhu Beiyuan, Oriental Pearl Garden, Mingzhu Xijiu and Liangzhou road related projects. In Yang County, our project is Yangzhou Pearl Garden and Yangzhou Palace. Most projects are being developed in multiple phases.

Real Estate Projects located in Hanzhong City

Mingzhu Garden -Mingzhu Nanyuan

Mingzhu Nanyuan consists of multi-layer residential buildings and sub-high-rise and high-rise residential buildings with commercial shops on the first floors, all of which were completed by 2012 with total GFA of 35,220 square meters. The unsold property remained in 4 residential buildings with total unsold GFA of 1,487 square meters as of September 30, 2016 (2015 – 1,874 square meters).

Mingzhu Garden -Mingzhu Beiyuan

This project is located in the south -west part of Hanzhong City. The Phase I project includes two high-rise residential buildings with commercial shops located on the first floor with unsold GFA of 2,500 square meters as of September 30, 2016 (2015 – 2,678 square meters). The Phase II Mingzhou Beiyuan project includes 17 high-rise residential buildings with GFA of 358,058 square meters. The Company started construction in the third quarter of fiscal 2012 and completed the construction in the last quarter of fiscal 2015. As of September 30, 2016, the unsold GFA was 177,069 square meters. (2015 - 198,928 square meters).

Mingzhu Xinju

This project is located in the downtown of Hanzhong City. It consists of two residential buildings, with commercial shops located on the first floors with total GFA of 21,137 square meters. One building was completed as of September 30, 2010 and the other one completed as of September 30, 2011 with remaining unsold GFA of 3,879 square meters as at September 30, 2016 (2015 - 3,879 square meters).

Oriental Pearl Garden

This project is located in the downtown of Hanzhong City and currently under development. The Company started construction in the third quarter of fiscal 2012. It consists of 12 high-rise residential buildings with commercial shops on the first and second floors with GFA of approximately 275,014 square meters. The project was fully completed as of September 30, 2016. As of September 30, 2016, the unsold GFA was 130,961 square meters.

Real Estate Projects located in Yang County

Yangzhou Pearl Garden

Yangzhou Pearl Garden mainly consists of multi-layer residential buildings and sub-high-rise residential buildings with commercial shops on the first floors. As of September 30, 2016, the remaining unsold GFA of Phase I of Yangzhou Pearl Garden, which includes multi-layer residential buildings, commercial units, sub-high-rise and high-rise residential buildings was a total GFA of 11,083 square meters (2015 – 15,490). Yangzhou Pearl Garden Phase II consists of five high-rise residential buildings and one multi-layer residential building, with a total GFA of 67,653 square meters as of September 30, 2016. The construction was completed in the last quarter of fiscal 2015. As of September 30, 2016, the unsold GFA of Yangzhou Pearl Garden Phase II was 18,100 square meters (2015 – 20,661).

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 and is expected to be completed by the early of 2017. The Company received the pre-sale license on September 1, 2016 and started to promote and sell the property in November 2016.

The following table sets forth our real estate projects in the year ended September 30, 2016:

Project Name	Location	Type of Buildings	GFA sold during the year	Unsold GFA as of September 30, 2016
Yangzhou Pearl Garden Phase I	Yang County	Multi-layer residential Sub-high-rise residential	4,407	11,083
Mingzhu Garden (Mingzhu Nanyuan)	Hanzhong City	Sub-high-rise residential	387	1,487
Mingzhu Garden (Mingzhu Beiyuan) Phase I	Hanzhong City	High-rise residential	178	2,500
NanDajie (Mingzhu Xinju)	Hanzhong City	High-rise residential	-	3,879
Mingzhu Garden (Mingzhu Beiyuan) phase II	Hanzhong	High-rise residential	21,859	177,069
Oriental Pearl Garden	Hanzhong	High-rise residential	39,931	130,961
Yang County Phase II	Yang County	High-rise residential	2,561	18,100
Total			69,323	345,079

(1) The amounts for “total GFA” in this table are the amounts of total saleable gross floor area and are derived on the following basis:

· for properties that are sold, the stated GFA is based on that sales contracts relating to such property;

· for unsold properties that are completed, the stated GFA is calculated based on the detailed construction blueprint and the calculation method approved by the PRC government for saleable GFA, after necessary adjustments; and

· for properties that are under planning, the stated GFA is based on the land grant contract and our internal projections.

Suppliers

Land Bank

In China, the supply of land is controlled by the government. Since the early 2000s, the real estate industry in China has been transitioning from an arranged system controlled by the PRC government to a more market-oriented system. At present, although the Chinese government still owns all urban land in China, land use rights with terms of up to 70 years can be granted to, and owned or leased by, private individuals and companies.

Land - under planning and development

In May 2011, the Company entered into a development agreement with the local government. Pursuant to the agreement, the Company will prepay the development cost of \$18,830,229 (RMB 119,700,000) 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 September 30, 2016, a deposit of \$2,998,411 (RMB 20,000,000) was paid by the Company. The local government is still in a slow process of re-zoning the property. The Company expects to make payment of the remaining development cost based on the government's current work progress.

In August 2011, the Company entered into a land transfer agreement with Hanzhong Shijin Real Estate Development Limited ("Shijin"). Pursuant to the agreement, Shijin agreed to transfer certain land use rights to the Company for the total price of \$6,821,385 (RMB 45,500,000). As of September 30, 2016, the Company has made full payments of \$6,821,385 and received the land use right certificate. The related security deposit balance was reclassified to real estate properties under development – Shijin Project.

On November 18, 2011, the Company won two bids for land use rights by auction to obtain two parcels of land in Yang County for a total consideration and a bidding commission of \$11,949,057 (RMB 79,702,600). As of September 30, 2016, the Company had made full payment and received the land use right certificate. The related security deposit balance was reclassified to real estate properties under development – Yangzhou Palace project.

All land transactions are required to be reported to and authorized by the local Bureau of Land and Natural Resources. With respect to real estate project design and construction services, the Company typically selects the lowest-cost provider based on quality selected through an open bidding process. Such service providers are numerous in China and the Company foresees no difficulties in securing alternative sources of services as needed.

Other Suppliers

The Company uses various suppliers in the construction of its projects. For the year ended September 30, 2016, two suppliers accounted for 22% and 17% of the total project expenditure, respectively. For the year ended September 30, 2015, three suppliers accounted for 23%, 21% and 17% of the total project expenditure, respectively.

Competition

The real estate industry in China is highly competitive. In the Tier 3 and Tier 4 cities and counties that we focus on, the markets are relatively more fragmented than in the Tier 1 or Tier 2 cities. We compete primarily with regional property developers and an increasing number of large national property developers who have also started to enter these markets. Competitive factors include the geographical location of the projects, the types of products offered, brand recognition, price, designing and quality. In the regional markets in which we operate, our major competitors include three regional real estate developers: Wanbang Real Estate Development Co. Ltd., (“Wanbang”), Jingtai Real Estate Development Co. Ltd., (“Jingtai”) and Shaanxi Fenghui Real Estate Development Co. Ltd., (“Fenghui”) as well other national real estate developers including Evergrande Real Estate Group (“Evergrande”) who have also started their projects in these local markets.

Nationally, there are numerous companies that have real estate projects across China. There are over 55 housing and land development companies listed on the Shanghai and Shenzhen Stock Exchanges. However, such companies usually undertake large scale projects and are unlikely to compete with the Company for business as the Company targets small to medium sized projects in Tier 3 and Tier 4 cities and counties.

In the regional market, the Company's only direct competitor with meaningful market share in the market is Wanbang. This company generally undertakes medium and small scale projects and focuses on development of commercial real estate properties, such as hotels and shopping centers. During the past two years, Wanbang has developed about 300,000 square meters residential property in the North West of Hanzhong city.

Competitive Strength:

We believe the following strengths allow us to compete effectively:

Well Positioned to Capture Opportunities in Tier 3 and Tier 4 Cities and Counties.

With the increase in consumer disposable income and urbanization rates, a growing middle-income consumer market has emerged driving demand for affordable and high quality housing in many cities across northwest China. We focus on building large communities of modern, mid-sized residential properties for this market segment and have accumulated substantial knowledge and experience about the residential preferences and demands of mid-income customers. We believe we can leverage our experience to capture the growth opportunities in the markets.

Standardized and Scalable Business Model.

Our business model focuses on a standardized property development process designed for rapid asset turnover. We break up the overall process into well-defined stages and closely monitor costs and development schedules through each stage. These stages include (i) identifying land, (ii) pre-planning and budgeting, (iii) land acquisition, (iv) detailed project design, (v) construction management, (vi) pre-sales, sales and (vii) after-sale service. We commence pre-planning and budgeting prior to the land acquisition, which enables us to acquire land at costs that meet our pre-set investment targeted returns and to quickly begin the development process upon acquisition. Our enterprise resource planning enables us to collect and analyze information on a real-time basis throughout the entire property development process. We utilize our customer relationship management system to track customer profiles and sales to forecast future individual preferences and market demand.

Experienced Management Team Supported by Trained and Motivated Workforce.

Our CEO and founder, Mr. Xiaojun Zhu has over 20 years of experience in the real estate industry and has gained considerable strategic planning and business management expertise in the past decade. Our management and workforce are well-trained and motivated. Employees receive on-going training in their areas of specialization at our head office in Hanzhong.

Guangsha is also an “AAA Enterprise in Shaanxi Construction Industry” as recognized by the Credit Association of Agricultural Bank of China, Shaanxi Branch.

Strategies

Our goal is to become the leading residential property developer focused on China’s Tier 3 and Tier 4 cities and counties by implementing the following strategies:

Continue Expanding in Selected Tier 3 and Tier 4 Cities. We believe that Tier 3 and Tier 4 cities and counties present development opportunities that are well suited for our scalable business model of rapid asset turnover. Furthermore, Tier 3 and Tier 4 cities and counties currently tend to be in an early stage of market maturity and have fewer large national developers. We believe that the fragmented market and relative abundance of land supply in Tier 3 and Tier 4 cities, as compared to Tier 1 and Tier 2 cities, offer more opportunities for us to generate attractive margins. And we also believe that our experience affords us the opportunity to emerge as a leading developer in these markets. In the near future, we plan to enter into other Tier 3 and Tier 4 cities that have:

- Increasing urbanization rates and population growth;
- High economic growth and increasing individual income; and
- Sustainable land supply for future developments.

We plan to continue to closely monitor our capital and cash positions and carefully manage our cost for land use rights, construction costs and operating expenses. We believe that we will be able to use our working capital more efficiently by adhering to prudent cost management, which will help to maintain our profit margins. When selecting a

property project for development, we will continue to follow our established internal evaluation process, including utilizing the analysis and input of our experienced management team and choosing third-party contractors through a tender process open only to bids which meet our budgeted costs.

Quality Control

We emphasize quality control to ensure that our buildings and residential units meet our standards and provide high quality service. We select only experienced design and construction companies. We, through our contracts with construction contractors, provide customers with warranties covering the building structure and certain fittings and facilities of our property developments in accordance with the relevant regulations. To ensure construction quality, our construction contracts contain quality warranties and penalty provisions for poor work quality. In the event of delay or poor work quality, the contractor may be required to pay pre-agreed damages under our construction contracts. Our construction contracts do not allow our contractors to subcontract or transfer their contractual arrangements with us to third parties. We typically withhold 2% of the agreed construction fees for two to five years after completion of the construction as security to guarantee quality, which provides us with assurance for our contractors' work quality.

Our contractors are also subject to our quality control procedures, including examination of materials and supplies, on-site inspection and production of progress reports. We require our contractors to comply with relevant PRC laws and regulations, as well as our own standards and specifications. We set up a profile for each and every unit constructed and monitor the quality of such unit throughout its construction period until its delivery. We also employ independent surveyors to supervise the construction progress. In addition, the construction of real estate projects is regularly inspected and supervised by the PRC governmental authorities.

Environmental Matters

As a developer of property in the PRC, we are subject to various environmental laws and regulations set by the PRC national, provincial and municipal governments. These include regulations on air pollution, noise emissions, as well as water and waste discharge. As of September 30, 2016, we have never paid any penalties associated with the breach of any such laws and regulations. Compliance with existing environmental laws and regulations has not had a material adverse effect on our financial condition and results of operations, and we do not believe it will have such an impact in the future.

Our projects are normally required to undergo an environmental impact assessment by government-appointed third parties, and a report of such assessment needs to be submitted to the relevant environmental authorities in order to obtain their approval before commencing construction.

Upon completion of each project, the relevant environmental authorities inspect the site to ensure the applicable environmental standards have been complied with, and the resulting report is presented together with other specified documents to the relevant construction administration authorities for their approval and record. Approval from the environmental authorities on such report is required before we can deliver our completed work to our customers. As of September 30, 2016, we have not experienced any difficulties in obtaining those approvals for commencement of construction and delivery of completed projects.

Employees

We currently have 142 full-time employees.

Accounting Staff	7
Sales and marketing staff	80
Administrative	28
Total	142

ITEM 1A. RISK FACTORS

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 policies 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 6.7% in the first nine months of 2016 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. 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 2014 and in 2015. The monetary easing policies stabilized in the first nine months of 2016; the concentrated release of various demands contributed to the overall market upside; and the first-tier and second-tier core cities and their surrounding cities experienced successive outperformances, while overall risk remained in tier 3 and 4 cities despite initial signs of improvement in sales. 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.

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; and
- 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 2013. 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.

The Company assessed its internal control over financial reporting and still has significant deficiencies as of September 30, 2016. 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 2015 and 2014, 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, 2016 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.

On July 15, 2014, SAFE issued the Notice on Relevant Issues in the Foreign Exchange Control over Investment, Financing and Return Investment Through Special Purpose Companies by Residents Inside China, generally referred to as Circular 37, which required PRC residents to register with the competent local 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 June 2007 (known as Notice 106), expanded the reach of Circular 37 by (1) purporting to cover the establishment or acquisition of control by PRC residents of offshore entities which merely acquire “control” over domestic companies or assets, even in the absence of legal ownership; (2) adding requirements relating to the source of the PRC resident's funds used to establish or acquire the offshore entity; (3) covering the use of existing offshore entities for offshore financings; (4) purporting to cover situations in which an offshore SPV establishes a new subsidiary in China or acquires an unrelated company or unrelated assets in China; and (5) making the domestic affiliate of the SPV responsible for the accuracy of certain documents which must be filed in connection with any such registration, notably, the business plan which describes the overseas financing and the use of proceeds. Amendments to registrations made under Circular 37 are required in connection with any increase or decrease of capital, transfer of shares, mergers and acquisitions, equity investment or creation of any security interest in any assets located in China to guarantee offshore obligations, and Notice 106 makes the offshore SPV jointly responsible for these filings. In the case of an SPV which was established, and which acquired a related domestic company or assets, before the implementation date of Circular 37, a retroactive SAFE registration was required to have been completed before March 31, 2006. This date was subsequently extended indefinitely by Notice 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 37, as applied by SAFE in accordance with Notice 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 asked our stockholders, who are PRC residents as defined in Circular 37, to register with the relevant branch of SAFE, as currently required, in connection with their equity interests in us and our acquisitions of equity interests in our PRC subsidiary. However, we cannot provide any assurances that they can obtain the above SAFE registrations required by Circular 37 and Notice 106. Moreover, because of uncertainty over how Circular 37 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. For example, our present and prospective PRC subsidiaries' ability to conduct foreign exchange activities, such as the remittance of dividends and foreign currency-denominated borrowings, may be subject to compliance with Circular 37 and Notice 106 by our PRC resident beneficial holders.

