RESEARCH

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Knight Frank

Economic outlook

Interest rates in the economy are set to rise again with the Reserve Bank of India increasing the policy rates by 25 bps in June 2011. The revised repo and reverse repo rates now stand at 7.5% and 6.5% respectively. In the last 16 months, the RBI has raised policy rates by more than 10 times. Inflation still remains a major concern for the RBI and the latest hike in diesel prices of INR 3 per litre will worsen the situation further. Since diesel is the primary fuel used by transporters in India, the hike will have a cascading impact on food prices too. The Whole Price Index (WPI) for the month of May 2011 is 9.1%, higher than 8.7% reported in April 2011. However, this is considerably lower than the double digit inflation witnessed in May 2011.

India's economic growth is expected to remain strong in the coming years backed by robust domestic demand and improving export market. However, the real estate market appears to be going through a rough patch with slowing demand and rising costs leading to a dip in profitability of the companies operating in the sector.

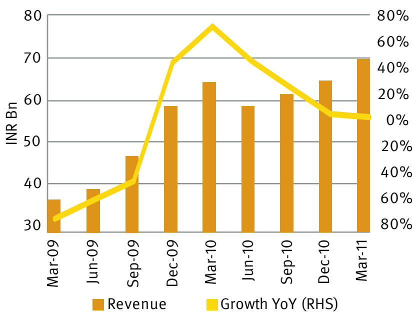
In order to analyze the performance of real estate sector we have considered the financial results of 22 listed real estate companies in India on a quarterly basis. These 22 companies can be considered as a fair representative of the overall real estate market of India since they not only cover the various sub-segments of real estate but also all the major cities of India.

Revenue of these companies has increased by 21% in 2010-11 on the back of higher prices in the residential segment and recovery in the office segment. However, on a quarterly basis the rate of growth in revenue has been reducing with every passing quarter.

Revenue growth during Q1, Q2, Q3 and Q4 of 2010-11 has been at 48%, 29%, 10% and 8% respectively. The slowdown in growth rate raises a serious concern for the investor community since revenue of other major sectors in the country like consumer durables and automobiles is still growing in double digits.

ON A QUARTERLY BASIS THE RATE OF GROWTH IN REVENUE OF REAL ESTATE COMPANIES HAS BEEN REDUCING WITH EVERY PASSING QUARTER IN 2010-11

Revenue trend of realty companies

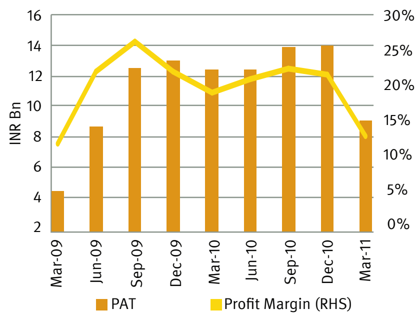


Source: BSE, Knight Frank Research

In terms of profit, the performance of realty companies during 2010-11 has been disappointing with a growth of 6% in profit after tax (PAT) against 21% growth in revenue during the same period. During Q4 2010-11, PAT growth was -27% year-on-year indicating the falling profitability of real estate companies. Dwindling profitability will not only impact the cash flow position but also affect the debt repayment capacity of real estate companies in the coming quarters.

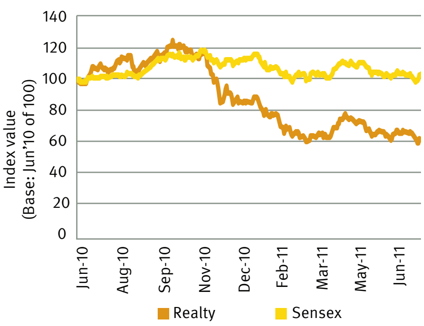
Slowdown in demand, rising input costs and increase in interest rate have started impacting margins of developers and this is evident from the latest result of the above mentioned set of companies. Profit margin for Q4 2010-11 has dropped to 13% from 22% in Q3 2010-11 and is at its lowest level in 2 years. Poor performance by realty companies is being reflected in their share price indicating the lack of interest by investor community towards the sector. The Realty Index on Bombay Stock Exchange (BSE) has dropped by more than 38% in the last one year compared to 4% increase in the Sensex. Strong cash flow position, lower inventory, reduced debt and higher margins could be some of the reasons to cheer up investors for attracting fresh funds towards the sector.

