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UK Housebuilding in 2015; and a look to the future

'The Fantastic Four'

Winter 2015/2016

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Prologue

The Fantastic Four

Year on year % change

Q1 +20
Q2 +55
Q3 +59
Q4 +40

The Fantastic Four is Marvel's original and longest running superhero team who, through a cosmic incident, develop super powers; and then use them for good.

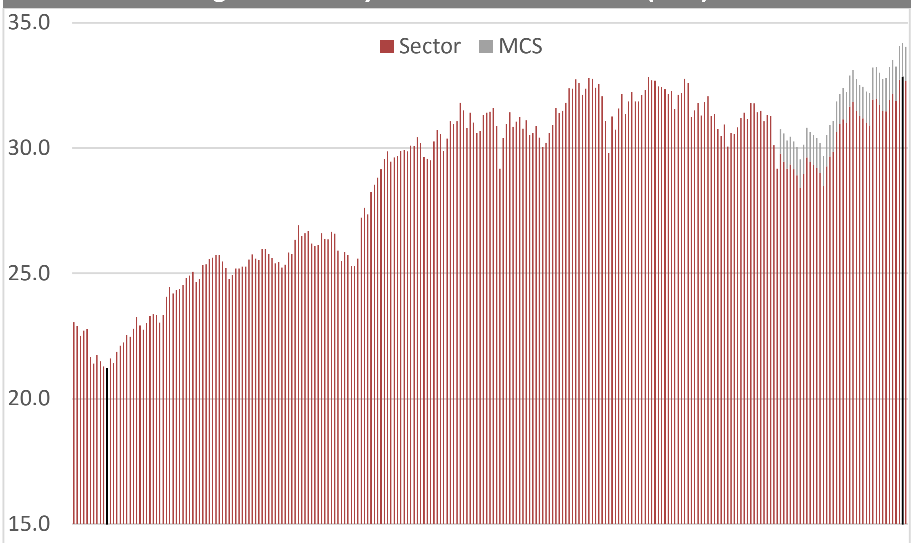
Reed Richards (Q1) is able to stretch like rubber, while Johnny Storm (Q2) can produce fire at supernova temperatures and is able to fly. Meantime, Sue Storm (Q3 and sister of Johnny) can turn invisible and create force fields, especially when angered; and, finally, Ben Grimm (Q4 or 'The Thing') becomes a large, rock-like creature with immense strength.

In 2015, the UK Housebuilding Sector embraced the legend and its own extraordinary powers - and was able to fight off the common arch enemy Dr Doom (see later).

The Fantastic Four are the eponymous stars of three movies which, to date, have grossed some $US 800 million which is more than two-and-a-quarter times production cost; and there could well be a fourth.

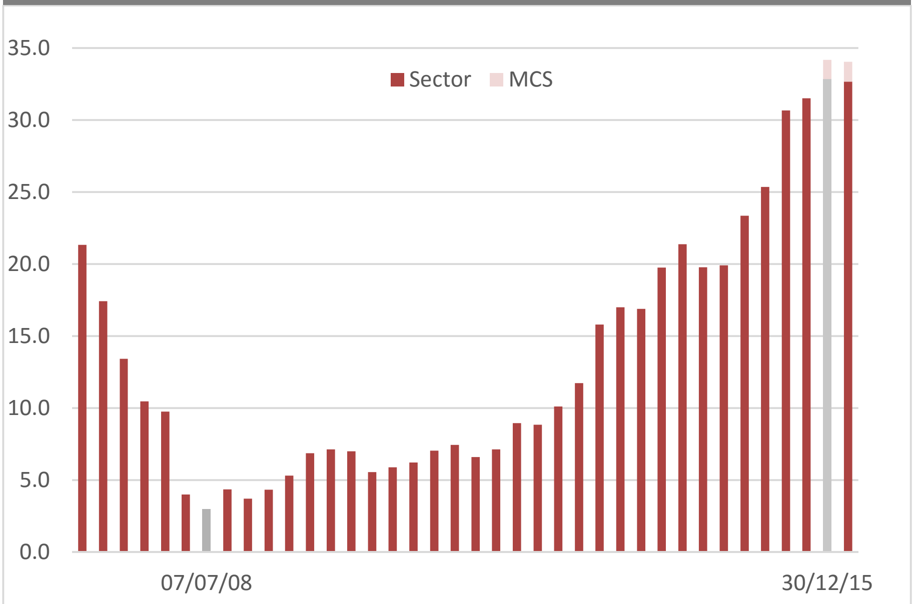
UK Housebuilders created £9.3 billion of value last year or a 40% hike. The Sector also broke new ground on 35 occasions and this included 30 December.
As The Thing often says: *"it's clobberin' time".*

UK Housebuilding Sector daily market value in 2015 (£bn)



year's low in black (13/01) with high (30/12) in black; McCarthy & Stone in grey from 05/11
Source: Hardman & Co

UK Housebuilding Sector - stock market value (£bn)*:



**Quarterly valuation from Q1 2007 to Q4 2015 (McCarthy & Stone in pink) - 7 July 2008 (most recent low); 30 December 2015 (most recent high) - Source: Hardman & Co*

All activities are controlled from the Group's HQ based on The Surrey Research Park in.