In addition, such PRC residents may not always be able to complete the necessary registration procedures required by Circular 37 and Notice 106. We also have little control over either our present or prospective direct or indirect stockholders or the outcome of such registration procedures. A failure by our PRC resident beneficial holders or future

PRC resident stockholders to comply with Circular 37 and Notice 106, if SAFE requires it, could subject these PRC resident beneficial holders 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 1B. Unresolved Staff Comments

None.

ITEM 2. Properties

The Company's principal administrative, sales, and marketing facilities are located at 6 Xinghan Road, 19th Floor, Hanzhong City, Shaanxi Province. The Company built the office building in which its headquarters are located and owns the floor that houses its headquarters. In addition, the Company also owns a sales office in Yang County. See Item 1. Business — Our Projects for a description of the location and general character of the Company's real estate projects.

ITEM 3. Legal Proceedings

There are no pending legal proceedings to which the Company is a party or in which any director, officer or affiliate of the Company, any owner of record or beneficially of more than 5% of any class of voting securities of the Company, or security holder is a party adverse to the Company or has a material interest adverse to the Company. The Company's property is not the subject of any pending legal proceedings.

ITEM 4. Mine and Safety Disclosure

Not applicable.

PART II

Item 5. Market For Registrant's Common Equity, Related Stockholder Matters And Issuer Purchases Of Equity Securities

Market Information

China HGS's common stock is currently quoted on the NASDAQ Capital Market under the symbol "HGS". Between September 13, 2010 and July 19, 2012, China HGS's common stock was quoted on the NASDAQ Global Market under the same symbol. Prior to China HGS's listing on NASDAQ Global Market, its common stock was quoted on the OTC Bulletin Board under the symbol "CAHS." The following table sets forth the high and low sale prices for the Company's common stock for the periods indicated.

FISCAL 2016	High	Low
1st Quarter Ended December 31, 2015	\$2.70	\$1.42
2nd Quarter Ended March 31, 2016	\$3.63	\$1.20
3rd Quarter Ended June 30, 2016	\$3.25	\$1.60
4th Quarter Ended September 30, 2016	\$3.19	\$1.63

FISCAL 2015	High	Low
1st Quarter Ended December 31, 2014	\$5.70	\$3.01
2nd Quarter Ended March 31, 2015	\$4.43	\$2.34
3rd Quarter Ended June 30, 2015	\$3.48	\$2.57
4th Quarter Ended September 30, 2015	\$2.72	\$1.67

Holders

According to the records of our transfer agent, China HGS had 288 stockholders of record as of September 30, 2016.

Dividends

All of our assets are located within the PRC. Under the laws of the PRC governing foreign invested enterprises, dividend distribution and liquidation are allowed but subject to special procedures under relevant rules and regulations. Any dividend payment is subject to the approval of the Board of Directors and subject to foreign exchange rules governing such repatriation. Any liquidation is subject to both the relevant government agency's approval and supervision, as well as foreign exchange controls.

We have never declared or paid any cash dividends on our common stock and we do not expect to pay any cash dividends in the foreseeable future. We expect to retain any earnings to support operations and to finance the growth and development of our business. Any future determination relating to our dividend policy will be made at the discretion of our Board of Directors and will depend on a number of factors, including future earnings, capital requirements, financial conditions and future prospects and other factors the Board of Directors may deem relevant. The payment of dividends from our subsidiaries to our parent company is subject to restrictions including primarily the restriction that foreign invested enterprises may only buy, sell and/or remit foreign currencies at those banks authorized to conduct foreign exchange business after providing valid commercial documents.

PRC regulations restrict the ability of our PRC subsidiary to make dividends and other payments to its offshore parent company. PRC legal restrictions permit payments of dividend by our PRC subsidiary only out of its accumulated after-tax profits, if any, determined in accordance with PRC accounting standards and regulations. Our PRC subsidiary is also required under PRC laws and regulations to allocate at least 10% of its annual after-tax profits determined in accordance with PRC GAAP to a statutory general reserve fund until the amounts in said fund reaches 50% of its registered capital. Allocations to this statutory reserve fund can only be used for specific purposes and are not transferable to us in the form of loans, advances or cash dividends. Any limitations on the ability of our PRC subsidiary to transfer funds to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our business, pay dividends and otherwise fund and conduct our business.

Stock Performance Graph

The following graph presents a comparison of the performance of our common stock with that of the NASDAQ Composite Index and the NASDAQ Capital Market Composite Index from September 30, 2010 to September 30, 2016. The graph shall not be deemed “filed” for purposes of Section 18 of the Exchange Act, or otherwise subject to the liabilities under that section, and shall not be deemed to be incorporated by reference into any filing of the Company under the Securities Act or the Exchange Act.

	30-Sep-10	30-Sep-11	30-Sep-12	30-Sep-13	30-Sep-14	30-Sep-15	30-Sep-16
China HGS Real Estate Inc.	100	32.30	6.22	183.97	121.77	40.76	56.46
Nasdaq Composite Index	100	101.97	131.56	159.23	189.70	195.06	224.27
NASDAQ Capital Market Composite	100	85.00	109.49	134.77	129.00	109.75	113.45

*\$100 invested at closing prices on September 30, 2010 in our common stock or in a stock index.

Equity Compensation Plan Information

See “Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters” for disclosure regarding our equity compensation plan.

Purchase of Equity Securities by Our Company and Affiliated Purchases

None.

Recent Sales of Unregistered Securities

None.

Item 6. Selected Financial Data

Not applicable.

25

Item 7. Management's Discussion And Analysis of Financial Conditions And Results Of Operations.

The following discussion and analysis of financial condition and results of operations relates to the operations and financial condition reported in the financial statements of China HGS Real Estate Inc. for the fiscal years ended September 30, 2016 and 2015 and should be read in conjunction with such financial statements and related notes included in this report.

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 and 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 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.

Our 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.

For fiscal 2016, our sales, gross profit and net income were \$40,576,717, \$9,803,323 and \$5,018,940 respectively, representing an approximately 50.0%, 73.3% and 84.0% decrease in sales, gross profit and net income from fiscal 2015, respectively. The decrease in sales, gross profit and net income mainly resulted from decreased GFA sold during fiscal 2016.

The Company adopted the percentage of completion method to account for real estate sales from large high rise residential projects with construction periods over 18 to 24 months. Total revenue recognized under the percentage of completion method for fiscal 2016 was \$25,243,962 (2015 - \$76,759,922), representing 62.2% of total revenue for the fiscal 2016 (2015 - 94.6%). The related costs of these real estate sales was \$18,777,467 (2015 - \$36,842,226) for fiscal 2016, representing 65.5% (2015 - 93.8%) of the real estate costs for fiscal 2016. The gross profit before sales taxes from the percentage of completion method was \$6,466,495 (2015-\$39,917,696), representing 54.3% (2015- 95.4%) of the total gross profits before sales taxes for fiscal 2016.

For fiscal 2016, our average selling price (“ASP”) for real estate projects (excluding sales of parking spaces) located in Yang County was approximately \$456 per square meter, consistent from the ASP of \$444 per square meter for fiscal 2015. The ASP of our Hanzhong real estate projects (excluding sales of parking spaces) was approximately \$600 per square meter for 2016, consistent from the ASP of \$599 per square meter for fiscal 2015.

Market Outlook

In the balance of 2016 and looking forward into 2017, the macro-economic backdrop will continue to be uncertain with unrelenting downside pressure, while the overall inventory level of properties will remain high. The central government will continue to adopt policies aimed to ensure stability, economic growth and improved employment. The details of implementation by local government will vary among different PRC cities.

In 2017, the Company expects to launch the Liangzhou Road related project. The new projects will comprise of residential for end-users and upgraders, shopping malls as well as serviced apartments and offices to satisfy different market demands. Our customers continue to experience growth of 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. From this perspective, the Company is positive about the outlook for the local real estate market in a long term. In the meantime, the Company is diversifying its revenue and developing more commercial and municipal projects.

We intend to remain focused on our existing construction projects in Hanzhong City and Yang County, deepening our institutional sales network, enhancing our cost and operational synergies and improving cash flows and strengthening our balance sheet. In this respect, we began the construction of the following large high rise residential projects in Hanzhong City and Yang County:

Liangzhou road and related projects

In September 2013, the Company entered into an agreement (“Liangzhou Agreement”) with the Hanzhong local government on the Liangzhou Road reformation and expansion project (Liangzhou Road Project”). Pursuant to the agreement, the Company is contracted to reform and expand the Liangzhou Road, a commercial street in downtown Hanzhong City, with a total length of 2,080 meters and width of 30 meters and to resettle the existing residences in the Liangzhou road area. The government’s original road construction budget was approximately \$33 million in accordance with the Liangzhou Agreement. The Company, in return, is being compensated by the local government to have an exclusive right on acquiring at least 394.5 Mu land use rights in a specified location of Hanzhong City. The Liangzhou Road Project’s road construction started at the end of 2013. In 2014, the original scope and budget on the Liangzhou road reformation and expansion project was extended, because the local government included more area and resettlement residences into the project, which resulted in additional investments from the Company. In return, the Company is authorized by the local government to develop and manage the commercial and residential properties surrounding the Liangzhou Road project. Due to the extension, the Company expected the road construction to be completed and approved by the local government in early 2017. The Company’s development cost incurred on Liangzhou Road Project is treated as the Company’s deposit on purchasing the related land use rights, as agreed by the local government.

As of September 30, 2016, the actual costs incurred by the Company was \$117,226,429 (2015 - \$85,069,755) and the incremental cost related to residence resettlement was approved by the local government. The Company determined that the Company's Investment in Liangzhou Road Project in exchange for interests in future land use rights is a barter transaction with commercial substance. For the years ended September 30, 2016 and 2015, the Company received government's subsidies in the amount of \$Nil and \$9,439,183 for its Shanty Area Reform Project surrounding Liang Zhou Road located in Hantai District, Hanzhong City, respectively, and the Company recorded the subsidies to offset against the development cost of Liangzhou Road Project.

The Liangzhou road related projects mainly consists Oriental Garden Phase II, Liangzhou Mansion and Pearl Commercial Plaza surrounding the Liangzhou road area.

Oriental Garden Phase II

Oriental Garden Phase II project is planned to consist of 8 high-rise residential buildings and 6 commercial buildings with total planned GFA of 370,298 square meters. The project will also include a farmer's market.

Liangzhou Mansion

Liangzhou Mansion project is planned to consist of 7 high-rise building and commercial shops on the first floor with total planned GFA of 160,000 square meters.

Pearl Commercial Plaza

Pearl Commercial Plaza is planned to consist one office building, one service apartment (or hotel), classical architecture style of Chinese traditional houses and shopping malls with total planned GFA of 124,191 square meters.

The Company plans to start these three real estate projects in spring of 2017 when the local government expects to complete the reallocation of the existing residence in the Liangzhou road area.

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 and is expected to be completed by the end of 2017. The Company has obtained pre-sale license in September 2016.

Road Construction

Other road construction projects mainly included a Yang County East 2nd Ring Road construction project. The Company was engaged by Yang County local government to construct East 2nd Ring Road with total length of 2.15 km and budgeted price approximately of \$25.2 million (or RMB 168 million) approved by local Yang County government in March 2014. The local government is required to repay the Company's project investment within 3-4 years with interest based on the commercial borrowing rate with the similar term published by China Construction Bank. The local government also was allowed to refund the Company by reducing local surcharges or taxes otherwise required in the real estate development. As of September 30, 2016, the actual costs incurred by the Company was \$2,390,633 which was included in real estate property under development on the consolidated balance sheet. The local government is in the process of acceptance and assessment process. The Company is expected to deliver these two road construction projects to local government in 2017.

In September 2012, the Company was approved by the Hanzhong local government to construct four municipal roads with a total length of approximately 1,192 meters. The project was deferred and then restarted during the quarter ended March 31, 2014. As of September 30, 2016, the local government was still in the process of planning and assessing the scope and budget for these projects. We expect these initiatives will help us during this difficult period and better position us to capitalize on opportunities from a future market upturn.

Summary of real estate projects completion status

	Actual (estimated) Completion time of construction	Estimated time to sell of the property
Development completed		
Hanzhong City Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)	Majority was completed during the third quarter of fiscal 2012	2017
Hanzhong City Nan Dajie (Mingzhu Xindu)	Phase one completed in 2010 and Phase two completed in 2011	2017
Hanzhong City Mingzhu Garden Phase II	Completed by Fiscal 2015	2017
Hanzhong City Oriental Pearl Garden	Completed by Fiscal 2016	
Yang County Yangzhou Pearl Garden Phase II	Completed by Fiscal 2015	2017
Yang County Yangzhou Pearl Garden	Majority completed in 2011 and 2012	2017
Under development:		
Yang County Yangzhou Palace	To be completed in 2017	
Hanzhong City Shijin Project	Under planning stage	
Hanzhong City Hanfeng Beiyuan East Road	To deliver the road to government in 2017	
Hanzhong City Liangzhou Road and related projects	The road construction to be completed in 2017, the related projects will be completed in 2018 and later years.	
Hanzhong City Beidajie project	Under planning stage	
Yang County East 2 nd Ring Road	To be completed in 2017	

RESULTS OF OPERATIONS**Year ended September 30, 2016 as compared to year ended September 30, 2015****Revenues**

The following is a breakdown of revenue for the years ended September 30, 2016 and 2015:

	For the year ended September 30,	
	2016	2015
Revenue recognized under full accrual method	\$15,332,755	\$4,355,572
Revenue recognized under percentage of completion method	25,243,962	76,759,922
Total	\$40,576,717	\$81,115,494

Percentage of Completion method

Real estate sales for our 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, whose balance is \$11,891,230 as of September 30, 2016 (2015 - \$11,825,036). 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 \$2,110,808 as of September 30, 2016 (2015 - \$3,315,302).

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.

Changes of estimated gross profit margins related to revenue recognized under the percentage of completion method are made in the period in which circumstances requiring the revisions become known. For the year end September 30, 2016, real estate development projects with gross profits recognized in 2015 had changes in their estimated revenue and related gross profit margins. The company reduced its prior estimates related to selling prices and total estimated sales values which led to an increase in the recognized costs of sales under percentage completion revenue recognition approach. As a result of these changes in gross profit margins, net income for the year ended September 30, 2016 decreased by \$3,940,964 (2015 – \$1,500,119) and basic and diluted earnings per share for the year ended September 30, 2016 decreased by \$0.09 (2015 - \$0.03).

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. As of September 30, 2016, the Company had security deposits for these guarantees amounted to approximately \$1.5 million. The period of the mortgage loan guarantee begins on the date the bank approves the buyer's mortgage and we receive the loan proceeds in our bank account and ends on the date the "Certificate of Ownership" evidencing that title to the property has been transferred to the buyer. The procedures to obtain the Certificate of Ownership take six to twelve months (the "Mortgage Loan Guarantee Period"). If, after investigation of the buyer's income and other relevant factors, the bank decides not to grant the mortgage loan, 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.

Revenue recognized under full accrual method

The following table summarizes revenue recognized under full accrual method from sales of completed real estate projects for the years ended September 30, 2016 and 2015, respectively:

	For the Years Ended September 30,							
	2016		2015				Variance	
	Revenue	%	Revenue	%	Variance		%	
Projects								
Yangzhou Pearl Garden Phase I and II	\$3,178,371	20.7 %	\$2,227,474	51.1 %	\$(950,897)		42.7	%
Mingzhu Xinju	-	- %	170,632	3.9 %	(170,632)		(100)%
Central Plaza	-	- %	973,189	22.3 %	(973,189)		(100)%
Mingzhu Garden (Nanyuan and Beiyuan) Phase I and II	12,154,384	79.3. %	984,277	22.6 %	(11,170,107)		1,134.9	%
Total Revenue	\$15,332,755	100 %	\$4,355,572	100 %	\$(10,977,183)		252.0	%
Sales Tax	(319,167)		(241,685)		(77,482)		32.1	%
Revenue net of sales tax	\$15,013,588		\$4,113,887		\$10,899,701		264.9	%

Our revenues are derived from the sale of residential buildings, commercial store-fronts and parking spaces in projects that we have developed. Comparing to fiscal 2015, revenues before sales tax increased by 252.0% to approximately \$15.3 million for the year ended September 30, 2016 from approximately \$4.4 million for last year. The total GFA sold during fiscal 2016 was 29,392 square meters, representing a significant increase from the 7,997 square meters completed and sold during fiscal 2015, because both Mingzhu Garden Phase II and Yangzhou Pearl Garden Phase II projects were completed by September 30, 2015 therefore the sales from related properties were included in the above table.