PAT trend of realty companies



Source: BSE, Knight Frank Research

Sensex vs Realty Index



Source: BSE, Knight Frank Research

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Mumbai Residential Market Summary - Q1 FY12

Market Overview

Mumbai has historically been the strongest residential market in India and has proved its resilience during the economic crisis of 2008. Since then, property prices have risen to highly unaffordable levels and are currently quoting more than 20% over their 2007 highs. These astronomical prices, increasing interest rates and liquidity pressures in the backdrop of a scam tainted industry have hurt market sentiment and caused transaction volumes to plummet. The Maharashtra State stamp and registration department data has shown a consistent decline in the number of property sales registrations over the previous year. Total property registrations have declined 20% for the six month period ending June 2011 compared to the corresponding period last year. June 2011 recorded a 30% decline in registrations compared to June, 2010. Consequently, unsold inventory levels have been steadily rising since Q1 FY11. Price levels have however proved to be more resilient but it remains to be seen how long they will sustain as the market tilts slowly and surely towards the buyers.

Supply and Demand

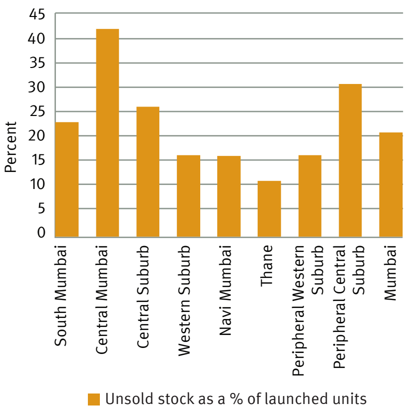
The Mumbai real estate market has stagnated over the previous three quarters with buyers largely keeping away from the market with the expectation of an imminent drop in prices in the near future. As a result, residential market transaction volumes have plummeted more than 70% since its 2007 heydays. Unsold inventory levels are currently estimated to be approximately 21% of the under construction stock. Also, The Investors' segment which makes up approximately 20% of the market demand has been observed to be actively reducing its real estate portfolio thereby adding significant shadow supply into the market.

The core of the residential market has been steadily shifting northward over the years as people are prepared to move further and further away from the CBDs to find an apartment which fits their budget. This has prompted a flurry of construction activity in the peripheral suburbs to accommodate this demographic shift. An estimated 180,000 units are currently in various stages of completion in the Mumbai market today. The bulk of supply is coming up on the northern fringes of the Mumbai market as developers tap into the largest chunk of buyers looking for apartments priced up to INR 7.5 mn. Nearly 65% of the launched units in the Mumbai market cater to this category. Approximately 61% of the launched units are concentrated in the Peripheral Central Suburbs, Thane and the Western Suburbs beyond Borivali due to the advent of mass affordable housing projects in these micro-markets. South and Central Mumbai account for 4% while Central Suburbs, Navi Mumbai and the Peripheral Western Suburbs account for 11%, 13% and 12% respectively of the launched units in the Mumbai market.

THE BULK OF SUPPLY IS COMING UP ON THE NORTHERN FRINGES OF THE MUMBAI MARKET AS DEVELOPERS TAP INTO THE LARGEST CHUNK OF BUYERS LOOKING FOR APARTMENTS PRICED UP TO INR 7.5 MN

A drop in transaction volumes has hit the Central Mumbai market the hardest as the quantum of unsold inventory makes up over 40% of the units launched in this micro-market. The peripheral central suburbs also have a comparatively high unsold inventory but we estimate that based on its absorption rate, the current unsold inventory will be absorbed in six quarters compared to Central Mumbai which will take much longer.

Unsold stock as a % launched units



Major Projects in Mumbai's Peripheral Suburbs

Project Name	Developer	Location	Number of Units	Price/ sq.ft	Possession
Rustomjee Evershine Global City	Rustomjee Developers	Virar (W)	10,000	4500*	Dec-15
Hex City	Armstrong Developers	Taloja	6,060	4,800	Jun-17
Hexworld	Armstrong Developers	Kharghar	5,877	5,500	Jun-14
India Bulls Greens	Indiabulls Developers	Panvel	3,000	3,100	Dec-14
Urbania	Rustomjee Developers	Thane (W)	1,500	6,720	Dec-16
Sanghvi Signature	Sanghvi Group	Kalyan	1,000	4,900	Aug-13
New Haven	Tata Housing	Boisar (E)	1,000	2,800	Dec-11
Eraval Tower	NL Builders	Dahisar	812	6,021	Dec-13
Mahavir Heights	Mahavir Developers	Nalasopara (W)	720	3,000	Jul-14
Ekta Parkville	Ekta Group	Virar (W)	720	3,750	Jun-14
Tropical Lagoon	Soham Group	Thane (E)	570	4,200	Jun-12
Chhaya Niwas	Usha Breco Realty	Boisar (W)	550	2,600	Sep-12
Balaji Garden	Neelsiddhi Group	Dombivali (E)	540	4,500	Mar-12
Arihant Arham	Arihant Developers	Panvel	537	3,200	Dec-12
Kalpataru Hills	Kalpataru Developers	Thane (E)	500	5,652	Jun-12