2015

On 30 December 2015, the Sector reached a new all-time box office high of £32.8 billion. The next day, however, the superhero relaxed its grip (by 0.5%) - but the gain for the year was still two-fifths.

Similarly, from trough (7 July 2008) to peak (30 December 2015), the Sector has increased in value by 1000% or in cash terms £30 billion.

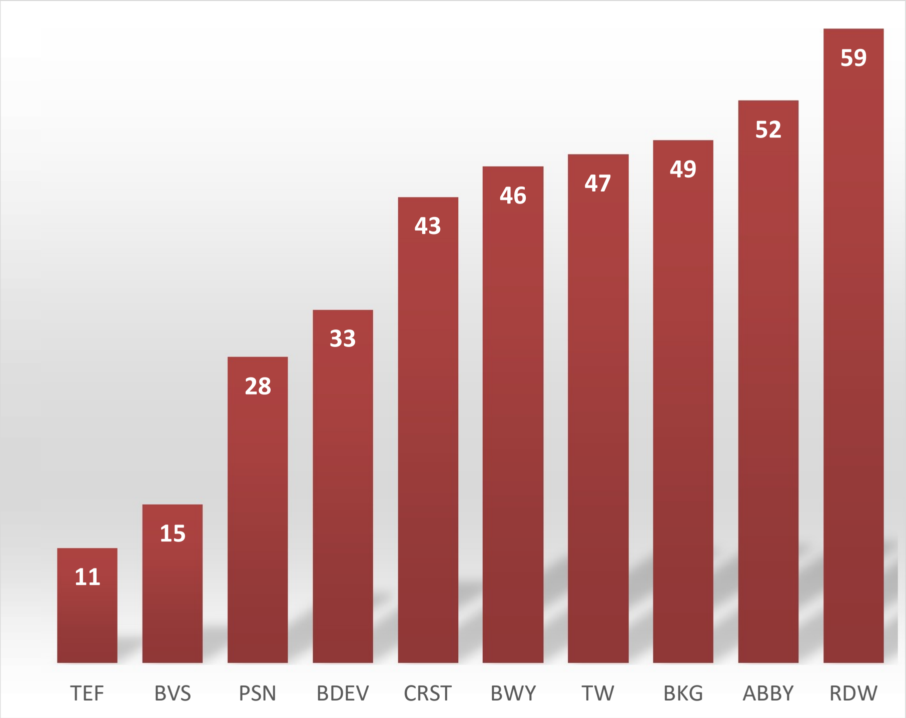
Silver surfer, McCarthy & Stone also returned to listed status on 5 November and promptly rode a 41% crest of value to £1.4 billion; and adding it in takes the Sector to just north of £34 billion.

In calendar 2015, there was a total of 253 trading days and on 54% the Sector rose versus 46% when it fell. In turn, the best daily score (+6.4%) on 8 May, the day after the General Election and the worst on Budget day 8 July (minus 5.5%) - erroneously as it turned out.

In terms of weeks, Week 31 (+6.6%) was the best, with Week 2 worst (minus 6.0%). Meantime, on month by month, May led by example (+15.5%) and there were only four (marginal) monthly negatives in January, September, October and November in a band from -0.6 to -2.7%.

The path of a superhero is not smooth; but what trading opportunities are there here?

Share prices in 2015 (annual % change)

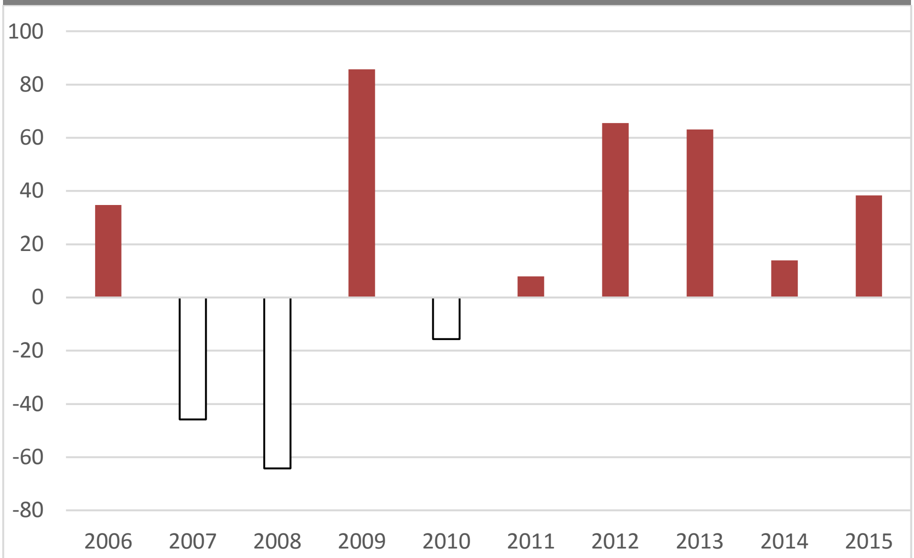


Source: Hardman & Co

Share prices in 2015

Housebuilders' share prices increased by an average 38% in 2015 on an actual basis and 40% weighted by market capitalisation (in 2014 these numbers were +13 and +19%). Redrow was Best Boy at +59% with supporting roles from Abbey (+52%) and Berkeley (+49%). Berkeley is also now The Housebuilder Four in the FTSE 100 along with Taylor Wimpey, Barratt and Persimmon. Taylor Wimpey (+47%) and Bellway (+46%) produced notable performances, whilst Bovis and Telford were least visible at +15 and +11% respectively. 2015 is also the seventh year out of the last 10 to be positive.