Sales tax for fiscal 2016 and 2015 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 years ended September 30, 2016 and 2015 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 fiscal 2016 increased by 32.1% from last year, primarily as a result of increase in revenue. In May of 2016, the Business Tax has been incorporated into Value Added Tax in China, which means there will be no more Business Tax and accordingly some business operations previously taxed in the name of Business Tax will be taxed in the manner of VAT thereafter. The Company is subject to 5% of VAT for all its exiting real estate project based on the local tax authority's practice. As our revenue is reported net of VAT, the Company does not expect the overall gross margin for the existing real estate properties will be significantly affected by the change from business tax to VAT.

Revenue recognized under percentage completion method

For the year ended September 30, 2016					
	Total GFA⁽³⁾	Average Qualified Contract Sales⁽²⁾ Percentage of Completion⁽¹⁾		Revenue Recognized under Percentage of Completion	Accumulated Revenue recognized under Percentage of completion
Real estate properties located in Hanzhong Oriental Garden	275,014	100%	\$ 105,741,424	\$ 25,243,962	\$ 105,741,424
For the year ended September 30, 2015					
	Total GFA	Average Qualified Contract Sales⁽²⁾ Percentage of Completion⁽¹⁾		Revenue Recognized under Percentage of Completion	Accumulated Revenue recognized under Percentage of completion
Real estate properties located in Hanzhong Mingzhu Garden	358,058	100%	\$99,513,407	\$ 41,624,417	\$99,513,407
– Mingzhu Beiyuan Phase II					
Oriental Garden	273,787	87 %	92,093,999	31,230,084	85,293,126
Real estate properties located in Yang County					
Yangzhou Pearl Garden Phase II	67,653	100%	18,986,483	3,905,421	18,986,483
Total	699,498		\$210,593,889	\$ 76,759,922	\$ 203,793,016

Percentage of Completion is calculated by dividing total costs incurred by total estimated costs for the relevant (1) buildings in each real estate building, estimated as of the date 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 September 30, 2016 equal or greater than 30% of contract sales amount and related individual of buildings were sold over 20%.

(3) The actual GFA will be re-measured when the real estate project is completed, which could be slightly different from the estimated GFA at the beginning of the real estate projects.

Both Mingzhu Garden Phase II and Yangzhou Pearl Garden Phase II projects were completed by September 30, 2015, therefore the related revenue was not included in the above table. For Oriental Garden real estate property, total contract sales as of September 30, 2016 were \$106,303,997 (September 30, 2015 - \$95,518,605). Total GFA sold

under contract sales as of September 30, 2016 was 144,289 square meters (September 30, 2015 – 119,353). The average unit price was \$737 per square meters (September 30, 2015 - \$800). For the purpose of percentage of completion calculation, the qualified contract sales amount was approximately \$105,741,424 for the year ended September 30, 2016 (September 30, 2015 - \$92,093,999). The Oriental Garden real estate property was completed as of September 30, 2016.

Cost of sales

The following table sets forth a breakdown of our cost of revenues for the years indicated.

	For the Years Ended September 30,							
	2016		2015					
	Cost	Percentage	Cost	Percentage	Variance		Variance %	
Land use rights	\$1,478,048	5.2	% \$3,010,314	7.7	% \$(1,532,266)	(50.9)%		
Construction costs	27,192,730	94.8	% 36,248,243	92.3	% (9,055,513)	(25.0)%		
Total	\$28,670,778	100	% \$39,258,557	100	% \$(10,587,779)	(27.0)%		

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 a 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 \$28.7 million for the year ended September 30, 2016 compared to \$39.3 million for the year ended September 30, 2015. The \$10.6 million decrease in cost of sales was mainly attributable to the decrease in total GFA sold during fiscal 2016 under percentage completion method which led to decreased revenue and cost of sales during fiscal 2016.

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 year ended September 30, 2016 were approximately \$1.5 million, as compared to \$3.0 million for the year ended September 30, 2015, representing a decrease of \$1.5 million from last year. The decrease in costs of land use rights was consistent with the fact that the total GFA sold under percentage completion method in 2016 was lower than 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, 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 year ended September 30, 2016 were approximately \$27.2 million as compared to approximately \$36.2 million for the year ended September 30,

2015, representing a decrease of \$9.0 million. The decrease in construction cost was due to the decrease in units sold under percentage completion method in 2016.

The total cost of sales as a percentage of real estate sales before sales tax for the year ended September 30, 2016 decreased to 70.7% from 48.4% for the year ended September 30, 2015, because a significant portion of revenue recognized under the percentage completion method in 2015 was from sales of commercial properties with higher selling price. Most of properties sold during the year ended September 30, 2016 were residential units with lower selling prices.

Gross profits

Gross profit was approximately \$9.8 million for the year ended September 30, 2016 as compared to approximately \$36.7 million for the year ended September 30, 2015, representing a decrease of \$26.9 million, which was mainly attributable to less GFA sold in Mingzhu Garden Phase II projects and Oriental project during fiscal 2016. We have only limited models available for customer selection in the Mingzhu Garden Phase I and II projects, therefore, the related sales decreased in fiscal 2016. Oriental Garden project was completed as of September 30, 2016, we expected the future sales of Oriental Garden will increase in fiscal 2017. The overall gross profit as a percentage of real estate sales decreased to 24.2% for the year ended September 30, 2016 from 45.2% for the year ended September 30, 2015, was mainly due to the fact that more commercial units with higher margins in Mingzhu Garden Phase II and Oriental project in Hanzhong City were sold in fiscal 2015 comparing to fiscal 2016. Approximately 69.2% of the gross profit in fiscal 2015 were from sales of commercial units in Mingzhu Garden Phase II and Oriental Garden project, but there was only 30% of gross profit in fiscal 2016 were from the related sales. During fiscal 2015, total revenue from sales of commercial units in Mingzhu Garden Phase II and Oriental Garden projects amounted to approximately \$35.2 million with average gross margin of 82%, while total revenue from sales of commercial units in Mingzhu Garden Phase II and Oriental Garden projects amounted to \$4.9 million in fiscal 2016 with average gross margin of 73%.

Project	For the Year Ended September 30								
	2016			2015					Variance
	Gross Profit	Gross Margin		Gross Profit	Gross Margin		Variance		%
Yangzhou Pearl Garden Phase I and II	\$1,630,142	51 %		\$1,291,480	21 %		\$338,662	26.2	%
Mingzhu Xinju	-	-		51,469	30 %		(51,469)	(100)%
Central Plaza	-	-		360,599	37 %		(360,599)	(100)%
Mingzhu Garden (Mingzhu Nanyuan and Beiyuan)	3,809,302	31 %		21,091,413	50 %		17,282,111	(81.9)%
Phase I and II									
Oriental Garden	6,466,495	26 %		19,061,976	61 %		(12,595,481)	(66.1)%
Sales Tax	(2,102,616)			(5,194,616)			3,092,000	(59.5)%
Total Gross Profit	\$9,803,323	24.2 %		\$36,662,321	45.2 %		\$(26,858,998)	(73.3)%
Total Revenue	\$40,576,717			\$81,115,494			\$ (40,538,777)	(50.0)%

Operating expenses

Total operating expenses increased by 11.3% or \$362,949 to \$3,584,999 for the year ended September 30, 2016 from \$3,222,050 for the year ended September 30, 2015, as a result of an increase in general and administration expenses of \$162,011 and an increase in selling expense of \$200,938. The increase in general and administration expense for fiscal 2016 was attributed to increases in surtax charges and office expense. The Company also incurred more marketing expense in fiscal 2016 to promote the Yang County Palace project and completed real estate projects.

	As of September 30,	
	2016	2015
General and administrative expenses	\$2,466,717	\$2,304,706
Selling expenses	1,118,282	917,344
Total Operating expenses	\$3,584,999	\$3,222,050
Percentage of Revenue	9 %	4 %

Interest expense - net

Net interest expense was \$225,155 for the year ended September 30, 2016, compared to net interest expense of \$61,419 for the year ended September 30, 2015. Interest expense for fiscal 2016 and 2015 mainly included \$72,400 interest from the one-year shareholder loan of \$1,810,000 with our Chairman and CEO – Mr. Xiaojun Zhu. The interest rate for the loan is 4% per annum. In addition, the loan interest of \$137,962 with China Construction Bank were fully

expensed in fiscal 2016, because the related Mingzhu Garden Phase II project was fully completed as of September 30, 2015. Prior to September 30, 2015, the loan interest with China Construction bank were capitalized in the development cost of Mingzhu Garden Phase II project.

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 years ended September 30, 2016 and 2015.

PRC Taxes

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

However, the local taxing authority of Hanzhong City has the power to assess corporate taxes annually on local enterprises at a pre-determined fixed rate as an incentive to stimulate the local economy and encourage entrepreneurship. In the fiscal years 2016 and 2015, the taxing authority assessed us for income taxes at the rate of 1.25% on revenue in Yang County and 2.5% on our revenue in Hanzhong, instead of the statutory rate of 25% of net income. As a result, income tax expenses for the year ended September 30, 2016 were \$974,688, representing a tax saving approximately of \$0.6 million. Income taxes decreased in fiscal 2016 by 50.0% as compared to \$1,951,226 for the year ended September 30, 2015 as a result of our lower revenue in fiscal 2016.

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 \$5,018,940 in net income for the year ended September 30, 2016, representing a decrease of 84.0% or \$26.4 million as compared to \$31,427,626 for the year ended September 30, 2015. The decline of net income was a result of the item discussed above.

Other comprehensive income

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

Translation adjustments amounted to \$(7,604,743) and \$(5,186,242) as of September 30, 2016 and 2015, respectively. The balance sheet amounts with the exception of equity at September 30, 2016 were translated at 6.6702RMB to 1.00 USD as compared to 6.3568RMB to 1.00 USD at September 30, 2015. The equity accounts were stated at their historical rate. The average translation rates applied to the income statements accounts for the years ended September 30, 2016 and 2015 were 6.5326 RMB to 1.00 USD and 6.1653 RMB to 1.00 USD, 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, bank borrowings and loan from financial institutions and borrowings from our principal shareholder.

As of September 30, 2016, the Company had an approximately of \$51.2 million in working capital, an increase of \$16.9 million as compared to \$34.3 million as of September 30, 2015. Our total cash and restricted cash balance increased to approximately \$7.9 million as of September 30, 2016 as compared to approximately \$3.0 million as of September 30, 2015. Since most of our current real estate developments are completed as of September 30, 2016, we are expecting to collect the full purchase price from our existing customers in the coming period. In addition, on June 26, 2015 and March 10, 2016, the Company signed phase I and Phase II agreements with Hanzhong Urban Construction Investment Development Co., Ltd, a state owned Company, to borrow up to \$116,188,420 (RMB 775,000,000) long term loan at 4.245% interest to develop Liang Zhou Road Project. As of September 30, 2016, the Company borrowed \$93,975,338 from this credit line. The loan is guaranteed by Hanzhong City Hantai District Municipal Government and pledged by the Company's Yang County Palace project with carrying value of \$76,618,856 as of September 30, 2016. On January 8, 2016, the Company signed a loan agreement with Hanzhong Municipal Housing Provident Fund Management Center to borrow up to \$11,993,643 (RMB 80,000,000) for development of Oriental Garden project. The loan carries interest at is 3.575% and is due in January 2019. The repayment is required based on certain sales milestones or a fixed repayment schedule starting in July 2018. Our major shareholder pledged their assets for the loan. The Housing Fund has rights to monitor the project's future cash flow.

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 principal shareholder, Mr. Xiaojun Zhu has been providing and will continue to provide his personal funds, if necessary, to support the Company on an 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 third party.

Cash Flow

Year ended September 30, 2016 as compared to year ended September 30, 2015

Comparison of cash flows results for the fiscal year ended September 30, 2016 and fiscal year ended September 30, 2015, are summarized as follows:

	As of September 30,		
	2016	2015	Variance
Net cash (used in) provided by operating activities	\$(76,948,063)	\$10,252,609	\$(87,200,672)
Net cash used in investing activities	(125,023)	-	(125,023)
Net cash provided by (used in) financing activities	\$82,311,136	\$(10,000,865)	\$92,312,001
Effect of changes of foreign exchange rate on cash	\$(170,732)	\$(43,370)	\$(127,362)
Net increase (decrease) in cash	\$5,067,318	\$208,374	\$4,858,944
Cash, beginning of year	\$1,333,919	\$1,125,545	\$208,374
Cash, end of year	\$6,401,237	\$1,333,919	\$5,067,318

Operating activities

Net cash used in operating activities during fiscal 2016 was approximately \$76.9 million, consisting of net income of \$5.0 million, noncash adjustments of \$0.8 million and net changes in our operating assets and liabilities, which mainly included an increase in real estate property completed of \$41.8 million mainly due to the completion of Oriental Garden real estate project, increase in real estate property under development of \$18.3 million for continuous spending on Liangzhou Road and related projects, a decrease in accounts payable and other payable of \$16.2 million due to more payments to our contractors and suppliers when the projects were at completion stage and an increase of security deposit of \$5.0 million made to obtain other loans for development of Liangzhou Road and related project, offset by a decrease of customer deposits of \$3.1 million due to more collections from our customer as most of our real estate projects were completed. The negative operation cash flow in fiscal 2016 mainly caused by less revenue and our continuous investment in the Liangzhou Road and related projects.

Net cash provided by operating activities during fiscal 2015 was approximately \$10.3 million, consisting of net income of \$31.4 million, noncash adjustments of \$2.0 million and net changes in our operating assets and liabilities, which mainly included an increase in real estate property completed of \$71.3 million and a reduction in real estate property underdevelopment of \$63.4 million, mainly due to the completion of Mingzhu Beiyuan Phase II and Yangzhou Pearl Garden Phase II real estate projects, a decrease in accounts payable and other payable of \$15.1 million due to more payments to our contractors and suppliers when the projects were at completion stage, a decrease of customer deposits of \$8.4 million due to the fact a significant portion of customer deposits were recognized in revenue. The positive cash flow provided by operating activities is mainly attributable to more collection from our customers when Mingzhu Beiyuan Phase II and Yangzhou Pearl Garden Phase II real estate projects were completed and the slow spending on real estate properties under development.

Financing activities

Net cash flows provided by financing activities was approximately \$82.3 million for fiscal 2016, which included a net proceeds from shareholder loan of \$0.9 million, a net proceeds from other loans of \$87.4 million and offset by net repayment of a bank loan of approximately \$6.1 million.

Net cash flows used in financing activities was approximately \$10 million for fiscal 2015, which included restricted cash of approximately \$0.2 million, a net repayment of shareholder loan of \$3.6 million, net repayment of a bank loan of approximately \$13.0 million and offset by a net proceeds from other loans of approximately \$6.8 million.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

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.

Critical Accounting Policies and Management Estimates

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.