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APPROXIMATELY 61% OF THE LAUNCHED UNITS ARE CONCENTRATED IN THE PERIPHERAL CENTRAL SUBURBS, THANE AND THE WESTERN SUBURBS BEYOND BORIVALI

Prices

Prices have been moving in a narrow range in the past four quarters as developers have held on and buyers have been playing a waiting game. It has been observed that prices in premium micro-markets tend to be much more volatile compared to the peripheral suburban micro-markets. Thus prices in some South and Central Mumbai locations like Parel, Lower Parel and Mahalaxmi, have declined close to 15%over the previous three quarters while prices in Navi Mumbai, Thane and the peripheral suburbs of Central & Western Mumbai have either been stable or have trended slightly upward.

Developers have been more open to negotiation in the premium segment reducing prices by as much as 20% in favour of a sizeable up-front payment.

The premium segment has also been experiencing a significant number of cancellations as investor confidence has deteriorated due to inordinate delays or indefinite suspension of project completions as a result of non-compliance with developmental norms.

The rental levels have been stable in-spite of a spike in prices since 2007 and continue to hold steady. Corporate appetite for leased apartments does seem to have reduced with budget cuts and overall weak market sentiments, however spacious premium apartments in the western suburbs of Bandra, Khar, Andheri and central suburb of Powai continue to perform well with steady demand for large apartments priced in the range of INR 0.4 – INR 0.8 mn per month. Demand for budget properties continues to be strong as buyers renew or sign new leases waiting for prices to decline.

Outlook

The stagnant real estate prices today suggest a stalemate between buyers and sellers but market indicators strongly hint at an imminent inflection point. Tight liquidity conditions, increasing inventories, rising interest rates and construction costs should eventually tip the scales in the buyers' favour. However, developers might be able to hold their ground if the current credit crunch eases which is unlikely in the present scenario where the RBI is sending cautionary signals to the banking fraternity pertaining to their lending to the real estate sector. Rental yields are expected to to rise as residential prices correct and owners compensate by increasing rental rates.

THE STAGNANT REAL ESTATE PRICES TODAY SUGGEST A STALEMATE BETWEEN BUYERS AND SELLERS BUT MARKET INDICATORS STRONGLY HINT AT AN IMMINENT INFLECTION POINT

Location	Price (Q1 FY12) in INR./sq.ft	Price (Q1 FY11) in INR./sq.ft
Cuffe Parade	35000-62000	32500-62000
Malabar Hills	60000-65000	55000-78000
Nepeansea Road	55000-75000	46000-75000
Mahalaxmi*	20000-42000	18000-35000
Worli	25000-50000	18000-50000
Lower Parel*	22000-37000	14000-25000
Prabhadevi	20000-44000	18000-30000
Dadar	18000-30000	18000-25000
Bandra West	21000-41000	20500-35000
Andheri	9850-17000	7200-15000
Goregoan	8500-11500	6500-11500
Kandivali	8500-11500	6500-9000
Borivali	7500-13000	7000-9000
Mira Road	4200-5350	3000-4500
Virar	3000-4500	2200-3200
Naigaon East	2900-3100	2200-3000
Vasai	2900-3500	2500-3200
Chembur	9000-15000	9000-14000
Bhandup	7500-9000	5800-8500
Mulund	7500-9500	6000-8500
Thane	5500-8700	5300-8700
Dombivali	3000-4000	2400-4000
Kalyan	2900-4200	2900-3800
Ambernath	2500-3800	1750-2250
Vashi	7000-9500	6000-8000
Airoli	6500-7200	4000-5000
Kopar Khairane	6000-7500	4500-6000
Kharghar	4500-7100	3200-4000
Panvel	3000-6500	2200-3600

** Price hikes in few select projects nearing completion have caused prices to spike in these locations. These rates are not indicative of prices in the micro- market which have in-fact not increased since last year*

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