

Pan Shiyi: SOHO China's Business Model

SOHO China has a unique business model. Over the past dozen or so years, it has also proven to be extremely successful. However, SOHO's model has always seen its share of detractors. Often media and investors will ask me, what exactly is SOHO China's business model? How will it bring the company success? I have compiled these questions together, and I do a Q&A to share with our friends in the media and investment communities.

Q1: You often talk about SOHO China's business model. Can you use one word to sum it up?

Pan Shiyi: SOHO China's business model is to develop commercial real estate (including offices) by doing overall planning, building and selling, with coordinated overall leasing and managing after sales.

Q2: The market has always viewed SOHO's model with skepticism. Why don't you keep a large landbank? Is this determined by the market or by some other reason?

Pan Shiyi: This is the question I hear most often from the market and the one which I have heard for the longest time. The reason why SOHO doesn't keep a so-called "large" landbank is based on the following two considerations:

First is consideration for the law. Chinese regulations are very clear: Land not developed within two years will be repatriated without compensation. In regards to the execution of this law, the experience of the recent few years is that, although the government reapproves and stresses this law every year, it has never strictly enforced it. From a Chinese land management standpoint, there are two regulations which are always talked about, but never enforced. First is the two years rule mentioned above. The second is that it is illegal to construct "small-property-rights housing".

We've all heard the story of the Boy who Cried Wolf. It is a reminder that the day might actually come when that which we were warned about comes true.

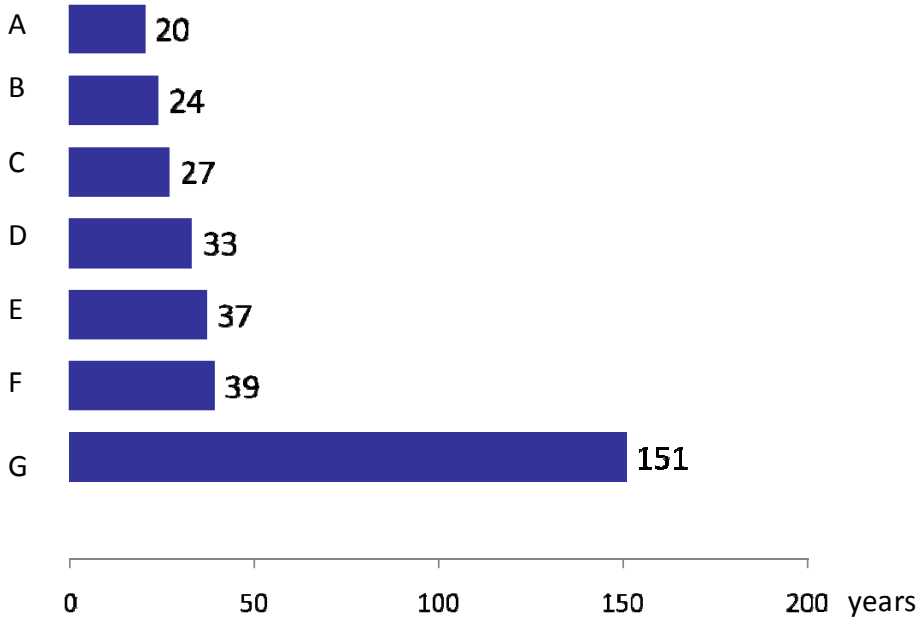
We observe that the contradictions brought about by these two illegal conducts are becoming increasingly acute. Some cities even have over 100,000 units of small-

property-rights housing. Also, there are a few developers that have stockpiled enough land for 20-30 years, or even 100 years. Perhaps this year or next the government really will begin strictly enforcing these two laws, and the wolf truly will come.

Although, these laws have not been enforced, SOHO China will absolutely not take any such legal risk. Only if a company's actions have legal protection is it safe. Otherwise, there is great risk. Strictly abiding by all laws and regulations is SOHO China's most fundamental, unwavering principle. We don't hoard land.

Second, SOHO does commercial real estate, concentrating on the most central and prime areas in the mega metropolises Beijing and Shanghai. The land value in these areas is incomparable to the land in the suburbs of any third tier city. One square meter at Beijing's Qianmen Avenue is equivalent to hundreds or thousands of times more than one square meter in the suburbs of Inner Mongolia. It would be bogus science to simply measure SOHO China's landbank square meter number versus that of a developer that focuses on land in the countryside. To invest one's limited capital in stockpiling undevelopable land and holding it for dozens or a hundred years is a waste not only to the company, but to society at large. You could let your security guards stand there and sunbathe all day, or you could let some farmers grow some grain, vegetables, or fruit!