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, deferred taxes, budgeted costs 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 of cash, restricted cash and all other current assets, security deposits for land use rights, loans and all current liabilities 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. It was impractical to estimate the fair value of the amount due from the local government and the long term other loans payable.

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 years ended September 30, 2016 and 2015, 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.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

CHINA HGS REAL ESTATE INC.

TABLE OF CONTENTS

<u>Report Of Independent Registered Public Accounting Firm</u>	42
<u>Consolidated Balance Sheets as of September 30, 2016 and 2015</u>	43
<u>Consolidated Statements of Income and Comprehensive Income (Loss) for the Years Ended September 30, 2016 and 2015</u>	44
<u>Consolidated Statements of Stockholders' Equity for the Years Ended September 30, 2016 and 2015</u>	45
<u>Consolidated Statements of Cash Flows for the Years Ended September 30, 2016 and 2015</u>	46
<u>Notes To Consolidated Financial Statements</u>	47

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

China HGS Real Estate Inc.

We have audited the accompanying consolidated balance sheets of China HGS Real Estate Inc. (the “Company”) as of September 30, 2016 and 2015, and the related consolidated statements of income and comprehensive income (loss), stockholders’ equity and cash flows for the years then ended. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of September 30, 2016 and 2015, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Friedman LLP

New York, New York

December 21, 2016

42

CHINA HGS REAL ESTATE INC.**CONSOLIDATED BALANCE SHEETS**

	September 30, 2016	2015
ASSETS		
Current assets:		
Cash	\$6,401,237	\$1,333,919
Restricted cash	1,493,537	1,715,268
Cost and earnings in excess of billings	11,891,230	11,825,036
Real estate property development completed	113,185,929	75,391,512
Real estate property under development	-	55,154,153
Other current assets	2,722,036	228,223
Total current assets	135,693,969	145,648,111
Property, plant and equipment, net	792,650	780,038
Real estate property development completed, net of current portion	1,657,055	2,140,271
Security deposits	7,940,137	3,146,237
Real estate property under development, net of current portion	207,384,015	143,660,781
Due from local government for real estate property development completed	2,920,990	3,065,000
Total Assets	\$356,388,816	\$298,440,438
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Bank loan	\$-	\$6,292,474
Other loans	6,125,753	5,674,239
Accounts payable	30,574,497	41,501,682
Other payables	5,200,807	12,676,362
Construction deposits	1,911,158	1,959,706
Billings in excess of cost and earnings	2,110,808	3,315,302
Customer deposits	16,790,208	17,387,969
Shareholder loans	2,709,523	1,810,000
Accrued expenses	3,205,099	4,855,891
Taxes payable	15,843,815	15,830,886
Total current liabilities	84,471,668	111,304,511
Deferred tax liabilities	5,107,887	4,711,161
Customer deposits, net of current portion	10,687,272	8,246,004
Other loans, less current portion	99,843,228	15,731,186

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Construction deposits, net of current portion	1,329,820	972,432
Total liabilities	201,439,875	140,965,294
Commitments and Contingencies		
Stockholders' equity		
Common stock, \$0.001 par value, 100,000,000 shares authorized, 45,050,000 shares issued and outstanding	\$45,050	\$45,050
Additional paid-in capital	129,793,572	17,764,316
Statutory surplus	8,495,631	16,439,333
Retained earnings	20,661,184	119,668,198
Accumulated other comprehensive income (loss)	(4,046,496)	3,558,247
Total stockholders' equity	154,948,941	157,475,144
Total Liabilities and Stockholders' Equity	\$356,388,816	\$298,440,438

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

CHINA HGS REAL ESTATE INC.**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (LOSS)****FOR THE YEARS ENDED SEPTEMBER 30,**

	2016	2015
Real estate sales	\$40,576,717	\$81,115,494
Less: Sales tax	2,102,616	5,194,616
Cost of real estate sales	28,670,778	39,258,557
Gross profit	9,803,323	36,662,321
Operating expenses		
Selling and distribution expenses	1,118,282	917,344
General and administrative expenses	2,466,717	2,304,706
Total operating expenses	3,584,999	3,222,050
Operating income	6,218,324	33,440,271
Interest expense- net	(225,155)	(61,419)
Other income - net	459	-
Income before income taxes	5,993,628	33,378,852
Provision for income taxes	974,688	1,951,226
Net income	5,018,940	31,427,626
Other comprehensive income (loss)		
Foreign currency translation adjustment	(7,604,743)	(5,186,242)
Comprehensive income (loss)	\$(2,585,803)	\$26,241,384
Basic and diluted income per common share		
Basic	\$0.11	\$0.70
Diluted	\$0.11	\$0.70
Weighted average common shares outstanding		
Basic	45,050,000	45,050,000
Diluted	45,050,000	45,052,252

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

CHINA HGS REAL ESTATE INC.**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY****FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015**

	Common Stock		Additional	Statutory	Retained	Accumulated Other	
	Shares	Amount	Paid-in Capital	Surplus	Earnings	Comprehensive Income (Loss)	Total
Balance at September 30, 2014	45,050,000	\$45,050	\$17,759,349	\$12,845,197	\$91,834,708	\$8,744,489	\$131,226,703
Stock-based Compensation			4,967				4,967
Appropriation of statutory reserve				3,594,136	(3,594,136)		-
Net income for the year	-				31,427,626		31,427,626
Foreign currency translation adjustments						(5,186,242)	(5,186,242)
Balance at September 30, 2015	45,050,000	\$45,050	\$17,764,316	\$16,439,333	\$119,668,198	\$3,558,247	\$157,405,054
Stock-based Compensation			59,600				59,600
Appropriation of statutory reserve				516,314	(516,314)		-
Net income for the year					5,018,940		5,018,940
Recapitalization of VIE ("Guangsha") equity*			111,969,656	(8,460,016)	(103,509,640)		-
Foreign currency translation adjustments						(7,604,743)	(7,604,743)
Balance at September 30, 2016	45,050,000	\$45,050	\$129,793,572	\$8,495,631	\$20,661,184	\$(4,046,496)	\$154,949,338

* For the year ended September 30, 2016, Shaanxi Guangsha Investment and Development Group Co., Ltd ("Guangsha"), the VIE of the Company, had a recapitalization. The VIE's accumulated retained earnings and statutory reserve were reclassified to additional paid – in capital in the consolidated financial statements.

The accompanying notes are an integral part of these consolidated financial statement

CHINA HGS REAL ESTATE INC.**CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED SEPTEMBER 30,**

	2016	2015
Cash flows from operating activities		
Net income	\$ 5,018,940	\$ 31,427,626
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Deferred tax provision	631,099	1,870,180
Depreciation	74,723	83,701
Stock based compensation	59,600	4,967
Changes in assets and liabilities:		
Advances to vendors	(60,480)	-
Security deposits	(5,045,816)	-
Cost and earnings in excess of billings	(634,893)	118,861
Real estate property development completed	(41,816,677)	(71,332,340)
Real estate property under development	(18,287,677)	63,376,691
Other current assets	(2,496,811)	1,171,630
Accounts payable	(9,166,316)	(14,428,567)
Other payables	(7,024,872)	(684,063)
Billings in excess of cost and earnings	(1,070,814)	462,916
Customer deposits	3,112,121	(8,439,960)
Construction deposits	456,014	1,654,075
Accrued expenses	(1,468,888)	1,201,727
Taxes payable	772,684	3,765,165
Net cash (used in) provided by operating activities	(76,948,063)	10,252,609
Cash flow from investing activities		
Purchase of fixed assets	(125,023)	-
Net cash used in investing activities	(125,023)	-
Cash flow from financing activities		
Restricted cash	144,112	(181,392)
Proceeds from other loans	93,658,620	27,670,998
Repayment of other loans	(6,286,930)	(20,865,164)
Repayment of bank loan	(6,123,137)	(12,975,849)
Proceeds from shareholder loan	3,236,078	11,642,580
Repayment of shareholder loan	(2,317,607)	(15,292,038)
Net cash provided by (used in) financing activities	82,311,136	(10,000,865)
Effect of changes of foreign exchange rate on cash	(170,732)	(43,370)
Net increase in cash	5,067,318	208,374
Cash, beginning of year	1,333,919	1,125,545

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Cash, end of year	6,401,237	1,333,919
Supplemental disclosures of cash flow information:		
Interest paid	\$5,102,735	\$1,840,535
Income taxes paid	\$424,970	\$144,742
Non-cash financing activities:		
Recapitalization of VIE (“Guangsha”)	\$111,969,656	-

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

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

China HGS Real Estate Inc. (the “Company” or “China HGS” or “we”, “our”, “us”) is a corporation organized under the laws of the State of Florida.

China HGS does not conduct any substantive operations of its own. Instead, through its subsidiary, Shaanxi HGS Management and Consulting Co., Ltd (“Shaanxi HGS”), it entered into certain exclusive contractual agreements with the management of the Company’s PRC operating subsidiary, Shaanxi Guangsha Investment and Development Group Co., Ltd (“Guangsha”). Pursuant to these agreements, Shaanxi HGS is obligated to absorb a majority of the risk of loss from Guangsha’s activities and entitles Shaanxi HGS to receive a majority of Guangsha’s expected residual returns. In addition, Guangsha’s shareholders have pledged their equity interest in Guangsha to Shaanxi HGS, irrevocably granted Shaanxi HGS an exclusive option to purchase, to the extent permitted under PRC Law, all or part of the equity interests in Guangsha and agreed to entrust all the rights to exercise their voting power to the person(s) appointed by Shaanxi HGS.

Based on these contractual arrangements, management believes that Guangsha should be considered a “Variable Interest Entity” (“VIE”) under ASC 810 “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51”, because the equity investors in Guangsha no longer have the characteristics of a controlling financial interest, and the Company, through Shaanxi HGS, is the primary beneficiary of Guangsha. Accordingly, Guangsha has been consolidated under ASC 810.

The Company, through its subsidiaries and VIE, engages in real estate development, in the construction and sale of residential apartments, parking lots and commercial properties. Total assets and liabilities presented on the consolidated balance sheets and sales, cost of sales, net income presented on Consolidated Statement of Income and Comprehensive Income as well as the cash flow from operation, investing and financing activities presented on the Consolidated Statement of Cash Flows are substantially the financial position, operation and cash flow of Guangsha. The Company has not provided any financial support to Guangsha for the years ended September 30, 2016 and 2015.

The following assets and liabilities of the consolidated VIE are included in the accompanying consolidated financial statements of the Company as of September 30, 2016 and 2015:

Balance as of	
September	September 30,
30,	2015
2016	

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Current assets	\$135,675,587	\$145,628,992
Non-current assets	220,295,366	152,360,755
Total assets	355,970,953	297,989,747

Current liabilities	83,547,250	110,515,207
Non-current liabilities	116,968,207	29,660,783
Total liabilities	\$200,515,457	\$140,175,990

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The Company's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

The consolidated financial statements include the accounts 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.

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.

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.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

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, 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.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

EFFECT OF CHANGE IN ESTIMATE

Changes of estimated gross profit margins related to revenue recognized under the percentage of completion method are made in the period in which circumstances requiring the revisions become known. For the year end September 30, 2016, real estate development projects with gross profits recognized in 2015 had changes in their estimated revenue and related gross profit margins. The Company reduced its prior estimates related to selling prices and total estimated sales values which led to an increase in the recognized costs of sales under percentage completion revenue recognition approach. As a result of these changes in gross profit margins, net income for the year ended September 30, 2016 decreased by \$3,940,964 (2015 – \$1,500,119) and basic and diluted earnings per share for the year ended September 30, 2016 decreased by \$0.09 (2015 - \$0.03).

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 of cash, restricted cash and all other current assets, security deposits for land use rights, loans and all current liabilities 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. It was impractical to estimate the fair value of the amount due from the local government and the long term other loans payable.

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 consolidated 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.

	2016	2015
Year end RMB : USD exchange rate	6.6702	6.3568
Annual average RMB : USD exchange rate	6.5326	6.1653

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currency translation (continued)

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 by the Federal Deposit Insurance Corporation or other programs.

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. 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.

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.

Security deposits for land use rights

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

Real estate property development completed and under development

Real estate property consists of finished residential unit sites, 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.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Real estate property development completed and under development (continued)

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. 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 years ended September 30, 2016 and 2015, 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. For the years ended September 30, 2016 and 2015, the total interest capitalized in the real estate property development was \$3,410,529 and \$3,064,621, respectively.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, Plant and equipment, net

Property, plant and equipment are recorded at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the fixed assets have been put into operation, such as repairs and maintenance and overhaul costs, is normally expensed in the year in which it is incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, less any estimated residual value. Estimated useful lives of the assets are as follows:

Buildings	39 years
Machinery and office equipment	5-10 years
Vehicles	8 years

Any gain or loss on disposal or retirement of a fixed asset is recognized in the profit and loss account and is the difference between the net sales proceeds and the net carrying amount of the asset. When property and equipment are retired or otherwise disposed of, the asset and accumulated depreciation are removed from the accounts and the resulting profit or loss is reflected in income.

Maintenance, repairs and minor renewals are charged directly to expense as incurred unless such expenditures extend the useful life or represent a betterment, in which case they are capitalized.

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 for the years ended September 30, 2016 and 2015.

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.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 years ended September 30, 2016 and 2015, the Company had not recognized any warranty costs in excess of the amount retained from subcontractors and therefore, no warranty reserve is considered necessary at the balance sheet dates.

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.

Stock-based compensation

Share-based payment transactions are 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.

Forfeitures to be estimated at the time of grant and revised, if necessary, in the subsequent period if actual forfeitures differ from initial estimates. Forfeiture rate is estimated based on historical and future expectation of employee

turnover rate and are adjusted to reflect future change in circumstances and facts, if any. Share-based compensation expense is recorded net of estimated forfeitures such that expense was recorded only for those stock options and common stock awards that are expected to vest.

Income taxes

Deferred tax assets and liabilities are 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 September 30, 2016 and 2015.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income taxes (continued)

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 years ended September 30, 2016 and 2015. As of September 30, 2016, the Chinese entities' income tax returns filed in China for the years ended December 31, 2015, 2014, 2013, 2012 and 2011 are subject to examination by the Chinese taxing authorities.

As of September 30, 2016, the tax years ended September 30, 2008 through September 30, 2016 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, 2012 through September 30, 2016 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%.

Comprehensive income

In accordance with ASC 220-10-55, comprehensive income (loss) 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 (loss) for the years ended September 30, 2016 and 2015 were net income and foreign currency translation adjustments.

Advertising expenses

Advertising costs are expensed as incurred. For the years ended September 30, 2016 and 2015, the Company recorded advertising expenses of \$591,390 and \$338,115, respectively.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**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.

The following table presents a reconciliation of basic and diluted net income per share:

	For the years ended September 30,	
	2016	2015
Net income attributable to common share holders	\$ 5,018,940	\$ 31,427,626
Weighted average common shares used in Basic computation	45,050,000	45,050,000
Effect of diluted stock options	-	2,252
Weighted average common shares used in Diluted computation	45,050,000	45,052,252
Earnings per share - Basic	\$ 0.11	\$ 0.70
Earnings per share - Diluted	\$ 0.11	\$ 0.70

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 year ended September 30, 2016, two suppliers accounted for 22% and 17% of the total project expenditure, respectively. For the year ended September 30, 2015, three suppliers accounted for 23%, 21% and 17% of the total project expenditure, respectively.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recent Accounting Pronouncements

In January 2016, the FASB has issued Accounting Standards Update (ASU) No. 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The new guidance is intended to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to existing U.S. GAAP by: (1) requiring equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. Requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (2) Requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; (3) Eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; and. (4) Requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk (also referred to as “own credit”) when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The new guidance is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of this update on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes the existing guidance for lease accounting, Leases (Topic 840). ASU 2016-02 requires lessees to recognize leases on their balance sheets, and leaves lessor accounting largely unchanged. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early application is permitted for all entities. ASU 2016-02 requires a modified retrospective approach for all leases existing at, or entered into after, the date of initial application, with an option to elect to use certain transition relief. The Company is currently evaluating the impact of this new standard on its consolidated financial statements.

