Sector review: Realty

Not out of the woods

AFP

There has been some uptick in volume, but RBI's recent money tightening may play spoilsport by putting pressure on prices. Meanwhile, the land acquisition bill has come as a fresh blow to the ailing industry

AMIT MUDGILL

THE real estate sector has been plagued by high interest rates, slow demand, acute labour shortage, project delays and new regulations. And the new land acquisition bill, which has already been approved by the Lok Sabha, can be another big blow for the industry.

The pain in the real estate sector can be clearly felt in the BSE realty index, which now quotes at lowest level since it was launched in August 2007.

The index is down 85 per cent from its early-2008 peak and even though real estate stocks have shed 25-70 per cent of their market value this calendar, they are still searching for the bottom.

Eight of 13 stocks the BSE realty index stocks hit their 52-week lows in August, while three of them — HDIL, DLF and Oberoi Realty — in fact hit their all-time lows during the month.

While industry watchers point to some improvement in volume in the commercial segment, market analysts have advised investors to wait until more meaningful reduction in their debt levels. The new land acquisition bill can also raise cost of land significantly and will impact project costs and margins, they said.

Revival hopes

India had a ready stock of nearly 460 million square feet (msf) of office space with 18 per cent vacancy as of June 30. Leasing activity in the seven major cities saw a recovery with the absorption of 7.2 msf in the June quarter against 3.4 msf in the March quarter.

DLF managed to sell 1.8 msf amounting to Rs 2,400 crore in the June quarter compared with sales worth Rs 1,240 crore in the March quarter and Rs 3,800 crore in the whole of FY13. The developer, which had a net debt of Rs 20,369 crore at the end of June quarter, aims to lower it to Rs 17,500 crore by the end of FY14.

Unitech, another north Indian player, delivered 1.05 msf of completed area during the quarter. The realtor saw bookings worth Rs 450 crore (highest in two years) in the first quarter, which included 0.62 msf of residential space valued at Rs 362 crore and non-residential sales worth Rs 88 crore. The company had consolidated debt of around Rs 5,600 crore at the end of FY13.

Mumbai-registered HDIL managed to cut its debt by around Rs 340 crore in the first quarter to Rs 3,830 crore. The company said its residential portfolio during the quarter improved. Demand was especially from the Mumbai outskirts while there was sluggishness in the high-end segment.

The Karnataka-based Sobha Developers clocked sales of 0.92 msf in the June quarter, up 10 per cent on a year-on-year basis. The firm has set a target of Rs 2,600 crore sales for FY14 and reported Rs 600 crore sales in Q1.

Dampening factors

Industry watchers say real estate players are unlikely to raise debt levels to fund new projects at the present juncture due to high interest rates.

"It is difficult to see any major recovery in the commercial property segment during the next quarter, as business sentiments have been affected adversely due to the fall of the rupee. With interest rates going up, debt levels of real estate companies are unlikely to see any significant rise," said Lalit Kant, executive vice-president for real estate at Arthveda Fund Management, the private equity arm of Dewan Housing Finance.

Some analysts do not expect any substantial reduction in debt. Dhananjaya Sinha of Emkay Global Securities said debt levels can be reduced only by reducing inventories or by accessing capital market.

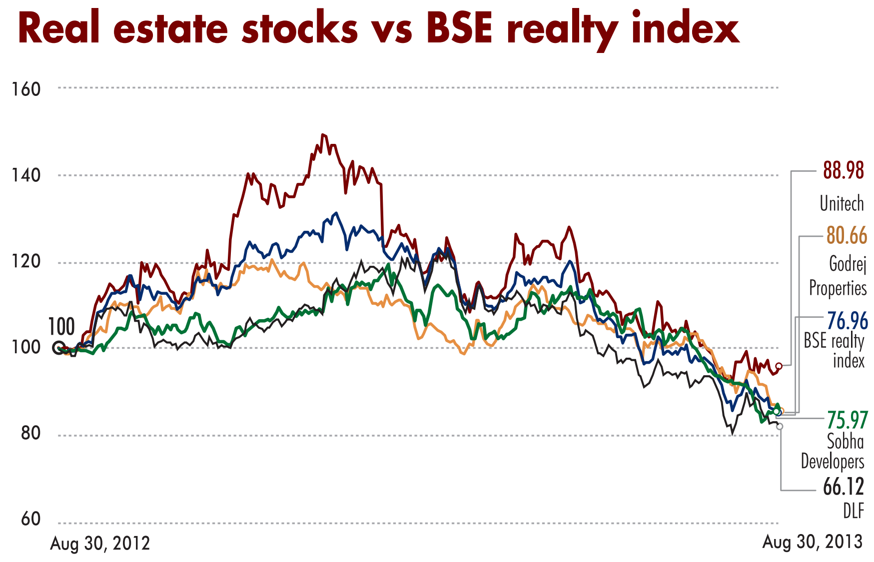
"In the case of the capital market, we believe the situation has worsened in recent times. Our visit to Gurgaon and Delhi regions suggests that there has been some correction in realty prices. If this is the case with other regions, we don't see any meaningful reduction in debt levels. Anyways, the recent money tightening by RBI will result in higher home loan rates, denting overall sentiments," he said.