UK Housebuilding Sector: annually 2006 - 2015- % change in share prices (ex MCS)



Source: Hardman & Co

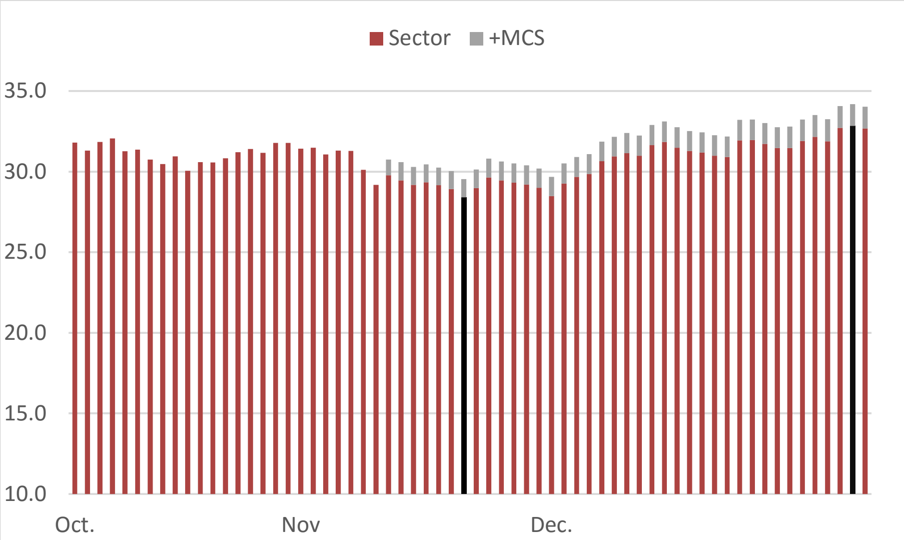
Quarter by quarter

Q4 2015's 64 trading days were split 30 up and 34 down and, overall, share prices rose 3.6% actual and 3.7% weighted in the quarter.

Bellway led by example (+14.1%) with Abbey (+13.4%) not far behind and Berkeley in double digits (+10.4%); note, too, that all three reported figures in Q4. Elsewhere, three companies took a break from saving the Planet in Q4 with Crest, Barratt and Telford off by 2.5 to 5.1%.

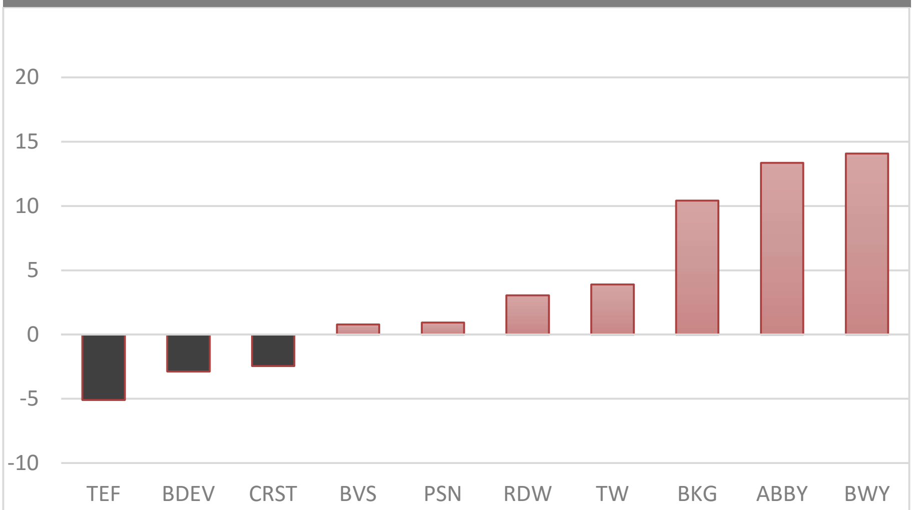
The Sector has also gained in 18 of the last 24 quarters (since Q1 2010). That said, Bellway, Persimmon and Redrow are alone in having just a single negative quarter (Q2 2014) in the last nine.

Housebuilding Sector stock market value - daily - in Q4 (£bn)