Land bank: No. of development years



Companies	G*	D	E	B	C	A*	F*
Land bank (Dec 2008) (million sq.m.)	12.88	22.23	25.74	28.72	13.91	43.02	29.10
Booked area (2008) (million sq.m.)	0.09	0.68	0.70	1.19	0.52	2.15	0.75
No. of development years	151	33	37	24	27	20	39

Source: interim/annual reports

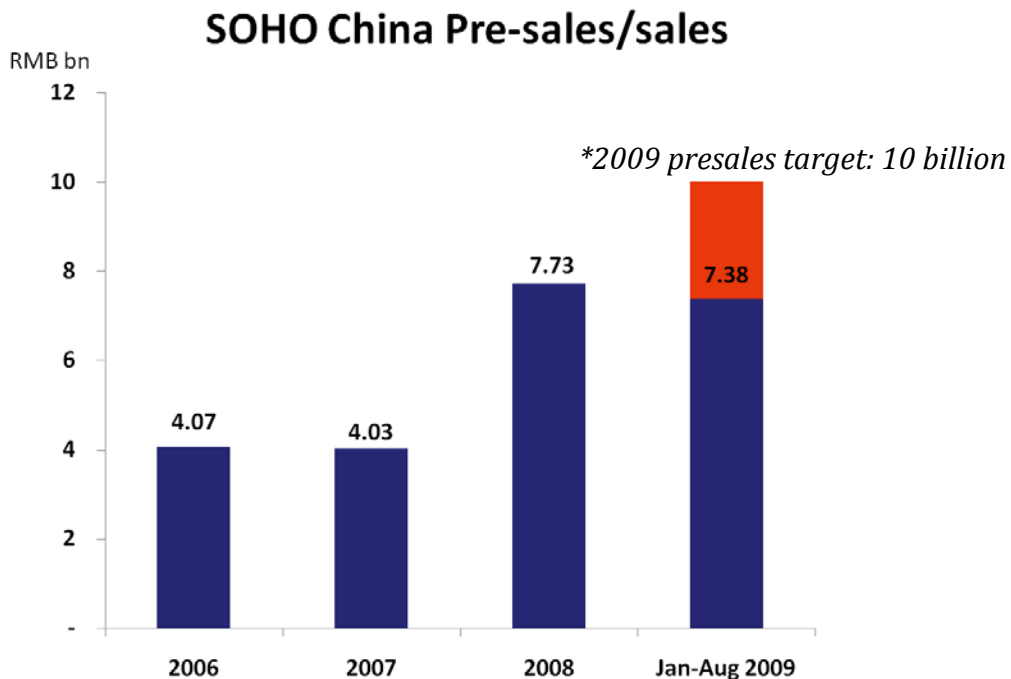
*Land bank as at Jun 2009.

Q3) Do you think the SOHO business model is successful? What metrics do you have for measuring this success?

Pan Shiyi: SOHO China's business model is extremely successful. Its success can be found in the use and value of our property. One reporter calculated, of SOHO's 12 projects, 6 of them were unoccupied distressed projects before SOHO took them

over. His conclusion was that we “turned distress into profit”. This illustrates SOHO China’s contribution to the city and society. Likewise, over the past ten years, the 7000-plus clients of SOHO China have been able to enjoy the appreciation and return brought by this successful business model. The rental yield they receive at our projects is much greater than that of other projects they bought in the same period. This forms a case study of why our old customers repeatedly buy SOHO products.

Another measure of the success is if the business model is able to withstand the test of market volatility. SOHO China’s model also has undergone the trials and tribulations brought by the global financial crisis, but while other buildings in the same area have seen their occupancies drop dramatically, we’ve maintained the occupancy rate of SOHO building’s office space above 95%. Moreover, in the dozen or so past years of the company’s growth, the best proof of the success of our business model is the sustained, rapid growth in sales, which we translate into high margin and profit for our shareholders.



Q4) SOHO China's business model has received the skepticism and criticism of industry peers. Aside from not keeping a large landbank, another comment is that we don't do block deals and rather strata sell units to different tenants. What is the reason for this?

