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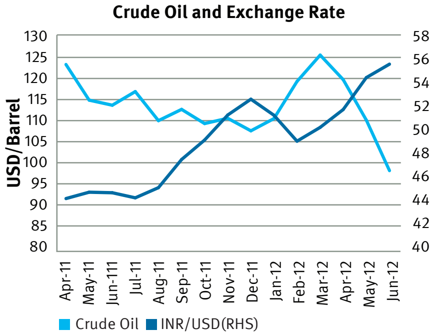
E&R @ GLANCE
ECONOMY & REALTY

Knight Frank

Outlook

Where there's smoke, there's fire! This adage finds great meaning in context to the current state of the Indian economy. The fire being mirrored is the government data for GDP growth, fiscal deficit and the latest numbers for Index of Industrial Production (IIP) and inflation. At a time when GDP growth has touched a nine year low of 6.5% for FY12, the latest IIP growth of 0.1% for April'12 also paints a sorry picture. Adding to the agony is the consistently high inflation that stands at 7.55% in the latest May'12 data and is higher than 7.23% recorded in April'12. Ironically, in the fight between taming inflation and propelling growth, we are losing out on both.

Crude Oil and Exchange Rate

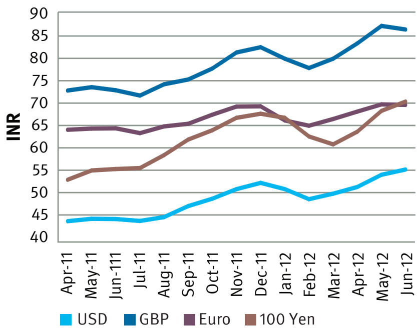


Source: RBI, US EIA

GDP AT A NINE YEAR LOW OF 6.5%, HIGH INFLATION AT 7.55%. IRONICALLY, IN THE FIGHT BETWEEN TAMING INFLATION AND PROPELLING GROWTH, WE ARE LOSING OUT ON BOTH.

The impact of inflation controlling measures coupled with policy inaction on long gestation capital intensive projects is reflecting on the economy's health. Global economic indicators continue to remain subdued. On the foreign trade front, the country's import bill which primarily represents the oil imports has swelled on account of the falling Indian currency. Although international crude oil price has declined by 20% since the beginning of the last fiscal year, the price of domestic fuel has gone up because the depreciation in Indian currency aganist USD by 25% during the same period has made import of crude oil expensive. Further, the Indian currency has depreciated against all the major international currencies since the beginning of the last fiscal year. The Indian Rupee has depreciated by 18%, 8% and 32% against the British Pound, Euro and Yen respectively. Hence, a stubbornly high inflation rate will defer a lower interest rate regime. RBI in its mid-quarter review of monetary policy in June reaffirms that cheap interest rate is a far-fetched expectation in the wake of high inflation rate.

Indian Currency Movement



Source: RBI

Although global factors have a bearing on the Indian economy, a liability transfer approach will lead us nowhere. This is because problems in the Euro Zone or slowdown in the USA or global oil prices are beyond our control. A focus on inherent domestic

ALTHOUGH GLOBAL FACTORS HAVE A BEARING ON THE INDIAN ECONOMY, A LIABILITY TRANSFER APPROACH WILL LEAD US NOWHERE.

strengths and a concerted policy approach to address the economy's problems is the need of the hour.

Financial performance of the listed companies

The impact of monetary policy's easing will be most positively felt on the cash strapped sector of real estate which has been suffering in terms of liquidity since the past few quarters. The financial performance of the real estate companies in the latest quarter is a testimony to the deteriorating condition of the sector. In order to analyze the performance in detail, we have considered the financial results of 25 listed real estate companies in India. These 25 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.

RBI IN ITS MID-QUARTER REVIEW OF MONETARY POLICY IN JUNE REAFFIRMS THAT CHEAP INTEREST RATE IS A FAR-FETCHED EXPECTATION IN THE WAKE OF HIGH INFLATION RATE.

India Research

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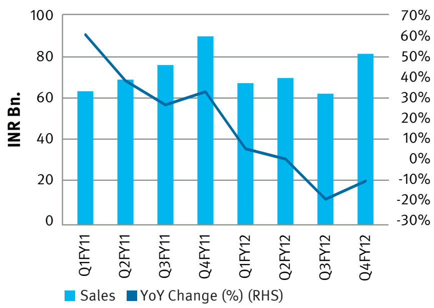
Revenue for these companies has been continuously declining every quarter on a year-on–year (Y-o-Y) basis since Q1FY12. In the last four quarters, highest growth of 6.10% was achieved in Q1FY12 when the sales stood at INR 67.40 bn. For Q4FY12 total revenue for these companies stood at INR 81.43 bn. while it declined by 9.30% Y-o-Y. The drop in revenues can primarily be attributed to the low sales off-take due to higher prices and higher mortgage rates.