In April 2016, the FASB released ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The ASU includes multiple provisions intended to simplify various aspects of the accounting for share-based payments. While aimed at reducing the cost and complexity of the accounting for share-based payments, the amendments are expected to significantly impact net income, EPS, and the statement of cash flows. Implementation and administration may present challenges for companies with significant share-based payment activities. The ASU is effective for public companies in annual periods beginning after December 15, 2016, and interim periods within those years. The Company is currently evaluating the impact of this new standard on its consolidated financial statements.

In May 2016, FASB issued ASU No. 2016-12—Revenue from Contracts with Customers (Topic 606); Narrow-Scope Improvements and Practical Expedients, which is intended to not change the core principle of the guidance in Topic 606, but rather affect only the narrow aspects of Topic 606 by reducing the potential for diversity in practice at initial application and by reducing the cost and complexity of applying Topic 606 both at transition and on an ongoing basis. The Company is assessing the impact of the adoption of the ASU on its unaudited financial statements, disclosure requirements and methods of adoption.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recent Accounting Pronouncements – continued

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, to provide guidance on the presentation and classification of certain cash receipts and cash payments on the statement of cash flows. The guidance specifically addresses cash flow issues with the objective of reducing the diversity in practice. The guidance will be effective for the Company in fiscal year 2018, but early adoption is permitted. The Company is currently evaluating the impact of this new standard on its consolidated financial statements and related disclosures.

In October 2016, the FASB issued ASU No. 2016-17, Consolidation (Topic 810): Interest Held through Related Parties That Are under Common Control, to provide guidance on the evaluation of whether a reporting entity is the primary beneficiary of a VIE by amending how a reporting entity, that is a single decision maker of a VIE, treats indirect interests in that entity held through related parties that are under common control. The amendments are effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact of this new standard on its consolidated financial statements and related disclosures.

In November 2016, the FASB issued ASU No. 2016-18, "Statement of Cash Flows: Restricted Cash". The amendments address diversity in practice that exists in the classification and presentation of changes in restricted cash on the statement of cash flows. The amendment is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of this new standard on its consolidated financial statements.

NOTE 3. REAL ESTATE PROPERTY COMPLETED AND UNDER DEVELOPMENT

The following summarizes the components of real estate property completed and under development as of September 30, 2016 and 2015:

	Balance as of September 30, 2016	September 30, 2015
Development completed:		
Hanzhong City Mingzhu Garden Phase I	\$952,066	\$1,146,277
Hanzhong City Mingzhu Garden Phase II	54,933,680	66,070,589
Hanzhong City Nan Dajie (Mingzhu Xijiu)	1,371,633	1,439,257
Hanzhong City Oriental Pearl Garden (a)	50,643,258	-
Yang County Yangzhou Pearl Garden Phase I	2,396,420	3,419,273
Yang County Yangzhou Pearl Garden Phase II	4,545,927	5,456,387
Real estate property development completed	\$114,842,984	\$77,531,783
Less: Real estate property completed – short-term	113,185,929	75,391,512
Real estate property completed – long-term	\$1,657,055	\$2,140,271
Under development:		
Hanzhong City Oriental Pearl Garden (a)	\$-	\$55,154,153
Yang County Yangzhou Palace	76,618,856	47,843,166
Hanzhong City Shijin Project	7,261,811	7,619,829
Hanzhong City Liangzhou Road and related projects (b)	117,226,429	85,069,755
Hanzhong City Hanfeng Beiyuan East (c)	657,706	587,993
Hanzhong City Beidajie (e)	3,228,580	78,735
Yang County East 2 nd Ring Road (d)	2,390,633	2,461,303
Real estate property under development	\$207,384,015	\$198,814,934
Less: Short-term portion	-	55,154,153
Real estate property under development –long-term	\$207,384,015	\$143,660,781

The Company recognized \$18,777,470 of development cost in the cost of real estate sales under the percentage of (a) completion method for the year ended September 30, 2016 (2015 - \$12,168,108). The project was completed as of September 30, 2016.

(b) In September 2013, the Company entered into an agreement (“Liangzhou Agreement”) with the Hanzhong local government on the Liangzhou Road reformation and expansion project (Liangzhou Road Project”). Pursuant to the agreement, the Company is contracted to reform and expand the Liangzhou Road, a commercial street in downtown Hanzhong City, with a total length of 2,080 meters and width of 30 meters and to resettle the existing residences in the Liangzhou road area. The government’s original road construction budget was approximately \$33 million in accordance with the Liangzhou Agreement. The Company, in return, is being compensated by the local

government to have an exclusive right on acquiring at least 394.5 Mu land use rights in a specified location of Hanzhong City. The Liangzhou Road Project's road construction started at the end of 2013. In 2014, the original scope and budget on the Liangzhou road reformation and expansion project was extended, because the local government included more area and resettlement residences into the project, which resulted in additional investments from the Company. In return, the Company is authorized by the local government to develop and manage the commercial and residential properties surrounding the Liangzhou Road project. Due to the extension, the Company expected the road construction to be completed and approved by the local government in the early 2017.

NOTE 3. REAL ESTATE PROPERTY COMPLETED AND UNDER DEVELOPMENT (continued)

The Company's development cost incurred on Liangzhou Road Project is treated as the Company's deposit on purchasing the related land use rights, as agreed by the local government. As of September 30, 2016, the actual costs incurred by the Company were \$117,226,429 (September 30, 2015 - \$85,069,755) and the incremental cost related to residence resettlement approved by the local government. The Company determined that the Company's Investment in Liangzhou Road Project in exchange for interests in future land use rights is a barter transaction with commercial substance. For the years ended September 30, 2016 and 2015, the Company received government's subsidies of \$Nil and \$9,439,183 for its Shanty Area Reform Project surrounding Liang Zhou Road located in Hantai District, Hanzhong City, respectively and the Company recorded the subsidies to offset against the development cost of Liangzhou Road Project.

(c) In September 2012, the Company was approved by the Hanzhong local government to construct four municipal roads with a total length of approximately 1,192 meters. The project was deferred and then restarted during the quarter ended March 31, 2014. As of September 30, 2016, the Company is waiting for the local government's assessment and planning for the scope and budget for these projects.

(d) The Company was engaged by the Yang County local government to construct the East 2nd Ring Road with a total length of 2.15 km and a budgeted price of approximately \$25.2 million (or RMB 168 million), which was approved by the local Yang County government in March 2014. The local government is required to repay the Company's project investment costs within 3 years with interest at the interest rate based on the commercial borrowing rate with the similar term published by China construction bank (September 30, 2016 - 4.75% and September 30, 2015 - 5%). The local government has approved a refund to the Company by reducing local surcharges or taxes otherwise required in the real estate development. The load construction is expected to be completed by 2017

(e) For the years ended September 30, 2016 and 2015, the Company received government's subsidies in the amount of \$3,153,544 and \$Nil for its Shanty Area Reform Project surrounding Beidajie Project located in Hantai District, Hanzhong City, respectively and the Company recorded the subsidies to offset against the development cost of Beidajie project.

As of September 30, 2016 and 2015, land use rights included in real estate property under development totaled \$19,568,460 and \$39,929,072, respectively.

NOTE 4. PROPERTY, PLANT AND EQUIPMENT, NET

As of September 30, 2016 and 2015, property, plant and equipment was as follows:

	As of September 30,	
	2016	2015
Buildings	\$819,621	\$860,030
Machinery	27,885	29,260
Office equipment	-	-
Automobiles	545,640	444,060
Total	1,393,146	1,333,350
Less: accumulated depreciation	600,496	553,312
Property, plant and equipment, net	\$792,650	\$780,038

Depreciation expense for the years ended September 30, 2016 and 2015 was \$74,723 and \$83,701, respectively.

NOTE 5. RECEIVABLE FROM LOCAL GOVERNMENT – LONG-TERM

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 \$2.9 million which was approved by the Hanzhong Ministry of Finance. The Company completed and delivered these two roads to the local government on March 21, 2014 with local government's approval. The Company recognized such revenue during the year ended September 30, 2014. As of September 30, 2016, a receivable from the Hanzhong local government of \$2,920,990 was classified as long term on the accompanying consolidated balance sheets (September 30, 2015 - \$3,065,000) because the Company expected to realize the receivable to offset municipal surcharges from local government for the Liangzhou road related projects in 2017 and a later time.

NOTE 6. SECURITY DEPOSITS

As of September 30, 2016 and 2015, security deposits were as follows:

	As of September 30,	
	2016	2015
Security deposit for land use right ⁽¹⁾	\$2,998,411	\$3,146,237
Security deposits for other loan ⁽²⁾	4,941,726	-
Security deposits	\$7,940,137	\$3,146,237

In May 2011, the Company entered into a development agreement with the Hanzhong local government. Pursuant to the agreement, the Company will prepay the development cost of \$17,945,489 (RMB 119,700,000) to acquire certain land use rights through public bidding. The prepaid development cost will be deducted from the final (1) purchase price of the land use rights. As of September 30, 2016, a deposit of \$2,998,411 (RMB 20,000,000) (2015 - \$3,146,237 or RMB 20,000,000) was paid. The Company currently expects to make payment of the remaining development cost as the government's work progresses. The Company classified the security deposits for land use rights as long term based on the Company's development plan.

(2) In connection with financing from Hanzhong Urban Construction Investment Development Co., Ltd (See note 8), the Company was required to provide a security deposit for the loan received. As of September 30, 2016, the security deposit balances were \$4,941,726 (September 30, 2015 - \$Nil) for other loan with Hanzhong Urban Construction Investment Development Co., Ltd.

NOTE 7. 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 development of the Company's Mingzhu Beiyuan project and was fully repaid as of September 30, 2016.

The average interest rate of the loan was 5% as of September 30, 2016 and 5.5% as of September 30, 2015. For the years ended September 30, 2016 and 2015, total loan interest was \$137,962 and \$952,083, respectively. Interest expense incurred in fiscal 2016 were included in the interest expense, because the Mingzhu Beiyuan project has been completed by September 30, 2015. Interest incurred in fiscal 2015 was capitalized in to the development cost of Mingzhu Garden – Mingzhu Beiyuan project Phase II.

NOTE 8. OTHER LOANS

	As of September 30,	
	2016	2015
Loan A (i)	\$-	\$954,883
Loan B (ii)	-	4,719,356
Loan C (iii)	93,975,338	15,731,186
Loan D (iv)	11,993,643	-
	105,968,981	21,405,425
Less: current maturities of other loans	6,125,753	5,674,239
Other loans – long-term portion	\$99,843,228	\$15,731,186

A working capital finance agreement with a local investment company in Hanzhong was fully repaid in fiscal 2016. The loan carried a fixed interest of 10% per year. For the years ended September 30, 2016 and 2015, total interest was \$23,364 and \$1,038,846, respectively, which was capitalized in to the development cost of Liangzhou road project.

On May 6, 2015, the Company renewed a credit agreement with a financial institution. On May 22, 2015, the Company borrowed \$4,497,616 (RMB 30,000,000) at a fixed interest rate of 20% per year for a six months period and the rate may up-float 50% if the loan proceeds were not used for the intended borrowing purpose. The loan was for the construction of Oriental Pearl Garden real estate project. The loan has been fully repaid as of September 30, 2016. For the years ended September 30, 2016 and 2015, total finance cost was \$107,055 and \$755,097, respectively, which was capitalized in the development cost of Oriental Pearl Garden real estate project.

On June 26, 2015 and March 10, 2016, the Company signed phase I and Phase II agreements with Hanzhong Urban Construction Investment Development Co., Ltd, a state owned Company, to borrow up to \$116,188,420 (RMB 775,000,000) for a long term loan at 4.245% interest per year to develop Liang Zhou Road Project. As of September 30, 2016, the Company borrowed \$93,975,338 under this credit line. The loan is guaranteed by Hanzhong City Hantai District Municipal Government and pledged by the Company's Yang County Palace project with carrying value of \$76,618,856 as of September 30, 2016. In addition, the Company was required to provide a security deposit for the loan received (see note 6). As of September 30, 2016, the security deposit balances were \$4,941,726 (2015- \$Nil) for loan received. For the years ended September 30, 2016 and 2015, the interest was \$2,949,185 and \$77,909, respectively, which was capitalized in to the development cost of Liangzhou road project. Subsequent to September 30, 2016, the Company further received \$7,032,773 (RMB 46,910,000) from Hanzhong Urban Construction Investment Development Co., Ltd. The combined loan repayment schedule assuming total loan proceeds are borrowed are listed below:

	Repayment in USD	Repayment in RMB
29-May-2017	6,125,753	40,860,000
20-November-2017	6,125,753	40,860,000
20-April -2018	13,116,548	87,490,000

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20-May-2018	6,232,197	41,570,000
20-November-2018	6,232,197	41,570,000
20-April-2019	13,116,548	87,490,000
20-May-2019	6,382,117	42,570,000
20-October-2019	13,116,548	87,490,000
29-November-2019	6,382,117	42,570,000
20-April-2020	13,121,046	87,520,000
20-October-2020	13,116,548	87,490,000
20-October-2021	13,121,046	87,520,000
Total	116,188,418	775,000,000

NOTE 8. OTHER LOANS (continued)

On January 8, 2016, the Company signed a loan agreement with Hanzhong Municipal Housing Provident Fund Management Center (“Housing Fund”) to borrow up to approximately \$11,993,643 (RMB 80,000,000) on development of Oriental Garden related projects. The loan carries interest at 3.575% per year and is due in January 2019. The Company’s major shareholder Mr. Xiaojun Zhu pledged his personal assets as collateral for the loan. As (iv) of September 30, 2016, the Company received all the proceeds from Housing Fund. The progress repayment is required based on certain sales milestones or a fixed repayment schedule starting in July 2018. The Housing Fund has rights to monitor the project’s future cash flow. For years ended September 30, 2016 and 2015, total interest was \$290,653 and \$Nil, respectively, which was capitalized in to the development cost of Oriental Garden project. The full amount of loan has following repayment schedule:

	Repayment in USD	Repayment in RMB
Earlier of July 2018 or 60% sales completed	2,998,411	20,000,000
Earlier of October 2018 or 70% sales completed	4,497,616	30,000,000
Earlier of January 2019 or 75% sales completed	4,497,616	30,000,000
Total	11,993,643	80,000,000

NOTE 9. CUSTOMER DEPOSITS

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

	As of September 30,	
	2016	2015
Customer deposits by real estate projects		
Mingzhu Garden (Mingzhu Nanyuan and Mingzhu Beiyuan)	\$9,150,119	\$7,832,619
Oriental Pearl Garden	5,582,158	7,220,575
Liangzhou road and related projects	2,593,625	2,035,615
Yang County Pearl Garden	2,057,931	2,334,775
Yang County Palace	8,093,647	6,210,389
Total	27,477,480	25,633,973
Including: Customer deposits - short-term	16,790,208	17,387,969
Customer deposits - long-term	\$10,687,272	\$8,246,004

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. As of September 30, 2016 and 2015, approximately \$1.5 million and \$1.7 million was guaranteed by the Company, respectively.