Pan Shiyi: I've already elaborated on why we don't hoard landbank. But why don't we block sell? This is a choice we have made based on the market feedback we have received over the past 10-plus years. For the 65 towers we have developed, before we've brought them to market, there have always been a number of institutions that come by to discuss a block deal. But this kind of transaction always seems to have strings attached, which the company cannot accept. We also observe that in other companies' involvement with block sales, there often occur cases of corruption. So in the end, we have not yet sold a single tower to institutions (except for the phase I of Chaoyangmen SOHO, a small completed part of a huge project).

At the same time, we see that there are rather few cases of institutions buying an entire building. The customers with the true buying power are the small or medium sized customers. In the early days, these customers invested a few million. Now they invest tens of millions. This illustrates the development and wealth accumulation in the Chinese market. But we still are not as wealthy as the developed countries, and our market positioning should not go beyond the current historical context. In plain words, a building is like a watermelon. In China, the number of people that can afford a watermelon is not that great. But if you slice up the melon, the number of people that can afford it increases in droves. This allows more people the chance to enjoy our products' and assets' value appreciation.

Q5) Why doesn't SOHO hold its properties, and only sells them?

Pan Shiyi: At present, selling our property results in much higher return on shareholder equity than leasing it would. Our effective capital use also is higher. The sale of our property allows us to quickly grow in lines with the large-scale growth of Beijing and Shanghai. By selling our property, we spark the activity and creativity of every department and employee at the company, in design, construction, and marketing. At the same time, by selling, we create the most value for society. Our profit and tax contribution are a concrete manifestation of this value.

As we go forward, if we are to increase the percentage of our holdings, they must be completely one-of-a-kind, irreplaceable resources, such as Qianmen Avenue.

Q6) Most SOHO China customers are concentrated in the North. Does this have a cultural background? Does this concentration pose any risk?

Pan Shiyi: SOHO China's real estate products are primarily focused in Beijing, and its customers largely come from the North. I think one big reason for this is Northerners' recognition of Beijing's development and its importance to the economy of the entire North. Most Northerners harbor a special sentiment toward Beijing. When I was in primary school, every pupil would draw pictures of Tiananmen, and we'd always draw it emanating rays of light. We all saw Beijing as a place that just radiates, as if it wore a halo.

Also, Northerners have a tradition of buying property. From generation to generation, it is their dream to own their own piece of property in a prosperous part of Beijing. Compared with clients from Jiangsu and Zhejiang, Northerners are a bit more steady-handed, being primarily focused on real estate for its rental yield and long-term appreciation potential. When we were developing SOHO Newtown, we had several clients from Wenzhou, who would all come at once, then suddenly all leave in speculative fashion – quite unstable.

Beijing is attractive to Northerners, just as Shanghai is more attractive to people from Yangtze River Delta. Compared with other developers, our client mix is a bit more diverse and less concentrated. We have clients in many provinces in the North.

Q7) Do you feel that SOHO China's business model has any areas that need to be improved?

Pan Shiyi: First, in SOHO China's business model, in the past, the property management phase has been entrusted to a first-rate property management company through a tender process. We ourselves managed the leasing and promotion. Going forward, as we refine our model, we are preparing to manage our properties ourselves through the property management companies we have already set up. This way, the organization and business model of SOHO will be better coordinated, and we'll be better able to take advantage of the strengths of our business model.

Second, if the architectural products we have developed over the last 10 years are "first generation SOHO", henceforward, we will continue to progress. The next generation of SOHO products will be more adapted to the internet era. The functionality of our buildings will be more unified, both online and offline.

Q8) How do you view the sustainability of the SOHO China business model?

Pan Shiyi: First, when considering if a company or business model can undergo sustained, healthy growth, most important is how it is able to sustain market volatility, especially when it is extreme.

Second, at a strategic level, we must always be in a state of flexibility for both buying and selling. When the market is good, we accelerate sales, as in 2009, which will be a record year for the company. When the market is in a downturn, we buy new projects, like in 2008, when we acquired Chaoyangmen SOHO for RMB 5.5 billion.

Finally, how much space does SOHO China have for sustained growth? If the real estate market still looks promising, the company will convert its capital into the construction of current projects. With saleable inventory of over RMB 50 billion, we can ensure growth for the next 4 years. On the contrary, if the market is weak, we will use our capital and loan facilities to buy low and accumulate over RMB 30 billion worth of land and projects. This shows our operational flexibility at August 2009 and our strategy for sustained development.