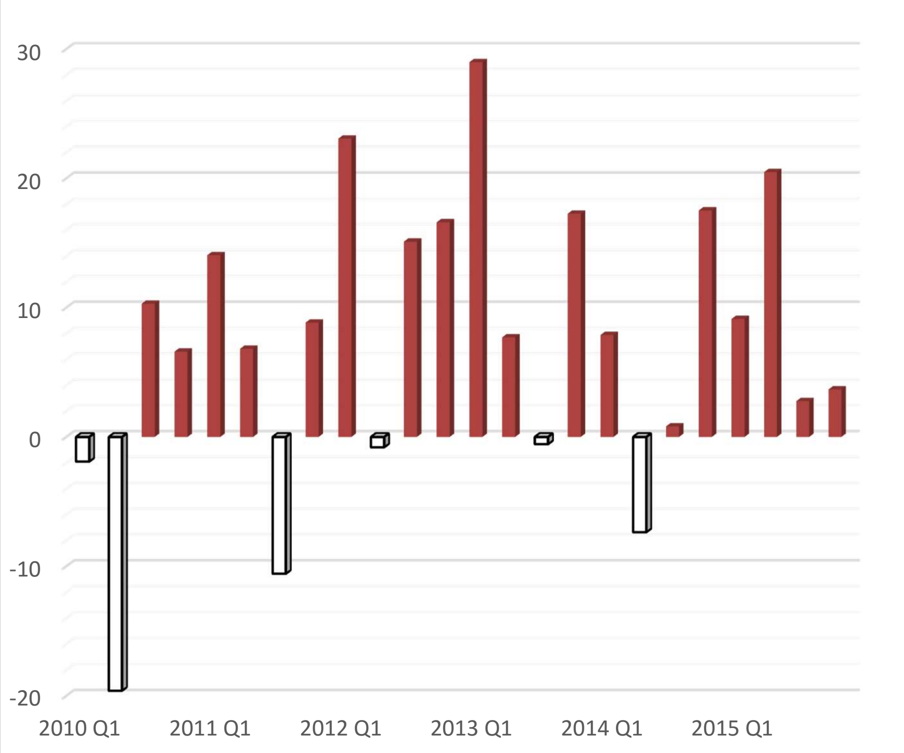
- McCarthy & Stone (grey) included from 5 November; Sector high (black) and Sector low (black) -

Share prices in Q4 versus Q3 2015 (% change) (ex MCS)



Source: Hardman & Co

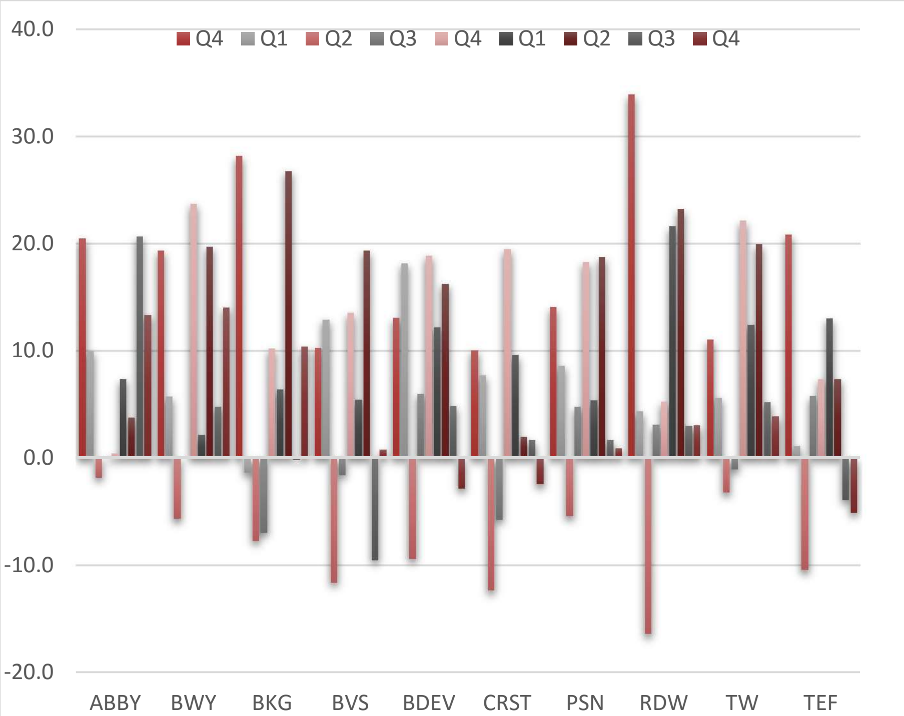
UK Housebuilding Sector: Q1 2010 - Q4 2015



Source : Hardman & Co

- weighted % change in share prices quarter by quarter (ex MCS) -

Individual share prices quarterly Q4 2013 to Q4 2015- % change (ex MCS)



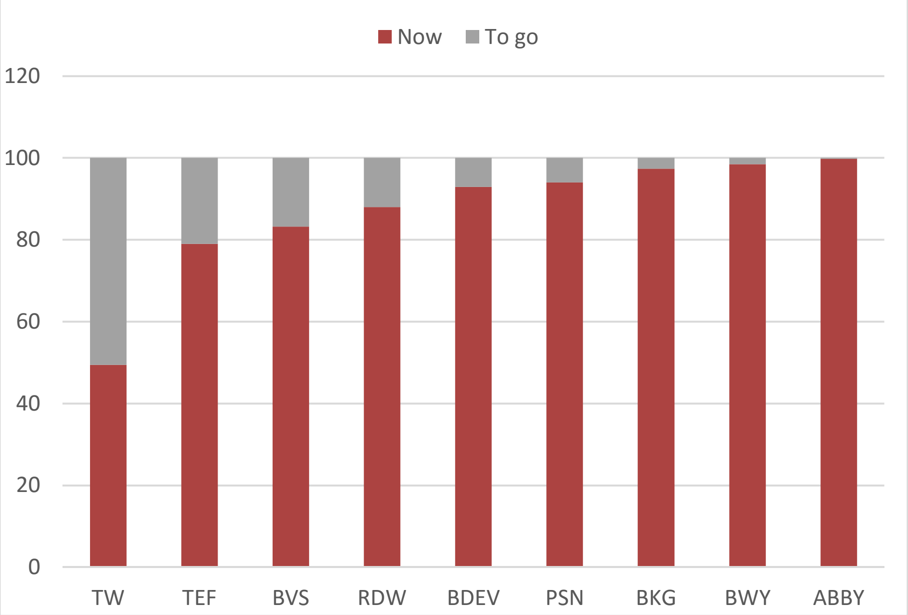
Source: Hardman & Co

Peak value, FTSE 100 and structure

Housebuilders' share prices are, on average, almost 20 times above the long term lows of 2008; and 56% up on 52 week lows (weighted these numbers are 30 and 61% respectively). But they are also some 13% below their 2007 heroic peaks (16% weighted); and 7% off 52 week highs (5% weighted).

