Rally in realty stocks just a catch-up game

Sector index underperformed other indices till the implementation of RERA

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Mumbai, January 10

Real estate stocks underperformed banking, housing finance companies and the benchmark index during 2011-2016. As if subdued buying sentiments due to high interest rates and property prices were not enough, demonetisation hit the sector very hard. As a result, the Nifty Realty index has given negative return of 10 per cent in the said period, while Nifty 50 climbed 77 per cent and the Bank Nifty more than doubled.

However, re-rating of the sector started in 2017 with the implementation of the Real Estate (Regulation and Development) Act (RERA) from May 1 and also due to rally in Indian equity markets in the run-up to the GST and its implementation. Effects of demonetisation also started fading last year.

Nifty Realty index has more than doubled (up 110 per cent) in 2017, while Bank Nifty and Nifty 50 ended with gains of 40 per cent and 29 per cent, respectively.

To be more specific, Nifty Realty is up 38 per cent since the implementation of RERA, while Bank Nifty and Nifty 50 have gained 12-13 per cent.

Good for long term, but ...

Given the five-year returns prior to 2017, the rally of real estate stocks is hence, just a catch-up game. Though demonetisation, GST and RERA are no doubt good for the sector in the long term, fundamentals have not improved as yet and will take time to improve because of the three reforms, according to experts.

In the first half of FY18, gross sales of 38 real estate companies increased 7.5 per cent year-on-year and adjusted net profit declined 4.8 per cent y-o-y, according to data provided by Capitaline. Between FY12 and FY17, net sales grew at 7.23 per cent CAGR, while net profit declined 6.26 per cent.

Crisil had said in October that residential real estate market is unlikely to look up soon as investors are out and end-users continue to wait post RERA. "The trend is unlikely to change for 12-18 months," it had added. Fitch had pointed out in November that unsold inventory for a sample of seven large developers rose to ₹66,800 crore at FY17 from ₹63,100 crore in FY16, which translates to an inventory turnover of around three years of annual revenue at FY17, up from two years at FY16. Thus in 2018, most developers will focus on completing their projects to comply with RERA.

Slow pace likely

Ramesh Nair, CEO & Country Head, JLL India, said in his outlook for 2018 that new launches are likely to maintain the slow pace as developers assess market sentiment in the RERA-era and prices are expected to remain stable.

Property as an asset class is also facing competition from the booming Indian equities market, thanks to the increasing financialisation trend post demonetisation on the one hand and cap on price rise due to high property rates and unsold inventory on the other.

Several real estate brokers in Mumbai told Nirmal Bang, broking firm, that as investors have exited the market (as investors demand is waning), overall market is expected to remain weak for the next three to four years; sales volume has declined 50-70 per cent and will continue to be weak and prices will fall 10-20 per cent over the next few years.

Upside risks to inflation due to higher crude prices and slippages on fiscal deficit are expected to prevent any cut in interest rates.

Single-digit topline growth

All this implies that topline growth of the sector will continue to be in single-digits or is unlikely to see any uptick in FY19. Profits will also continue to be under pressure due to high leverage.

Amid all this, the rally in real estate stocks should be seen as an opportunity to either sell or churn within the sector and go for quality players such as Sobha Developers, Godrej Properties, Oberoi Realty, DLF, Prestige Estates and Kolte Patil. Of course, for the long term.