NOTE 10. RELATED PARTY LOANS

	As of September 30,	
	2016	2015
Shareholder loan – USD loan (a)	\$1,810,000	\$1,810,000
Shareholder loan – RMB loan (b)	899,523	-
Total	\$2,709,523	\$1,810,000

The Company has a one year loan agreement (“USD Loan Agreement”) with Mr. Xiaojun Zhu, our Chairman, CEO and major shareholder (“Mr. Zhu”), 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 and the loan matured on July 19, 2014. The Company entered into the amendments to the USD Loan Agreement to extend the term until July 31, 2017. The Company recorded interest of \$72,400 for each of the years ended September 30, 2016 and 2015. The Company has not yet paid this interest and it is recorded in accrued expenses in the accompanying consolidated balance sheets as of September 30, 2016 and 2015.

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 the Chairman (the “Shareholder RMB Loan Agreement”), pursuant to which Guangsha is able to borrow 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, and has been renewed with a new expiration date of June 30, 2017, with at an interest rate of 4.35% per year. The RMB loan balance as of September 30, 2016 and 2015 was \$899,523 and \$Nil, respectively. For the years ended September 30, 2016 and 2015, the interest was \$40,172 and \$240,687, respectively, which is capitalized in the development cost of Liangzhou road project.

NOTE 11. STOCK OPTIONS

On August 22, 2015, 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 (“2015 Stock Options”). The shares underlying the options become exercisable during the following 36 months period at the end of each quarter. The exercise price of the options is \$1.89 per share. As of September 30, 2016 and 2015, 36.1% and 2.8% 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 2015	
Risk-free interest rate	0.95	%
Expected life of the options	3 year	
Expected volatility	143	%
Expected dividend yield	0	%
Fair value	\$ 178,800	

NOTE 11. 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, 2014	140,000	\$ 2.39	0.89	44,207
Granted	120,000	\$ 1.89	2.89	178,800
Forfeited	(130,000)	\$ 2.39	-	(31,093)
Exercised	-	-	-	-
Outstanding, September 30, 2015	130,000	\$ 1.93	2.71	\$ 191,914
Granted	-	-	-	-
Forfeited *	(10,000)	\$ 2.37	-	(13,114)
Exercised	-	-	-	-
Outstanding, September 30, 2016	120,000	\$ 1.89	1.89	\$ 178,800
Exercisable, September 30, 2016	43,333	\$ 1.89	1.89	\$ 64,567

* options expired for the years ended September 30, 2016.

Stock-based compensation expense recognized in the years ended September 30, 2016 and 2015 was \$59,600 and \$4,967, respectively. As of September 30, 2016 and 2015, there was \$114,233 and \$173,833 unrecognized compensation cost related to stock option awards that are expected to be recognized.

NOTE 12. TAXES**(A) Business sales tax and VAT**

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 September 30, 2016, the Company had business sales tax payable of \$13,453,236 (2015- \$13,306,414), which is expected to be paid when the projects are completed and assessed by the local tax authority. In May of 2016, the Business Tax has been incorporated into Value Added Tax in China, which means there will be no more Business Tax and accordingly some business operations previously taxed in the name of Business Tax will be taxed in the manner of VAT thereafter. The Company is subject to 5% of VAT for all its exiting real estate project based on the local tax authority's practice.

(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 years ended September 30, 2016 and 2015, the Company's income taxes were \$974,688 and \$1,951,226, 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. The following table reconciles the statutory rates to the Company's effective tax rate for the years ended September 30, 2016, 2015 and 2014:

	2016	2015
Chinese statutory tax rate	25.0 %	25.0 %
Valuation allowance change	0.7 %	0.1 %
Net impact of Exemption rendered by local tax authorities and other adjustments	(9.4)%	(19.3)%
Effective tax rate	16.3 %	5.8 %

NOTE 12. TAXES (continued)**(B) Corporate income taxes (“CIT”) - continued**

Income tax expense for the years ended September 30, 2016 and 2015 is summarized as follows:

	For the years ended September 30,	
	2016	2015
Current tax provision	\$343,589	\$81,046
Deferred tax provision	\$631,099	\$1,870,180
Income tax expense	\$974,688	\$1,951,226

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 \$533,160 and \$401,160 as of September 30, 2016 and 2015, respectively, which are available to reduce future years’ taxable income. These carry forwards will expire in 2036. However, the change in control resulting from the reverse merger in 2010 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 September 30, 2016 and 2015. The components of deferred taxes as of September 30, 2016 and 2015 consist of the following:

	As of September 30,	
	2016	2015
Deferred tax assets:		
Deferred tax asset from net operating loss carry-forwards for parent company	\$181,274	\$136,394
Valuation allowance	(181,274)	(136,394)
Deferred tax asset - net	\$-	\$-
Deferred tax liability:		
Revenue recognized based on percentage of completion	\$5,107,087	\$4,711,161
Deferred tax liability – long term	\$5,107,087	\$4,711,161

Movement of valuation allowance:

As of September 30,

	2016	2015
Beginning Balance	\$136,394	\$110,089
Current year additions	44,880	26,305
Ending Balance	\$181,274	\$136,394

The valuation allowance increased \$44,880 and \$26,305 for the years end September 30, 2016 and 2015, respectively.

(C) Land appreciation tax (“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 September 30, 2016, the outstanding LAT payable balance was \$1,049,401 with respect to completed real estate properties sold up to September 30, 2016. As at September 30, 2015, the Company has an outstanding LAT payable balance of \$752,664 with respect to completed real estate properties sold up to September 30, 2015.

NOTE 12. TAXES (continued)**(D) Taxes payable consisted of the following:**

	September 30, 2016	September 30, 2015
CIT	\$ 677,734	\$ 794,780
Business tax	13,453,236	13,306,414
Other taxes and fees	1,712,845	1,729,692
Total taxes payable	\$ 15,843,815	\$ 15,830,886

NOTE 13. STOCKHOLDERS' EQUITY**(a) Common stock**

Prior to the Share Exchange, the Company had 20,050,000 shares of common stock issued and outstanding. Before the closing of the Share Exchange transaction, the Company retired 14,000,000 shares of common stock in connection with the spin-off of Dalian Holding. In connection with the Share Exchange consummated on August 31, 2009, the Company issued 14,000,000 shares of its common stock to the HGS Shareholder and an additional 25,000,000 shares to the management team of Guangsha. As of September 30, 2016 and 2015, the Company has a total of 45,050,000 shares of common stock issued and outstanding.

For the year ended September 30, 2016, in order to expand business in the large municipal market, which requires participants with significant paid in capital, the Company's VIE – Guangsha completed an equity recapitalization. The VIE's accumulated retained earnings of \$103,509,640 and statutory reserve of \$8,460,016 were reclassified to additional paid in capital in the consolidation financials statements.

(b) Statutory surplus reserves

The Company is required to make appropriations to reserve funds, comprising the statutory surplus reserve and discretionary surplus reserve, based on after-tax net income determined in accordance with generally accepted accounting principles of the PRC ("PRC GAAP").

Appropriations to the statutory surplus reserve is required to be at least 10% of the after tax net income determined in accordance with PRC GAAP until the reserve is equal to 50% of the entities' registered capital. Appropriations to the discretionary surplus reserve are made at the discretion of the Board of Directors. The statutory surplus reserve fund is non-discretionary other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of shares currently held by them, provided that the remaining statutory surplus reserve balance after such issue is not less than 25% of the registered capital before the conversion. Pursuant to the Company's articles of incorporation, the Company is to appropriate 10% of its net profits as statutory surplus reserve. Due to the recapitalization of VIE equity, reserve of \$8,460,016 was reversed and transferred to additional paid in capital in the year ended September 30, 2016. As of September 30, 2016 and 2015, the balance of statutory surplus reserve was \$8,495,631 and \$16,439,333, respectively.

NOTE 13. STOCKHOLDERS' EQUITY (continued)

(b) Statutory surplus reserves (continued)

The discretionary surplus reserve may be used to acquire fixed assets or to increase the working capital to expend on production and operation of the business. The Company's Board of Directors decided not to make an appropriation to this reserve for the years ended September 30, 2016 and 2015.

NOTE 14. CONTINGENCIES AND COMMITMENTS

From time to time, the Company is a party to various legal actions arising in the ordinary course of business. The Company accrues costs associated with these matters when they become probable and the amount can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred. The Company's management does not expect any liability from the disposition of such claims and litigation individually or in the aggregate would have a material adverse impact on the Company's consolidated financial position, results of operations and cash flows.

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. As of September 30, 2016 and 2015, the amount of security deposit provided for these guarantees was approximately \$1.5 million and \$1.7 million respectively.

CHINA HGS REAL ESTATE INC.**SCHEDULE I- PARENT COMPANY BALANCE SHEETS****(UNAUDITED)**

	September 30,	
	2016	2015
ASSETS		
Investment in subsidiary	\$ 157,139,041	\$ 159,592,844
Total Assets	\$ 157,139,041	\$ 159,592,844
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accrued expenses	380,100	307,700
Shareholder loan	1,810,000	1,810,000
Total current liabilities	2,190,100	2,117,700
Stockholders' equity		
Common stock, \$0.001 par value, 100,000,000 shares authorized, 45,050,000 shares issued and outstanding	\$45,050	\$45,050
Additional paid-in capital	129,793,572	17,764,316
Statutory surplus	8,495,631	16,439,333
Retained earnings	20,661,184	119,668,198
Accumulated other comprehensive income	(4,046,496)	3,558,247
Total stockholders' equity	154,948,941	157,475,144
Total Liabilities and Stockholders' Equity	\$ 157,139,041	\$ 159,592,844

The accompanying notes are integral part of Schedule I

CHINA HGS REAL ESTATE INC.

SCHEDULE I - STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (LOSS)

FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015

(UNAUDITED)

	2016	2015
Equity in profit of subsidiary	\$5,150,940	\$31,504,993
General and administrative expenses	59,600	4,967
Interest expense - net	72,400	72,400
Income before income taxes	5,018,940	31,427,626
Provision for income taxes	-	-
Net income	5,018,940	31,427,626
Other comprehensive income		
Foreign currency translation adjustment	(7,604,743)	(5,186,242)
Comprehensive income (loss)	\$(2,585,803)	\$26,241,384

The accompanying notes are integral part of Schedule I

CHINA HGS REAL ESTATE INC.

SCHEDULE I - STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015

(UNAUDITED)

	2016	2015
Cash flows from operating activities		
Net income	\$5,018,940	\$31,427,626
Adjustments to reconcile net income to net cash used in operating activities:		
Stock based compensation	59,600	4,967
Equity in profit of subsidiary	(5,150,940)	(31,504,993)
Changes in assets and liabilities:		
Accrued expenses	72,400	72,400
Net cash used in operating activities	\$-	\$-
Net increase (decrease) in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	\$-	\$-
Supplemental disclosures of cash flow information:		
Interest paid	\$-	\$-
Income taxes paid	\$-	\$-

The accompanying notes are integral part of Schedule I

CHINA HGS REAL ESTATE INC.

NOTES TO SCHEDULE I

NOTE 1. BASIS OF PRESENTATION

Certain information and footnote disclosures normally included in financial statements prepared in conformity with generally accepted accounting principles have been condensed or omitted. The Company's investment in subsidiary and variable interest entity ("VIE") is stated at cost plus equity in undistributed earnings of subsidiaries.

NOTE 2. RESTRICTED ASSETS

The Company's PRC VIE and subsidiary are restricted in their ability to transfer a portion of their net assets to the Company. The payment of dividends by entities organized in China is subject to limitations, procedures and formalities. Regulations in the PRC currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in China. The Company's subsidiaries and its VIEs are also required to set aside at least 10% of its after-tax profit based on PRC accounting standards each year to its statutory reserves account until the accumulative amount of such reserves reaches 50% of its respective registered capital. The aforementioned reserves can only be used for specific purposes and are not distributable as cash dividends.

In addition, the Company's operations and revenues are conducted and generated in China, all of the Company's revenues being earned and currency received are denominated in RMB. RMB is subject to the foreign exchange control regulation in China, and, as a result, the Company may be unable to distribute any dividends outside of China due to PRC foreign exchange control regulations that restrict the Company's ability to convert RMB into US Dollars.

Schedule I of Article 5-04 of Regulation S-X requires the condensed financial information of registrant shall be filed when the restricted net assets of consolidated subsidiaries exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year. For purposes of the above test, restricted net assets of consolidated subsidiaries shall mean that amount of the registrant's proportionate share of net assets of consolidated subsidiaries (after intercompany eliminations) which as of the end of the most recent fiscal year may not be transferred to the parent company by subsidiaries in the form of loans, advances or cash dividends without the consent of a third party. The condensed parent company financial statements have been prepared in accordance with Rule 12-04, Schedule I of Regulation S-X as the restricted net assets of the Company's PRC subsidiary and VIE exceed 25% of the consolidated net assets of the Company.

NOTE 3. COMMITMENTS

The Company did not have any significant commitments or long-term obligations as at September 30, 2016 and 2015.

Item 9. Changes and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we carried out an evaluation of the effectiveness of our disclosure controls and procedures (as such term is defined in SEC Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based on such evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, has concluded that our disclosure controls and procedures were not effective as of September 30, 2016, because of the material weakness in our internal control over financial reporting as described below.

(b) Management's Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining internal controls over financial reporting. Internal Control Over Financial Reporting is a process designed by, and under the supervision of, the Company's principal executive and principal financial officers, or persons performing similar functions, and effected by the Company's 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 and includes those policies and procedures that:

1. Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of its management and board of directors; and

3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on its financial statements.

Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our consolidated financial statements would be prevented or detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management, including our chief executive officer and chief financial officer, has conducted a self-assessment, including attestation of the design and operational effectiveness of the Company's internal controls over financial reporting as of September 30, 2016. In making its assessment, management used the *2013 Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "2013 COSO Framework"). The 2013 COSO Framework outlines the 17 underlying principles and the following fundamental components of a company's internal control: (i) control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication, and (v) monitoring. Our management has implemented and tested our internal control over financial reporting based on these criteria and identified certain material weaknesses set forth below.

Based on this evaluation, our management concluded that our internal control over financial reporting as of September 30, 2016 was ineffective.

A material weakness is a deficiency or a combination of deficiencies in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected on a timely basis.

Management identified the following material weaknesses in its assessment of the effectiveness of internal control over financial reporting as of September 30, 2016:

- Lack of utilization of integrated information system, which could result in over reliance on spreadsheet applications without quality control assurances, lack of adequate policies and procedures to review and update spreadsheet information on timely basis, and lack of formal data backup policies and procedures.

- Lack of adequate policies and procedures in internal audit function, which could result in: (1) lack of communication between internal audit department and the Audit Committee and the Board of Directors and (2) insufficient internal audit work to ensure that the Company's policies and procedures have been carried out as planned.

- Lack of sufficient full-time accounting staff in our accounting department that have U.S. GAAP experience.

Remediation Efforts to Address Significant Deficiencies

To remediate the material weaknesses described above 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.

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.

Any actions we have taken or may take to remediate these material weaknesses are subject to continued management review supported by testing, as well as oversight by the Audit Committee of our Board of Directors. We cannot assure you that these material weaknesses will not occur in the future and that we will be able to remediate such weaknesses in a timely manner, which could impair our ability to accurately and timely report our financial position, results of operations or cash flows. See the Risk Factor included in this Annual Report on Form 10-K.

(c) Changes in Internal Controls over Financial Reporting

The management is committed to improving the internal controls over financial reporting and will undertake the consistent improvements or enhancements on an ongoing basis. Except as described above, there has been no change to our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Directors

The Board of Directors is presently composed of five (5) members: Xiaojun Zhu, Shenghui Luo, Christy Young Shue, John Chen, and Yuankai Wen. Mr. Zhu serves as Chairman of the Board of Directors. The Board of Directors has determined that Christy Young Shue, John Chen, and Yuankai Wen are independent directors within the meaning set forth in the NASDAQ listing rules and as required by the rules and regulations of the SEC, as currently in effect.