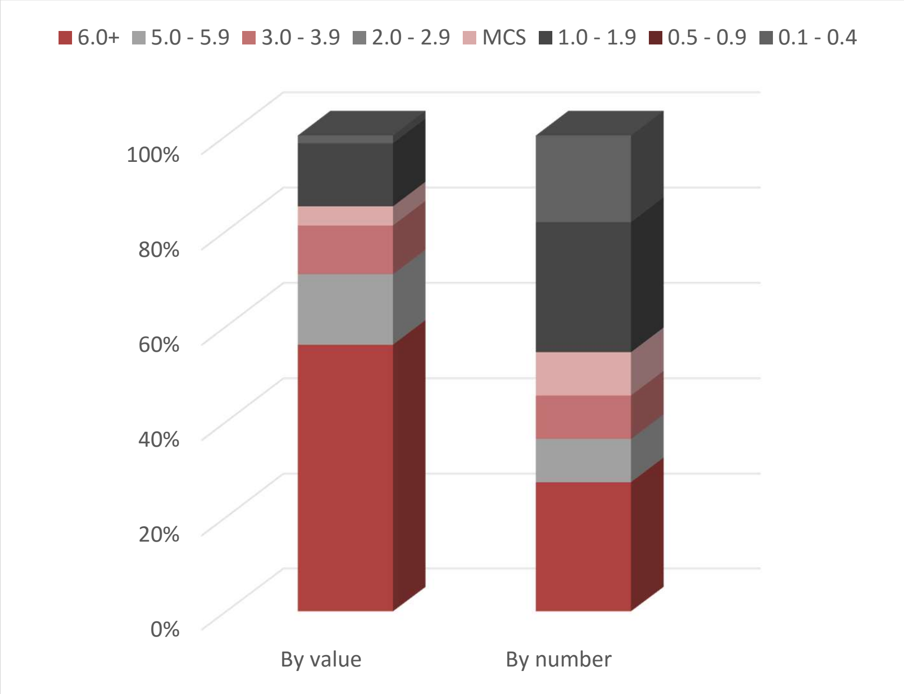
By any measure, too, Housebuilders have led all other would-be equity champions with a 40% rise in the calendar year i.e. a number of measures of the UK equity market were in negative territory in 2015. And, as noted earlier, there are four housebuilders in the FTSE 100: Berkeley (83) which was recruited in September; Persimmon (63); Barratt (61); and Taylor Wimpey (58) - all at 31 December 2015. The latter three are also all worth in excess of £6 billion each in market capitalisation and, together, account for 56% of the UK Housebuilding Sector value; for the record Berkeley was valued at £5.1 billion on 31 December.

Current share prices as % of all-time peak level at 31/12/15



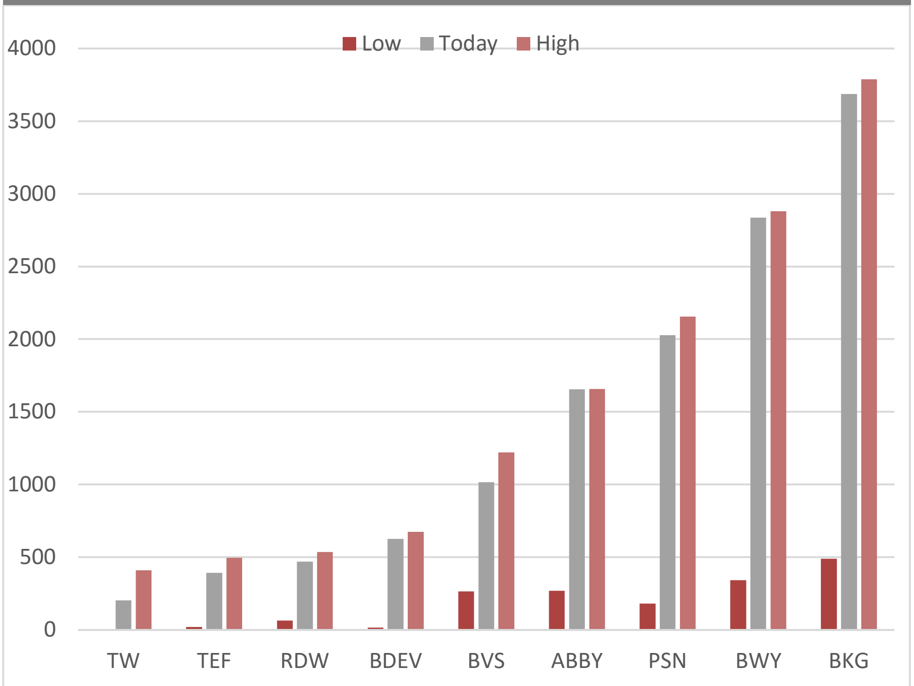
Exc Crest & MCS
Source: Hardman & Co

Sector structure by stock market value (£34 billion at 31/12/15)



