# Could A Property Correction Be Good For Developers?

Danny Sandler posted a very interesting comment on The Residential Property Conundrum last week. Having done some analysis of the numbers for **AV Jennings**, **Devine** and **Sunland**, he pointed out that while declining margins have been an issue for these property developers, profitability has also been substantially impacted by a declining ratio of sales to inventory ('inventory turn' in the jargon). You can see what he’s talking about in the graph below.

AV Jennings’ margins have declined from 30% in the boom years to 19% today. But, over the same 10-year period, the asset turnover ratio has declined from 1.96 in 2001 to 0.75. Putting it another way, they used to sell their inventory once every six months or so. Today it takes 16 months. It’s no wonder there has been a marked decline in profitability (shown as return on equity in the graph above).

The property boom in the early part of the decade was undoubtedly a tailwind for AV Jennings and other businesses like it – between 2001 and 2005 the company’s return on equity averaged in excess of 20%. In a rising market, developers get to arbitrage the difference between property prices when they bought the land and higher prices when it comes time to sell. But these high prices eventually feed through to their own cost of inventory. So, unless they keep rising, elevated property prices do not help profitability. In fact, to the extent they discourage sales, high prices are probably a hindrance.

If the property market fell 20%, it would have a substantial negative impact on AV Jennings’ existing inventory. But it might also be the catalyst new home buyers need to kick-start the moribund construction market. For AV Jennings’ long-term prospects, short-term pain could equal long-term gain.