Below you will find a tabular summary of our entire Board, their age as of September 30, 2016, the year they were each elected, and the year in which their term ends.

Name	Age	Position	Director Since
Xiaojun Zhu	49	President, Chief Executive Officer and Chairman of the Board of Directors	2009
Shenghui Luo	47	Director	2010
Christy Young Shue	53	Director	2012
John Chen	44	Director	2012
Yuankai Wen	69	Director	2010

The following paragraphs provide information about each director, including all positions he or she holds, his or her principal occupation and business experience for the past five years, and the names of other publicly-held companies of which he or she currently serves as a director or has served as a director during the past five years.

Xiaojun Zhu, the President, Chief Executive Officer, and Chairman of the Board of Directors of China HGS, began his entrepreneurial career in 1995 by creating a privately-run real estate company in Hanzhong, Shaanxi Province. With more than 20 years' experience, Mr. Zhu is considered to be one of China's most influential business leaders in the real estate industry. In October 2005, Mr. Zhu received the "Top 100 Management Elites in China's Building Industry 2005" award by the Chinese Academy of Management Science. Mr. Zhu also received the "Innovative Shaanxi - Person of the Year 2007" award and the "Outstanding Socialism Builder of Shaanxi Province in 2008" award. In August 2009, Mr. Zhu joined China Agro as Chairman and Chief Executive Officer. In 2007, before joining China Agro, Mr. Zhu served as the Chairman and General Manager of Shaanxi Guangsha Investment and Development Group Co., Ltd. From 1995 to 2007, Mr. Zhu was the Chairman and General Manager of Hanzhong Guangsha Real Estate Development Co, Ltd., a real estate development company. From 1992 to 1995, prior to starting his own business, Mr. Zhu served as a Vice General Manager in the real estate-based subsidiary of Hanjiang Building Material Group Corporation. From 1985 to 1988, Mr. Zhu studied at Shaanxi Metallurgy College. As the founder of the Company, Mr. Zhu is acknowledged to be one of China's leading business executives in the real estate industry and is able to provide the Board with an understanding of the Company's business as well as provide expert perspective on industry trends and opportunities. Mr. Zhu's experience with the Company from its founding also offers the Board insight to the evolution of the Company, including from execution, cultural, operational, competitive and industry points of view.

Christy Young Shue has served as a director since August 2012. Ms. Shue served as Executive Vice President, Finance and Investor Relations and Corporate Secretary of Harbin Electric, Inc. (NASDAQ: HRBN) from 2007 through April 2012, when Harbin went private as a result of a management buyout transaction. From 2006 through 2007, Ms. Shue was a Vice President, a Senior Investor Relations Consultant at Christensen, an Investor Relations advisory firm. From 2003 through 2006, Ms. Shue served as Investor Relations Manager at International Paper (NYSE: IP). Ms. Shue received her MBA degree in finance/international business from Stern School of Business, New York University, a Ph.D. in Chemistry from Purdue University, and a Bachelor of Science degree in Chemistry from Sichuan University. Ms. Shue's previous experience as an officer and Investor Relations manager for public companies has given her insights into various challenges that public companies experience, as well as extensive knowledge and understanding of capital market related issues such as corporate governance and financial reporting.

John Chen has served as a director since August 2012. Mr. Chen is a California Certified Public Accountant. Mr. Chen has been the Chief Financial Officer of General Steel Holdings Inc. (NYSE: GSI) since May 2004. From 1997 to 2003, Mr. Chen was a Senior Accountant at Moore Stephens Frazer and Torbet. Mr. Chen received his Bachelor of Science degree in Business Administration, Accounting from California State Polytechnic University. Mr. Chen's experience as a California Certified Public Accountant and his experience as a chief financial officer of a public company have provided him with broad experience in finance including accounting and financial reporting. This experience has led our Board of Directors to determine that he is an "audit committee financial expert" as that term is defined in Item 407(d)(5) of Regulation S-K under the 1934 Act.

Yuankai Wen has served as a director since January 2010. Since 1998, Mr. Wen has served as the Chairman of Beijing Neolinde Management Training Center. From 1997 to 1998, he was also the Chairman of Beijing Neolinde Management Consulting Co. From 1994 through 1997, Mr. Wen was a Vice President of Roosevelt China Investment Co., an investment firm. Mr. Wen received his Bachelor's degree in Chemistry from Nanjing University. He was also a visiting scholar of Physical and Chemical Biology Institute, University of Paris in France. Mr. Wen's experience as Chairman of the Beijing Neolinde Management Training Center and as Chairman of the Beijing Neolinde Management Consulting Co. has provided him with broad leadership and executive experience. Moreover, his management experience in China provides him with a perspective on Chinese business operations.

Shenghui Luo has served as a director since January 2010. Ms. Luo joined Shaanxi Guangsha Investment and Development Group Co., Ltd., the Company's subsidiary, in 1997. From 2000 through March 2009, Ms. Luo served as Vice Director of the Finance Department of Shaanxi Guangsha Investment and Development Group Co., Ltd. In March 2009, Ms. Luo was appointed a Manager of the Finance Department of Shaanxi Guangsha Investment and Development Group Co., Ltd. Ms. Luo received her Bachelor's degree in Accounting from Shaanxi Finance College. As a result of Ms. Luo's service as a member of the Company's finance department, she developed an extensive understanding of the Company's business. In addition, her knowledge and experience in finance and accounting provides her with a broad understanding of the Company's financial reporting under both PRC and US GAAP.

Family Relationships

No family relationships exist among our directors, executive officers, or persons nominated or chosen by us to become directors or executive officers.

All directors hold office until the next annual stockholders' meeting or until their death, resignation, retirement, removal, disqualification, or until their successors have been elected and are qualified. Our officers serve at the will of the Board of Directors.

Involvement in Certain Legal Proceedings

To the best of our knowledge, none of our directors or executive officers have been convicted in a criminal proceeding, excluding traffic violations or similar misdemeanors, or has been a party to any judicial or administrative proceeding during the past five years that resulted in a judgment, decree or final order enjoining the person from future violations of, or prohibiting activities subject to, federal or state securities laws, or a finding of any violation of federal or state securities laws, except for matters that were dismissed without sanction or settlement. Except as set forth in our discussion below in “Certain Relationships and Related Transactions,” none of our directors, director nominees or executive officers has been involved in any transactions with us or any of our directors, executive officers, affiliates or associates which are required to be disclosed pursuant to the rules and regulations of the SEC.

Code of Ethics

On January 22, 2010, the Board of Directors adopted a Code of Conduct which sets forth the standards by which the Company’s employees, officers and directors should conduct themselves. The Company will disclose any amendment to the Code of Conduct or waiver of a provision of the Code of Conduct that applies to the Company’s Chief Executive Officer, Chief Financial Officer and any other principal financial officer, and any other person performing similar functions and relates to certain elements of the Code of Conduct, including the name of the officer to whom the waiver was granted.

Committees of the Board of Directors

The Board of Directors has the following standing committees: Audit, Compensation, and Nominating and Corporate Governance. The Board of Directors has adopted written charters for each of these committees. All members of the committees appointed by the Board of Directors are non-employee directors and the Board of Directors has determined that all such members are independent under the applicable rules and regulations of NASDAQ and the SEC, as currently in effect. In addition, all directors who served on a committee during any portion of the fiscal year ended September 30, 2016 were independent under the applicable rules and regulations of NASDAQ and the SEC during such director’s period of service.

The following chart details the membership of each standing committee as of September 30, 2016 and the number of meetings each committee held in fiscal year 2016.

Name of Director	Audit	Compensation	Nominating & Corporate Governance
Christy Young Shue	M	M	C
John Chen	C	M	M
Yuankai Wen	M	C	M
Number of Meetings in Fiscal 2016	4	1	1

M = Member C = Chair

Executive Officers

Our executive officers and their age as of September 30, 2016 are as follows:

Name	Ages	Position
Xiaojun Zhu *	48	President, Chief Executive Officer and Chairman of the Board of Directors
Wei (Samuel) Shen**	37	Chief Financial Officer

*Mr. Zhu's background and business experience is described above under "Directors"

**Wei (Samuel) Shen has been the Chief Financial Officer of the Company since May 2012. From November 2011 to May 2012, Mr. Shen was the Vice President for Finance of the Company. Mr. Shen is also the Director at Bluehill Investment Advisory Group, a PRC based financial consulting firm and the chief financial officer of New Era Minerals Inc. (TSX.V: NEM), a junior resource company. From 2006 to 2011, Mr. Shen served as an Audit Assurance Manager for a national public accounting firm, where he managed audit engagements for U.S. public companies. Mr. Shen holds both Chartered Accountant and Certified Public Accountant designations and is experienced with financial reporting under IFRS and US GAAP. Mr. Shen holds a Master of Management and Public Accounting.

Audit Committee

The Audit Committee oversees our accounting, financial reporting and audit processes; appoints, determines the compensation of, and oversees, the independent registered public accountants; pre-approves audit and non-audit services provided by the independent registered public accountants; reviews the results and scope of audit and other services provided by the independent registered public accountants; reviews the accounting principles and practices and procedures used in preparing our financial statements; oversees the Company's internal audit function; and reviews our internal controls.

The Audit Committee works closely with management and our independent registered public accountants. The Audit Committee also meets with our independent registered public accountants without members of management present, on a quarterly basis, following completion of our independent registered public accountants' quarterly reviews and annual audit and prior to our earnings announcements, to review the results of their work. The Audit Committee also meets with our independent registered public accountants to approve the annual scope and fees for the audit services to be performed.

The Board of Directors has determined that John Chen is an "audit committee financial expert" as defined by SEC rules, as currently in effect.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act, requires the executive officers and directors of the Company and every person who is directly or indirectly the beneficial owner of more than 10% of any class of security of the Company to file reports of ownership and changes in ownership with the SEC. Such persons also are required to furnish our company with copies of all Section 16(a) forms they file.

Based solely on our review of copies of such forms received by us, we believe that during the fiscal year 2013, the executive officers and directors of the Company and every person who is directly or indirectly the beneficial owner of more than 10% of any class of security of the Company complied with the filing requirements of Section 16(a) of the Exchange Act.

Item 11. Executive Compensation

Compensation of Executive Officers

Compensation Discussion and Analysis

Our primary goal with respect to our compensation programs has been to attract and retain the most talented and dedicated employees in key positions in order to compete effectively in the market place, successfully execute our growth strategies, and create lasting shareholder value. The Compensation Committee evaluates both individual and Company performance when determining the compensation of our executives. Our executives' overall compensation is tied to the Company financial and operational performance, as measured by revenues and net income, as well as to accomplishing strategic goals such as merger and acquisitions and fund raising. We apply our compensation policies consistently for determining compensation of our Chief Executive Officer as we do with the other executives. The Compensation Committee assesses the performance of our Chief Executive Officer annually and determines the base salary and incentive compensation of our Chief Executive Officer. Our Chief Executive Officer is primarily responsible for the assessment of our other executive officers' performance.

Summary Compensation Table

The following identified persons (the “Named Executive Officers”) of the Company received compensation in the amounts set forth in the chart below for the fiscal years ended September 30, 2016, 2015 and 2014. All compensation listed is in US dollars. No other item of compensation was paid to any officer or director of the Company other than reimbursement of expenses.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	All Other Compensation (\$)	Totals (\$)
Xiaojun Zhu, Chief Executive Officer and Chairman of the Board (1)	2016	29,984	-		(2) 29,984
	2015	31,462	-		(2) 31,463
Wei Shen, Chief Financial Officer	2016	107,943	-	-	107,943
	2015	113,265	-	-	113,265

Mr. Zhu was paid in Renminbi. His annual salary was RMB 200,000 for fiscal 2016 and 2015. The amounts (1) reflected in this column have been converted to U.S. dollars at the exchange rate of RMB 6.6702 to the U.S. dollar for fiscal 2016 and RMB 6.3568 to the U.S. dollar for fiscal 2015.

(2) The Company owns a motor vehicle which is available for Mr. Zhu’s use for business purposes. The value of this vehicle is less than \$10,000.

Option Grants Table. There were no individual grants of stock options to purchase our common stock made to the executive officers named in the Summary Compensation Table in fiscal 2016 and 2015.

Aggregated Option Exercises and Fiscal Year-End Option Value Table. There were no stock options exercised during fiscal 2016 and 2015 by any executive officer named in the Summary Compensation Table.

Long-Term Incentive Plan (“LTIP”) Awards Table. There were no awards made to a Named Executive Officer in fiscal 2016 and 2015 under any LTIP.

Our executive officers are reimbursed by us for any out-of-pocket expenses incurred in connection with activities conducted on our behalf. There is no limit on the amount of these out-of-pocket expenses and there will be no review of the reasonableness of such expenses by anyone other than our board of directors, which includes persons who may

seek reimbursement, or a court of competent jurisdiction if such reimbursement is challenged.

Employment Contracts and Termination of Employment

On May 28, 2012, the Company entered into a contract with Mr. Samuel Shen to serve as Chief Financial Officer of the Company. The initial term of the contract was for one year and extended for an indefinite period upon mutual agreement between Mr. Shen and the Company, subject to parties' right to terminate on reasonable notice. Pursuant to the contract, Mr. Shen receives a monthly salary of RMB 60,000 (approximately US\$8,995) and a discretionary bonus of up to RMB 180,000 (approximately US\$26,986). Mr. Shen is also entitled to 100,000 shares of restricted common stock of the Company at the end of the term, subject to his continuing employment with the Company and the board's approval. Mr. Shen did not receive any bonus or restricted stock for the years ended September 30, 2016, 2015 and 2014. According to the contract, the Company may terminate the contract with Mr. Shen for causes defined in the contract with thirty days' advance written notice. Under certain circumstances provided in the contract, the Company may elect to pay an additional month's salary in lieu of providing advance written notice to terminate Mr. Shen. Mr. Shen may terminate the contract with the Company by giving ninety days' advance written notice to the Company. The contract also contains covenants regarding non-competition and confidentiality.

Outstanding Equity Awards at Fiscal 2016 Year End

None.

Compensation of Directors

The following tables provides information regarding compensation earned by non-employee directors who served during fiscal 2016.

FISCAL 2016 DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
Yuankai Wen *	\$ 14,992	-	-	-	-	-	\$ 14,992
John Chen	\$ 36,000	-	29,800	-	-	-	\$ 65,800
Christy Young Shue	\$ 24,000	-	29,800	-	-	-	\$ 53,800

These amounts reflect the value determined by the Company for accounting purposes for these awards and do not reflect whether the recipient has actually realized a financial benefit from the award (such as by exercising stock options). These amounts represents a compensation expense for fiscal year 2016. Pursuant to SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. No stock option awards were forfeited by any of our non-employee directors in fiscal year 2016.

* Mr. Wen receives annual compensation in the amount of RMB 100,000. The amount set forth in this column is based on an exchange rate of RMB6.6702 to the U.S. dollar.

Independent Director Agreements

The Company has entered into Independent Director Agreements with Ms. Shue, and Messrs. Chen and Wen pursuant to which the Company has agreed to pay each of these directors annual cash compensation in the amount of \$24,000, \$36,000 and RMB 100,000, respectively. In addition, in August 2012, the Company agreed to grant each of Ms. Shue, and Messrs. Chen, two of our independent directors, nonstatutory stock options to purchase 60,000 and 60,000 shares of the Company's common stock, respectively, which options shall vest in accordance with the schedule determined as of the date of grant. On August 22, 2015, the Company renewed the independent Director Agreements with Ms. Shue, and Messrs. Chen and granted stock options to them to purchase up to an aggregate of 120,000 shares of the Company's common stock. 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 \$1.89 per share. In addition, the Company has agreed to reimburse each director for all reasonable, out-of-pocket expenses, subject to the advance approval of the Company incurred in connection with the performance of Director's duties.