REVENUES OF TOP-25 REALTY COMPANIES DECLINED 9.30% IN Q4FY12, MAINLY ON ACCOUNT OF LOW SALES OFF-TAKE DUE TO HIGHER PRICES AND HIGHER MORTGAGE RATES.

Sales

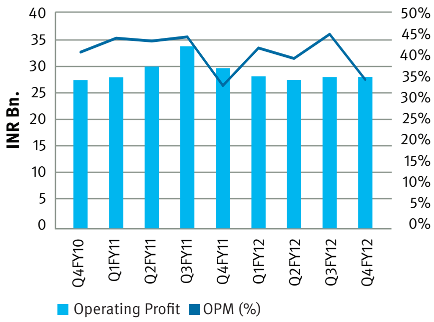


Source: CapitalLine database, Knight Frank Research

Performance of the realty companies in terms of operating profit has been quite dismal in the last four quarters. It has been consistently waning since Q1FY12. This can be explained by increased raw material cost and higher labour cost. Thereby having a cascading impact on the operating profit margin that declined from 41.8% in Q1FY12 to 34.5% in Q4FY12. Operating profit stood at INR 28.09 bn. in Q4FY12.

Rising input cost coupled with high interest rates has an adverse impact on the net profits of these companies. During the March 2012 quarter, the Y-o-Y growth in profit has been -15% despite revenues falling by 9%. Net profit margins too have plunged extensively to 13.6% during the latest quarter compared to more than 22% reported during the March 2010 quarter.

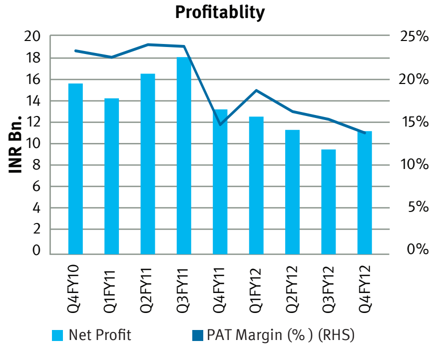
Operating Profit



Source: CapitalLine database, Knight Frank Research

DURING THE MARCH 2012 QUARTER, INTEREST COST AS A PERCENTAGE TO SALES STOOD AT 15% COMPARED TO ONLY 8% REPORTED DURING THE MARCH 2010 QUARTER.

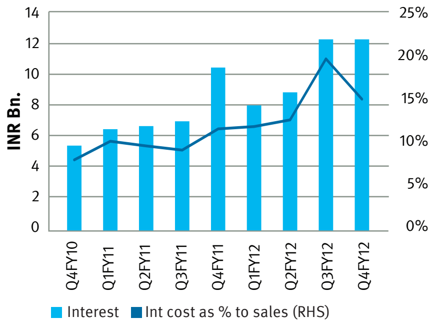
Profitablity



Source: CapitalLine database, Knight Frank Research

The central bank in order to tame inflation took a hawkish stance on growth, thereby consistently increasing the repo rate from 5.25% in Q4FY10 to 8.50% in Q4FY12. This impacted adversely the sales of the realty companies and also their interest cost. Interest cost as a percentage to sales has built up over last two years, corroborating the high borrowing cost phenomenon. During the March 2012 quarter, interest cost as a percentage to sales stood at 15% compared to only 8% reported during the March 2010 quarter. Such high borrowing cost scenario is expected to continue until there is significant improvement in the overall Indian economy. Till then developers are expected to absorb the hike in construction cost which in turn will impact their profitability.

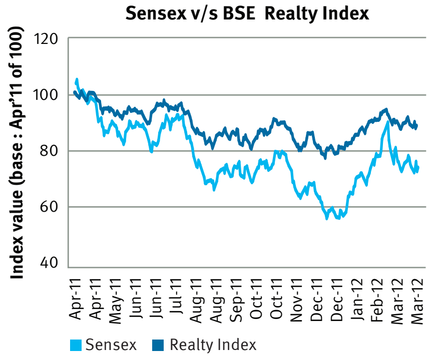
Interest cost



Source: CapitalLine database, Knight Frank Research

Poor performance by realty companies is 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 26% during the last one year compared to a 10% fall in the Sensex during the last fiscal year. In order to bring back the enthusiasm of the investor community into the sector, real estate companies will have to focus on factors such as improving cash flow position, lowering inventory, reducing debt and increasing profit margins.

Sensex v/s BSE Realty Index



Source: BSE, Knight Frank Research

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