

Real Estate Sector

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Interaction with Real Estate Industry Expert Anuj Puri - Key Takeaways

We recently held an Experts Day during which we interacted with Mr. Anuj Puri, chief executive officer of Anarock, and former managing director of consultancy firm Jones Lang LaSalle. The key takeaways are as follows: 1. The real estate industry is transforming into a regulated, consolidated market with increased efficiency. 2. Residential segment is still stressed with an upswing expected only after 18 months. 3. Residential segment expected to focus increasingly on affordable housing. 4. Ongoing consolidation in residential segment will reduce the number of brokers and developers. 5. Office market is in upswing with stable vacancy level and improved market conditions. 6. Rationalisation of retail space with Grade C malls expected to go out of business. We reiterate our Sell rating on Oberoi Realty with a target price of Rs327 (based on FY20E NAV) and also on Sobha with a target price of Rs363 (based on FY20E NAV). However, we have a Buy rating on Nesco with a target price of Rs794 (based on FY20E NAV).

Residential real estate segment in transformation phase: Mr. Puri highlighted in his presentation the sharp transformation happening in the residential real estate segment. From an unregulated, fragmented and highly inefficient segment, it is expected to transform into a regulated, consolidated and efficient market. The key aspects of the transformation are: 1. Increased market transparency with a regulator in place. 2. Industry expected to consolidate with marginal players unable to cope with regulations, raising finance and bringing in efficiency to remain competitive. 3. Demonetisation has fast tracked eradication of black money in real estate sector.

Residential realty segment to remain stressed for another 18 months: Absorption continued to show a decline in CY17 with a fall of 15% YoY in units sold. With slowing launches, total inventory has started to decline, but with weak demand and lack of investors oversupply is expected to maintain pressure on prices. In an interesting discussion, Mr. Puri highlighted that in the past six years (2QCY09- 4QCY16) the value of residential property under construction increased to 85% of total property under construction (residential+office) compared to only 49% in 2QCY09, thus creating oversupply in residential housing space. Real Estate (Regulation and Development) Act or RERA has been the biggest game changer in the residential space with focus on timely delivery and creation of an escrow account. There is a rising shift towards affordable housing even among developers who have historically focused only on premium housing (e.g. Oberoi Realty). Further, more and more developers are entering into development agreement with landowners to develop and sell the project, thus reducing the risk.

Improvement in office space dynamics: Mr. Puri highlighted that with a sharp correction in rentals and lower addition to the inventory in the past eight years, the demand-supply imbalance has largely been corrected. The current rentals are approximately 40% -50% lower than the rentals in CY09. The vacancy level has reduced from approximately 18% in CY13 to 14% in CY17. He expects stable vacancy level and rising market activity which will lead to further improvement in fundamentals of office space. Interestingly, it was pointed out that approximately 40% of the office space has been leased to US-based companies. Therefore, US President Mr. Donald Trump's policies on outsourcing will govern the leasing pattern in future. .

Rationalisation of retail space: The mall space has is witnessing rationalisation of space with approximately 4.8mn sqft having been withdrawn from 28 malls during the period CY09 to CY17. It has been observed that while in Grade A malls the vacancy level is less than 10%, the vacancy levels in Grade C malls exceeds 40%, going up to 71% in Bengaluru.

We maintain our negative view on the sector: Weak sales together with rising cost pressure may be compounded by negative news flow arising from implementation of RERA and Insolvency & Bankruptcy Code. Likely further decline in residential real estate prices together with rising costs will add to the pressure on stock valuation. We have a negative view on the sector and therefore assigned Sell rating to Oberoi Realty with a target price of Rs327 and to Sobha as well with a target price of Rs363. However, we have a Buy rating on Nesco with a target price of Rs794.

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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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