Board Leadership Structure and Role in Risk Oversight

One person currently holds the positions of principal executive officer and chairman of the Board of Company. The Board does not have a policy on whether or not the roles of the Chief Executive Officer and Chairman should be separate. Instead, the Company's By-Laws provide that the directors may designate a Chairman of the Board from among any of the directors. Accordingly, the Board reserves the right to vest the responsibilities of the Chief Executive Officer and Chairman in the same person or in two different individuals depending on what it believes is in the best interest of the Company. The Board has determined that the consolidation of these roles is appropriate because it allows Mr. Zhu to bring a wider perspective to the deliberations of the Board on matters of corporate strategy and policy. The Board believes that there is no single Board leadership structure that would be most effective in all circumstances and therefore retains the authority to modify this structure to best address the Company's and the Board's then current circumstances as and when appropriate.

The Company's management is responsible for identifying, assessing and managing the material risks facing the business. The Board and, in particular, the Audit Committee are responsible for overseeing the Company's processes for assessing and managing risk. Each of the Chief Executive Officer and Chief Financial Officer, with input as appropriate from other appropriate management members, report and provide relevant information directly to either the Board and/or the Audit Committee on various types of identified material financial, reputational, legal, operational, environmental and business risks to which the Company is or may be subject, as well as mitigation strategies for certain salient risks. In accordance with NASDAQ requirements and as set forth in its charter, the Audit Committee periodically reviews and discusses the Company's business and financial risk management and risk assessment policies and procedures with senior management, the Company's independent auditor. The Audit Committee reports its risk assessment function to the Board. The roles of the Board and the Audit Committee in the risk oversight process have not affected the Board leadership structure. Although the board has not formally designated a lead independent director, Mr. Sherman, the chairman of the audit committee, has led the meetings of the audit committee which include at least a majority of the independent directors and at which matters appropriate for consideration at executive sessions of the board of directors were discussed.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth information regarding the beneficial ownership of our common stock as of December 8, 2016 as to (i) each person who is known by us to own beneficially more than 5% of our outstanding common stock, (ii) each of the executive officers and other persons named in the Summary Compensation Table, (iii) each director and nominee for director, and (iv) all directors and executive officers as a group. Except as otherwise indicated in the footnotes, all information with respect to share ownership and voting and investment power has been furnished to us by the persons listed. Except as otherwise indicated in the footnotes, each person listed has sole voting power with respect to the shares shown as beneficially owned. Unless otherwise indicated, the address of each listed shareholder is c/o China HGS Real Estate Inc., 6 Xingnan Road, 19th Floor, Hanzhong City, Shaanxi Province, PRC 723000.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)	Percent of Class (2)	
5% Holders			
Rising Pilot, Inc. (a British Virgin Islands company)(3)	14,000,000	31.1	%
Directors and Officers			
Mr. Xiaojun Zhu(4)	29,800,000	66.1	%
Shenghui Luo	1,680,000	3.7	%
Yuankai Wen(5)	-	*	
Christy Young Shue (5)	21,667	*	
John Chen (5)	21,667	*	
Wei (Samuel) Shen	-	-	
All directors and executive officers as a group (5 persons)	31,523,334	70.0	%

* less than 1%

(1) Except as indicated in the footnotes to this table and pursuant to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all shares of common stock owned by such person. The number of shares beneficially owned includes common stock that such individual has the right to acquire as of December 8, 2016 or within 60 days thereafter, including through the exercise of stock options.

(2) Percentage of beneficial ownership is based upon 45,050,000 shares of common stock outstanding as of December 8, 2016. For each named person, this percentage includes common stock that the person has the right to acquire either currently or within 60 days of December 8, 2016, including through the exercise of an option; however, such common stock is not deemed outstanding for the purpose of computing the percentage owned by any other person.

(3) Mr. Xiaojin Zhu has voting and dispositive control over securities held by Rising Pilot, Inc.

(4) Includes 15,800,000 shares of common stock owned by Mr. Zhu directly and 14,000,000 shares owned through Rising Pilot, Inc.

(5) Includes stock options to purchase 43,334 shares of common stock exercisable as of December 8, 2016 or within 60 days thereafter.

Securities Authorized for Issuance Under Equity Compensation Plans

On September 25, 2012, our shareholders approved the Company's 2012 Omnibus Securities and Incentive Plan (the "2012 Plan"). The 2012 Plan provides for the grant of awards which are distribution equivalent rights, incentive stock options, non-qualified stock options, performance shares, performance units, restricted shares of common stock, restricted stock units, stock appreciation rights ("SARs"), tandem stock appreciation rights, unrestricted shares of common stock or any combination of the foregoing, to key management employees and nonemployee directors of, and nonemployee consultants of, the Company or any of its subsidiaries (each a "participant"). We have reserved a total of 2,000,000 shares of common stock for issuance as or under awards to be made under the 2012 Plan. The number of shares of common stock for which awards which are options or SARs may be granted to a participant under the 2012 Plan during any calendar year is limited to 1,000,000.

The following table summarizes information with respect to shares of the Company's common stock that may be issued under the Company's existing equity compensation plans as of September 30, 2016:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	120,000	\$ 1.89	1,880,000
Total	120,000	\$ 1.89	1,880,000

Changes in Control

There are no arrangements known to us, including any pledge by any person of our securities, the operation of which may at a subsequent date result in a change in control of the Company.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Certain Relationships and Related Transactions

The Audit Committee is responsible for reviewing, approving or ratifying all material transactions between us and any related person. Related persons can include any of our directors or executive officers, certain of our shareholders, and any of their immediate family members. This obligation is set forth in our Audit and Finance Committee Charter. Although we do not have a formal written policy with respect to our Audit Committee's policies and procedures for reviewing related party transactions, in evaluating such transactions, the Audit Committee members apply the same standards of good faith and fiduciary duty they apply to their general responsibilities as a committee of the board and as individual directors. In any transaction involving a related party, our Audit Committee considers all available material facts and circumstances of the transaction, including: (i) the direct and indirect interests of the related party; (ii) if the related party is a director (or immediate family member of a director or an entity with which a director is affiliated), the impact such transaction would have on the director's independence; (iii) the risks, costs and benefits to us; and (iv) whether any alternative transactions for comparable purposes are available. Our Audit Committee then makes a determination as to whether the proposed terms of the transaction are in the best interests of the Company and otherwise consistent with arm's length dealings with unrelated third-parties.

The following related party transactions occurred during the fiscal year ended September 30, 2016:

The Company has 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 and the loan matured on July 19, 2014. The Company entered into the amendments to the USD Loan Agreement to extend the term until July 31, 2017. The Company recorded interest of \$72,400 for each of the years ended September 30, 2016 and 2015. The Company has not yet paid this interest and it is recorded in accrued expenses in the accompanying consolidated balance sheets as of September 30, 2016 and 2015.

On December 31, 2013, Guangsha, the Company's PRC operating subsidiary, entered into a loan agreement with the Chairman (the “Shareholder RMB Loan Agreement”), pursuant to which Guangsha is able to borrow 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, and has been renewed with a new expiration date of June 30, 2017, with at an interest rate of 4.35% as of September 30, 2016 and 5.5% as of September 30, 2015. The RMB loan balance as of September 30, 2016 and 2015 was \$899,523 and \$Nil, respectively. For the years ended September 30, 2016 and 2015, the interest was \$40,172 and \$240,687, respectively, which is capitalized in the development cost of Liangzhou road project.

Director Independence

The Board of Directors has determined that Christy Young Shue, John Chen, and Yuankai Wen are independent directors within the meaning set forth in the NASDAQ listing rules, as currently in effect.

Item 14. Principal Accountant Fees and Services

Friedman LLP served as the Company's independent registered public accounting firm for fiscal years 2016 and 2015. Fees (excluding reimbursements for out-of-pocket expenses) paid to Friedman LLP for services in fiscal 2016 and 2015 were as follows:

	2016	2015
Audit Fees	\$207,500	\$190,000
Audit-Related Fees	-	-
Tax Fees	-	-
All Other Fees	-	-
Total	\$207,500	\$190,000

"Audit Fees" consisted of fees for the audit of our annual financial statements, review of the financial statements included in our quarterly reports on Form 10-Q and services that are normally provided by the independent registered public accountants in connection with statutory and regulatory filings or engagements for those fiscal years. This category also includes advice on audit and accounting matters that arose during, or as a result of, the audit or the review of interim financial statements, statutory audits required by non-U.S. jurisdiction, the preparation of an annual "management letter" on internal control matters and assurance services provided in connection with the assessment and testing of internal controls with respect to Section 404 of the Sarbanes-Oxley Act of 2002.

"Audit-Related Fees" consisted of assurance and related services by Friedman LLP that are reasonably related to the performance of the audit or review of our financial statements and are not reported above under "Audit Fees."

"Tax Fees" consisted of professional services rendered by Friedman LLP for tax compliance and tax planning. The services for the fees disclosed under this category include tax return preparation and technical tax advice.

The above amounts relate to services provided in the indicated fiscal years, irrespective of when they were billed. The Audit Committee considered the compatibility of non-audit services by Friedman LLP with the maintenance of that firm's independence and determined, in each case, that at all times, Friedman LLP remained independent.

The Audit Committee Charter establishes a policy governing our use of Friedman LLP for audit and non-audit services. Under the Charter, the Audit Committee is required to pre-approve all audit and non-audit services performed by the Company's independent registered public accountants in order to ensure that the provision of such

services does not impair the public accountants' independence. The Audit Committee pre-approves certain audit and audit-related services, subject to certain fee levels. Any proposed services that are not a type of service that has been pre-approved or that exceed pre-approval cost levels require specific approval by the Audit Committee in advance. The Audit Committee has approved all audit and audit-related services to be performed by Friedman LLP in 2016.

Part IV

ITEM 15 Exhibits and Financial Statement Schedules

Exhibit No.	Title of Document
3.1	Articles of Incorporation(1)
3.2	Articles of incorporation of the registrant as amended with the Secretary of State of Florida on October 8, 2009(2)
3.3	Bylaws(1)
10.1	Share Exchange Agreement by and between the Company, China HGS Investment, Inc., and Rising Pilot, Inc. dated August 21, 2009(3)
10.2	Entrusted Management Agreement, dated as of September 18, 2009, by and among the Company, Mr. Xiaojun Zhu and his management staff (English translation)(4)
10.3	Independent Director Agreement between China HGS Real Estate Inc. and Yuankai Wen(2)
10.4	Form of Indemnification Agreement(2)
10.5	Form of Nonstatutory Stock Option Agreement(5)
10.6	Residential Apartment Bulk Purchasing Agreement dated May 28, 2011 between Hanzhong Municipal Public Security Bureau and Shaanxi Guangsha Investment and Development Group Co., Ltd. (English translation)(6)
10.7	Residential Apartment Bulk Purchasing Agreement dated June 8, 2011 between Hanzhong Municipal Bureau of Justice and Shaanxi Guangsha Investment and Development Group Co., Ltd. (English translation)(7)
10.8	USD Shareholder Loan Agreement by and between the Company and Mr. Xiaojun Zhu dated July 28, 2011(English translation)(8)
10.9	Land Use Rights Transfer Agreement between Shaanxi Guangsha Investment and Development Group Co., Ltd. and Hanzhong Guangxia Real Estate Development Limited dated March 16, 2011 (English translation)(9)
10.10	Loan Agreement by and between Shaanxi Guangsha Investment and Development Group Co. and Mr. Xiaojun Zhu dated November 14, 2011 (English translation)(9)
10.11	Independent Director Agreement by and between China HGS Real Estate Inc. and John Chen, dated August 22, 2012(12)
10.12	Independent Director Agreement by and between China HGS Real Estate Inc. and Christy Young Shue, dated August 22, 2012(13)
10.13	Labor Contract by and between Shaanxi Guangsha Investment and Development Group Co., Ltd. and Wei (Samuel) Shen, dated May 28, 2012(14)
10.14	Form of Indemnification Agreement(15)
10.15	Loan Amendment Agreement by and between China HGS Real Estate Inc. and Mr. Xiaojun Zhu, dated July 19, 2013(16)
10.16	Loan Agreement by and between Shaanxi Guangxia Investment Development Group Co., Ltd. and China Construction Bank, dated August 23, 2013(17)
10.17	Loan Agreement between dated December 31, 2013 by and between Shaanxi Guangsha Investment and Development Group Co., Ltd and Mr. Xiaojun Zhu(18)
14	Code of Conduct(10)
21	List of subsidiaries of the Registrant(11)

- 31.1* Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
- 31.2* Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
- 32.1* Section 1350 Certification of Chief Executive Officer and Chief Financial Officer
- 101* XBRL Instance Document

*Filed herewith

- (1) Incorporated herein by reference to the SB-2 Registration Statement filed on August 31, 2001.
- (2) Incorporated by reference to Exhibit 3.2 to registrant's quarterly report on Form 10-Q filed on August 16, 2010.
- (3) Incorporated herein by reference to the current report on Form 8-K filed on August 21, 2009.

- (4) Incorporated herein by reference to the current report on Form 8-K filed on September 18, 2009.
- (5) Incorporated herein by reference to Exhibit 10.1 to the current report on Form 8-K filed on March 17, 2011.
- (6) Incorporated herein by reference to Exhibit 10.1 to the current report on Form 8-K filed on June 3, 2011.
- (7) Incorporated herein by reference to Exhibit 10.1 to the current report on Form 8-K filed on June 14, 2011.
- (8) Incorporated herein by reference to registrant's quarterly report on Form 10-Q filed August 15, 2011.
- (9) Incorporated herein by reference to the current report on Form 8-K filed on December 23, 2011.
- (10) Incorporated herein by reference to the current report on Form 8-K filed on January 22, 2010.
- (11) Incorporated by reference to Exhibit 21 to registrant's annual report on Form 10-K filed on December 29, 2010.
- (12) Incorporated by reference to Exhibit 10.1 to the current report on Form 8-K filed on August 22, 2012.
- (13) Incorporated by reference to Exhibit 10.2 to the current report on Form 8-K filed on August 22, 2012.
- (14) Incorporated by reference to Exhibit 10.1 to the current report on Form 8-K filed on May 29, 2012.
- (15) Incorporated by reference to Exhibit 10.1 to the current report on Form 8-K filed on March 15, 2013.
- (16) Incorporated by reference to Exhibit 10.1 to the current report on Form 8-K filed on July 22, 2013.
- (17) Incorporated by reference to Exhibit 10.1 to the current report on Form 8-K filed on October 15, 2013.
- (18) Incorporated by reference to Exhibit 10.1 to the current report on Form 8-K filed on January 7, 2014.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

China HGS Real Estate Inc.

Date: December 21, 2016 By: /s/ Xiaojun Zhu
 Xiaojun Zhu
 President, Chief Executive Officer,
 and Chairman of the Board
 of Directors

Date: December 21, 2016 By: /s/ Samuel Shen
 Samuel Shen
 Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Xiaojun Zhu Xiaojun Zhu	President, Chief Executive Officer, and Chairman of the Board of Directors (Principal Executive Officer)	December 21, 2016
/s/ Samuel Shen Samuel Shen	Chief Financial Officer (Principal Financial and Accounting Officer)	December 21, 2016
/s/ Shenghui Luo Shenghui Luo	Director	December 21, 2016
/s/ Christy Young Shue Christy Young Shue	Director	December 21, 2016
/s/ John Chen John Chen	Director	December 21, 2016
/s/ Yuankai Wen Yuankai Wen	Director	December 21, 2016