Source: Hardman & Co

Peak share price, today's price (31/12/15) & lows since 2002 in pence per share*



Source: Hardman & Co

**except Abbey in Euro cents; and ex Crest and MCS*

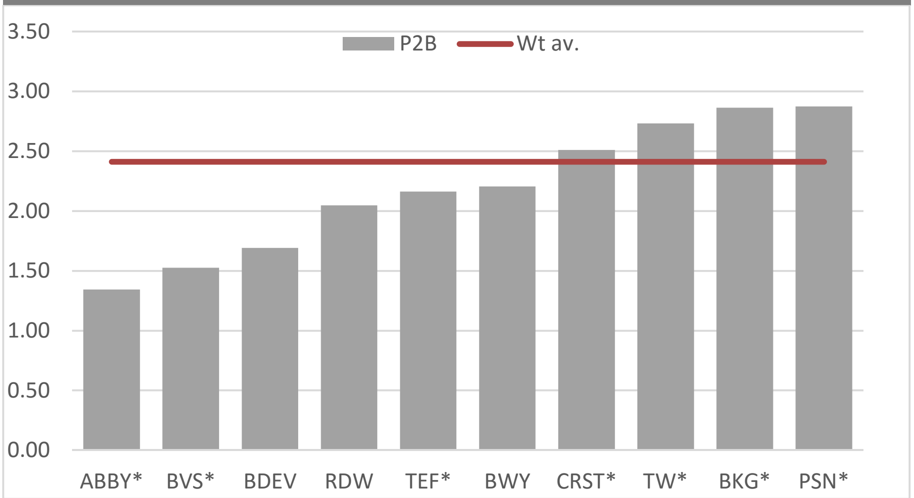
Price-to-book and Total Return

The Housebuilders' latest average Price-to-Book valuation was 2.20 at 31 December 2015 and 2.41 weighted; excluding McCarthy & Stone. A year ago they were 1.79 and 1.92 respectively.

Two out of 10 companies (Berkeley and Persimmon) are now better than 2.8 and only three are less than 2.0. In our view, too, an average price-to-book value comfortably above 2.0 is armour not an Achilles Heel.

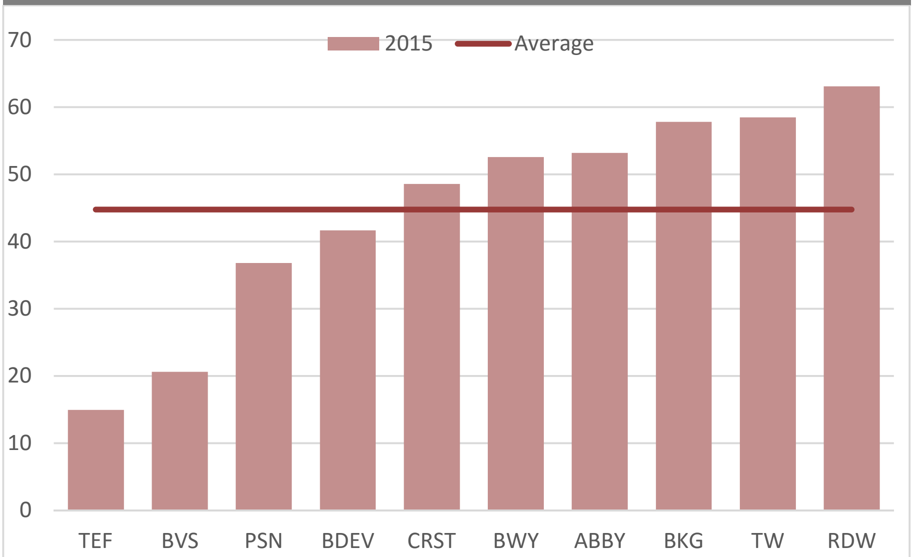
Total Shareholder Return (TSR) for the Sector was a startling average of 48.8% in 2015 with Redrow leading by example at 63.1%; at the other extreme Telford was on 14.9%. In 2014, average TSR was 15.5% and in 2013 it was 82.3%.

Price-to-book-value at year end/latest interim* & priced at 31/12/15



Source: Hardman/Bloomberg

UK Housebuilders (TSR) in 2015 (%)