Sinha says Godrej Properties, Oberoi Realty and south-based players such as Sobha Developers are better placed among the real estate players.

While he cited zero debt for his preference for Oberoi Realty, he says property prices in south India are still affordable and could see an uptick in demand.

Kant, on the other hand, prefers Jaypee Infratech and Godrej Properties. A report by brokerage IIFL said it would take 11 years each for the companies in the utilities and financial (mainly real estate) sectors to repay their existing debt.

Real estate stocks vs BSE realty index



Pinaki Paul

Land acquisition bill

Mayank Saksena, managing director for land services at Jones Lang LaSalle India, said: "For developers, the cost of land is going to increase significantly, impacting project costs and, therefore, margins. Land valuations are already high and an further increase would make land acquisition more difficult. Anyone without an existing land bank will now be looking at vastly increased entry costs."

Navin Raheja, president of the National Real Estate Development Council (Naredco) said not only will the cost of land go up, the time taken for acquiring land will get prolonged as the rehabilitation and resettlement policy will be applicable in the case of land acquisition of 50 acres in urban areas and 100 acres in rural areas.

"In most parts of the country, private developers acquire land at mutually-negotiated market price with 100 per cent consent of landowners. Additional financial burden of the R&R component will increase the cost of land," he explained.

Other concerns

While there are persisting concerns over high debt levels, these concerns could get elevated as the deleveraging cycle of banks is under way as investment-to-deposit ratios have hit a multi-decade high of 108 per cent.

"The reversal of easy business cycle, scarcity of capital and tight monetary cycle in domestic and international markets will force banks to deleverage their balance sheets over the next three to four years. This augurs a difficult time for the real estate industry, which has witnessed huge inflows during the last decade and set the stage for a correction," said Manish Bhabdari of Vallum Capital.

Bhandari said with impending central and state elections in 10 states, costing around $15 billion, real estate due to its "ancillary role as a vault of illicit wealth" could witness outflow of money to fund elections over the next 18 months.

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STOCK WATCH

DLF

LTP: **129.80** 52-wk H/L: **289.2/120.25** EPS: **1.86**

Business & background: DLF develops residential commercial and retail properties.

Prospects: DLF has reported a 38 per cent fall in its year-on-year net profit to Rs 181.19 crore in the June quarter compared with Rs 292.79 crore in the year-ago quarter. The firm has seen revenues from constructed properties as a percentage of total sales falling from 52 per cent in FY11 to 37.54 per cent in FY13. On the other hand, revenues from rent have gone up to 21 per cent per cent in FY13 from 13.40 per cent in FY11. Brokerage Religare Securities believe that a sustained stock performance would reflect in the present market price only once cash flows improve and higher sales visibility is established. The developer has a net debt of Rs 20,369 crore and it expects it to reduce it to Rs 10,000 crore within three years.

Standalone results

	JUNE-13*	JUNE-12	%
Net sales	766.66	792.35	-3.24
Expenditure	357.58	21.64	1,552.40
PAT	150.16	367.15	-59.10

*For the quarter ended Mar 31 All figures in Rs crore

Valuation: At Friday's close of Rs 129.80, the scrip was trading at 69.73 times its EPS for the past four quarters.

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UNITECH

LTP: **16.55** 52-wk H/L: **40.9/14.65** EPS: **0.73**

Business & background: Unitech develops residential areas, amusement parks and commercial spaces, among the others.

Prospects: Unitech generates around 75 per cent of its revenues from real estate business. The firm has clocked 37 per cent YoY rise in consolidated net profit to Rs 62.89 crore in the June quarter. Brokerage Motilal Oswal in a note though believe Ebitda at 13.10 per cent was not up to the mark due to higher revenue from transmission tower business, unfavorable project mix impacting the core real estate margins, and muted margins in hospitality business. It remains cautious over the quality of loans and advances, subdued incremental presales, and weaker than expected scale-up in execution.

