Business Standard The Smart Investor

Bangalore - Mar 14, 2023

Page No: 2
Page Name: Smart Investor
Size: 443 sq. cm
AVE: INR 95,689

Type: Supplement
Language: English
Circulation: 6,265
Frequency: Daily

News monitored for: JM Financial

Realty market's hall of mirrors no fun house, but mood upbeat

Despite multi-year low valuations, brokerages see rise in demand and fall in inventory

RAM PRASAD SAHU
Mumbai, 13 March

Though the 2022-23 financial year (FY23) is expected to end with record sales for the Indian real estate sector, valuations are at multi-year lows on worries of rising interest rates hurting volumes. Most brokerages, however, expect listed realty majors to get support, given their comfortable leverage, steady rise in location-agnostic demand, and falling inventory levels.

According to real estate data and analytics platform PropEquity, the sector grossed sales of 149 million square feet (msf) in the top seven cities in the October-December quarter (third quarter, or Q3) of FY23 — the highest quarterly sales in the past decade.

In the nine months that ended December, sales increased 34 per cent year-on-year (YoY) to 412 msf. Strong sales, on the back of high demand and increased affordability, helped bring down the levels of inventory.

The unsold inventory levels dropped to 839 msf as of December 2022, from 923 msf in December 2021. Consequently, the years-to-sell for unsold inventory declined to a decade-low of 1.5 years, says rating agency ICRA.

Further, the average sale price rose 10 per cent in Q3FY23 on a YoY basis, driven by a partial pass-on of an increase in input costs, as well as a change in the product mix, with a higher share of luxury units. The trend of strong sales continued into the current calendar year.

In the Mumbai market, for instance, property registrations in February were up 8 per cent over January, albeit down 7 per cent on a YoY basis.

Real estate research analysts Rupesh Sankhe and Tanvi Tambat of Elara Securities say Mumbai's residential market is stable, undeterred by strong headwinds, on the strength of consumer sentiment, supported by a rise in income levels and sustained inclination towards house ownership after the pandemic.

In the face of higher home loan rates, zero sops from the state government, and a rise in capital values versus last year, demand has remained constant, they observe. This should benefit organised listed realty players, such as Macrotech Developers (formerly Lodha Developers), Oberoi Realty, Sunteck Realty, and Godrej Properties, which get a substantial portion of their sales from the residential property market.

UNDER PRESSURE

	6-month returns (%)	Price-to-earnings ratio (x) 1-year forward	5-year average	Discount (%)
NSE Nifty50	-2.4	19.4	18.9	3.0
BSE Sensex	-1.1	20.8	19.7	5.1
BSE Realty	-14.9	27.3	29.0	-5.6
NSE Nifty Realty	-15.3	26.9	28.5	-5.5
DLF	-11.8	30.9	32.5	-5.0
Macrotech Developers	-18.2	23.9	32.2	-25.9
Godrej Properties	-17.5	36.9	62.3	-40.7
Oberoi Realty	-13.8	18.1	18.8	-3.8
The Phoenix Mills	-5.6	26.5	34.9	-23.9
Prestige Estates Projects	-15.7	23.2	24.1	-3.5
Brigade Enterprises	-17.3	28.5	28.1	1.5
Mahindra Lifespace Developers	-33.5	35.1	88.1	-60.1
Sobha	-23.2	14.3	15.2	-5.6

Source: Bloomberg Compiled by BS Research Bureau

While sales have remained upbeat, stocks of real estate majors are facing the heat, given worries about the rising cost of loans and the impact on equated monthly instalments, higher interest rates, leverage for developers, and homebuyers' ability to absorb price increases by developers.

Compared to a flat performance of the benchmark indices over the past six months, the realty indices - the S&P BSE Realty and the National Stock Exchange Nifty Realty - are down 14 per cent apiece.

Given the lower stock prices, valuations have hit five-year lows. The Nifty Realty and the BSE Realty are trading at a 33 per cent discount on 2024-25 earnings estimates, weighed up against their five-year averages.

Analysts Murtuza Arsiwalla and Abhishek Khanna of Kotak Securities say that valuations for residential real estate companies are hitting a new low as regards implied enterprise value to operating profit, while the premium to net asset value has nearly disappeared.

Even as investors are worried about rising interest costs, the brokerage highlights that empirical data on residential sales points to little correlation of demand with interest rates.

Macrotech Developers, Sobha, and Prestige Estates Projects offer maximum upside on account of derating of multiples, says Kotak Securities. The other worry for the Street is the increase in leverage and pressure on cash flows attributable to the rising cost of operations and interest rates.

Experts are, however, of the view that operational metrics will continue to remain buoyant.

Says Anupama Reddy, vice-president and co-group head, corporate ratings, ICRA, "While the outflows towards new launches and land investments are likely to increase, we expect net debt/cash flow from operations to remain healthy at less than 2x in the next two years, supported by stable inflows and consequent deleveraging of the balance sheet."

JM Financial, too, is bullish about the prospects of the sector and feels the real estate cycle is here to stay. While there could be minor moderation in demand, given the strong balance sheet strength and a long runway for growth, developers offer a healthy risk/reward ratio, says Manish Agrawal, senior real estate analyst, JM Financial.

At current levels, DLF, Macrotech Developers, Phoenix Mills, and Prestige Estates are his preferred picks.