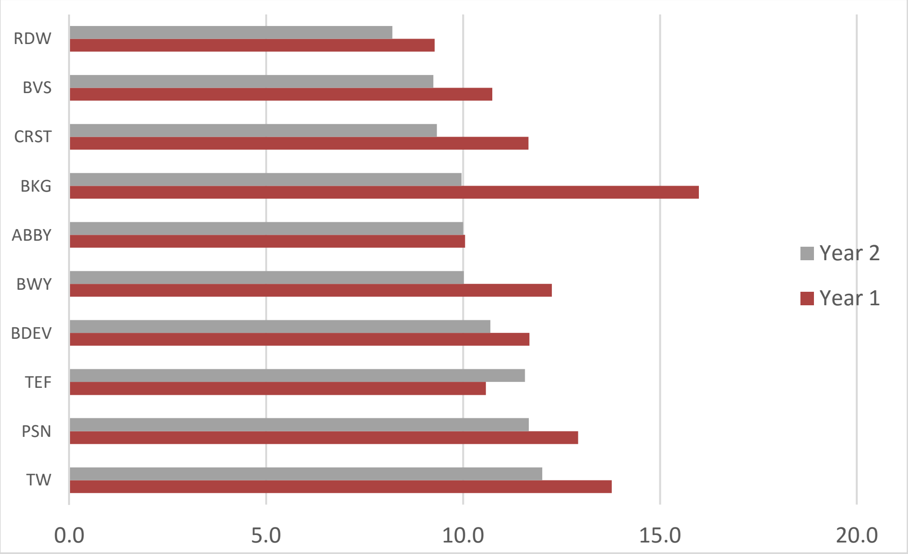
Source: Bloomberg

Valuation

Morningstar data put the Sector's historic Price Earnings Ratio (PER) at 13.9x with 11.9x prospective in Forecast Year 1 and 10.3x in Forecast Year 2; this implies annual earnings growth of 35% historic - and, respectively, 14% and 14% going forward. At the same time, historic PERs for the UK equity market range from 17.2 to 20.2x.

Dividends are gathering momentum in the Housebuilding Sector too (including specials) and the prospective average increase in Forecast Year 1 is +77% which translates to a 3.6% average yield and cover of 3.4x. At the same time, the UK equity market yields between 2.6 and 4.0% historic with cover at an average 1.6x.

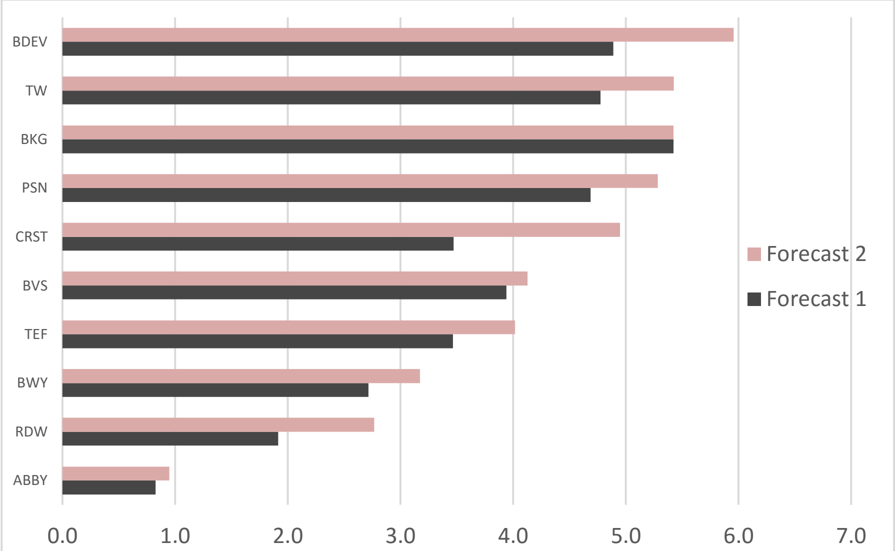
Forecast PER: year 1 (average 11.9x); and year 2 (average 10.3x)



Source: Morningstar/Digital Look

- consensus EPS sourced from Morningstar (Abbey = Digital Look); priced at 31 December 2015 -

Forecast Yield: year 1 (average 3.6%); and year 2 (average 4.2%)



Source : Morningstar/Digital Look

- consensus DPS sourced from Morningstar (Abbey = Digital Look); priced at 31 December 2015 -

Results and trading in Q4

In Q4 there were three sets interim results and one final; plus eight trading updates.

Average individual pretax profits rose 58% whilst average individual EBIT or operating margins stretched from 19.9 to 21.1% on revenue up 21% to £3.1 billion.

Earnings per share rose 45% and with them dividends were raised 27% with average individual cover a force field at 6.5x.

The average increase in orders was 6% and 5% (Bellway and Berkeley only and respectively).

Average individual ROCE (Return on Capital Employed) rose from 17.9% to a supernova 22.6% in Q4 with Capital Turn rising from an average 0.92 to 1.11x.

Table 1: Revenue Account

Date	Company	Event	Period ending	Pretax profit (£m) Old	Pretax profit (£m) New	PBT % chge	EBIT margins Old (%)	EBIT margins New (%)	Orders % chge	DPS % chge	DPS cover (x) Old	DPS cover (x) New
10-Dec	Abbey (Euro)	Half Year	31-Oct	17.0	29.7	74.6	22.8	26.2	-	20.0	12.7	10.9
10-Dec	Abbey (GBP)	Half Year	31-Oct	13.6	21.4	57.9	22.8	26.2	-	20.0	12.7	10.9
14-Oct	Bellway	Full Year	31-Jul	245.0	347.3	41.8	17.2	20.4	5.9	48.1	3.0	3.0
04-Dec	Berkeley	Half Year	31-Oct	219.8	242.3	10.2	23.3	22.1	4.6	11.1	1.4	1.4
02-Dec	Telford	Half Year	30-Sep	9.4	21.0	122.6	16.2	15.8	-	27.5	2.5	4.3
TOTAL (£m)				487.8	632.0	-	-	-	-	-	-	-
Individual average change (%) / cover (x)				-	-	58.1	-	-	5.3	26.7	6.6	6.5
Sector average change (%) / cover (x)				-	-	29.6	-	-	-	24.8	2.3	2.4
Individual average margin (%)				-	-	-	25.6	27.7	-	-	-	-
Sector average margin (%)				-	-	-	19.3	20.6	-	-	-	-