Standalone results

	JUNE-13*	JUNE-12	%
Net sales	281.09	178.85	57.17
Expenditure	265.62	172.18	54.27
PAT	35.93	31.76	13.13

*For the quarter ended Mar 31 All figures in Rs crore

Valuation: At Friday's close of Rs 16.55, the scrip was trading at 22.67 times its EPS for the past four quarters.

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GODREJ PROPERTIES

LTP: **393.45** 52-wk H/L: **640.32/377.00** EPS: **11.03**

Business & background: Godrej Properties is a Mumbai-based real estate firm.

Prospects: Godrej Properties has reported 28.46 per cent YoY growth in consolidated net profit to Rs 53.25 crore in the June quarter. Net debt of the firm stood at Rs 1,611 crore as of June 30. The firm, which has 18 ongoing projects, is looking at 15 new projects. The firm has seen a total booking of Rs 606 crore in the June quarter out of which Rs 224 crore worth of bookings were for residential projects and rest Rs 382 crore were in commercial segment. Brokerage Edelweiss Securities believes that key triggers for are progress on BKC (Bandra Kurla Complex) sales, new project launches and the deployment of the Rs 700 crore rights issue.

Standalone results

	JUNE-13*	JUNE-12	%
Net sales	81.57	56.24	45.04
Expenditure	88.53	55.4	59.80
PAT	14.08	26.91	-47.68

*For the quarter ended Mar 31 All figures in Rs crore

Valuation: At Friday's close of Rs 393.45, the scrip was trading at 35.47 times its EPS for the past four quarters.

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SOBHA DEVELOPERS

LTP: **249.75** 52-WK H/L: **472.40/224.10** EPS: **20.74**

Business & background: Sobha Developers is present in residential and commercial development services.

Prospects: Sobha Developers has clocked 11.3 per cent rise in YoY net profit to Rs 50.10 crore on 6.78 per cent YoY rise in sales to Rs 463 crore. Amit Agarwal of SBI Securities believes the quarterly earnings supported the brokerage's bullish view on the stock with evidence of strong cash flows due to rising customer advances and steady net debt to equity ratio. He pointed out in a note that the execution remained strong as the developer has completed and handed over contractual projects of 0.13 msf. IIFL, HDFC Securities, BNP Paribas, KR Choksey and Ambit Capital are some of the other brokerages recommending buy on the stock.

Standalone results

	JUNE-13*	JUNE-12	%
Net sales	467.8	421.5	10.98
Expenditure	348.9	311.5	12.01
PAT	52.7	46	14.57

*For the quarter ended Mar 31 All figures in Rs crore

Valuation: At Friday's close of Rs 249.75, the scrip was trading at 12.02 times its EPS for the past four quarters.

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ANALYST OUTLOOK

Huge debt of realty players remains a concern

SUDIP BANDYOPADHYAY

Destimoney Securities

INDIAN economy continues to remain under significant pressure due to multiple domestic and international factors. Rapid slowing down of growth has caused significant pain in the economy and financial markets. The real estate sector also has taken a severe beating with BSE realty index down around 85 per cent from its peak. Real estate as a sector has many problems plaguing its progress. High interest rates prevailing in the economy for the last couple of years, has been one of the principal reasons for slowing down of the economy and demand for real estate. While commercial real estate demand has all but collapsed, the residential demand is also subdued. The real estate companies have been hit from both the ends i.e. cost of production (due to high interest rates) has increased significantly, while demand has slowed down (due to overall adverse economic situation and high interest rates on housing loan). The situation does not look anything better for the foreseeable future. The problems of the real estate sector have been compounded by few other extraneous issues involving corporate governance or the lack of it in most of the leading real estate companies. Huge concern also remains over unrelated diversification resulting in huge debt in their balance sheets. Apart from companies like Godrej Properties, Oberoi Realty etc., most other leading listed companies from the real estate space suffer from the above ailments. Last one year has been a year of reckoning for these real estate companies and many of them have worked hard to improve governance and shed unrelated assets to bring down debt levels.

A lot still needs to be done. The seasonal spurt in residential demand in certain pockets of the country should not be construed as a signal of trend reversal for the industry.

Till economic situation improves and the company specific issues of governance and debt are adequately addressed, we do not expect a recovery in market demand for real estate companies. Investors may be better advised to buy their preferred real estate rather than buying shares of real estate companies.