Notes:

(i) Pretax profit numbers are adjusted where necessary and are net of exceptionals

(ii) EBIT is Earnings Before Interest & Tax; DPS is dividend per share

(iii) Abbey is domiciled (hence the Euros) but is listed on both the Dublin and London stock exchanges

(iv) Berkeley's profit from sale of ground rent is excluded: H1 2014 (£99.8m); H1 2015 (£53.4m)

(v) Telford's revenue (and profit) are gross of its share JVs: £22.8m (£10.8m) and £0.8m (£0.4m) in H1 2014 & H1 2015

(vi) Telford has £700 million of forward sales which compares with fiscal 2014-15's annual revenue of £173.5m

Source: Hardman & Co

Balance Sheets

Date	Company	Event	Period ending	Net Assets (£m) Old	Net Assets (£m) New	Net (Debt)/Cash (£m) Old	Net (Debt)/Cash (£m) New	Gearing Old %	Gearing New %	ROCE^ Old %	ROCE^ New %	Capital Turn (x)
10-Dec	Abbey (Euro)*	Half Year	31-Oct	210.1	273.1	63.6	95.3	-30.3	-34.9	15.6	21.4	0.8
10-Dec	Abbey (GBP)*	Half Year	31-Oct	164.5	195.3	49.8	68.2	-30.3	-34.9	15.6	21.4	0.8
14-Oct	Bellway	Full Year	31-Jul	1,366.1	1,575.9	3.6	-38.5	-0.3	2.4	18.3	21.8	1.1
04-Dec	Berkeley	Half Year	31-Oct	1,596.5	1,760.0	148.4	263.1	-9.3	-14.9	26.2	26.0	1.2
02-Dec	Telford	Half Year	30-Sep	110.5	134.9	-39.2	-50.4	35.5	37.4	11.6	21.2	1.4
TOTAL (GBP)				3,237.6	3,666.1	162.6	242.4	-	-	-	-	-
Individual average change (%)				-	16.6	-	-	-	-	-	-	-
Sector average change (%)				-	13.2	-	-	-	-	-	-	-
Individual average ROCE (%) adjusted				-	-	-	-	-	-	17.9	22.6	1.1
Sector average ROCE (%) adjusted				-	-	-	-	-	-	18.5	20.4	1.0
Individual average gearing (%)				-	-	-	-	-1.1	-2.5	-	-	-
Sector average gearing (%)				-	-	-	-	-5.0	-6.6	-	-	-

Notes:

^ ROCE is return on capital employed; and adjusted where required for half year

** Abbey holds gilts and restricted cash of Euro 14.8 million (2014 = Euro 24.8 million) within its net cash tally*

Source: Hardman & Co

Performance and outlook

Telford (Interims - 2 December): Profit before tax more than doubled to £21.0 million (as did earnings) with operating margins steady at 15.8% against 16.2% last time; and the dividend was raised 27%.

Its focus is on non-prime locations in London where demand remains strong - and there is an *"acute shortage of new homes"* (its sweet spot is selling prices between £500 and 800 per square foot).

Telford's forward sales are also in excess of £700 million *"to be recognised from the year to 31 March 2016 onwards"*; and it remains positive on the institutional private rented sector.

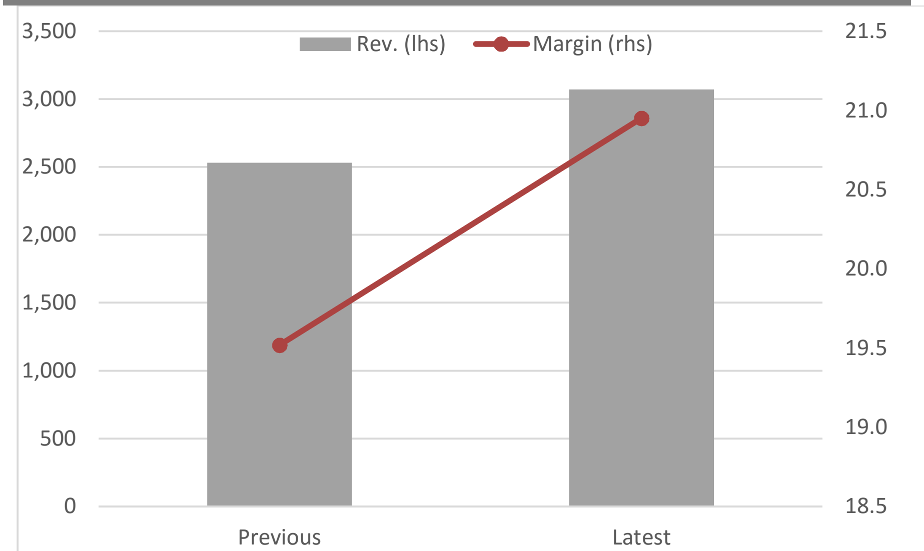
In September, the Group acquired the regeneration business of United House (for £23 million); Telford also raised £50 million gross through a share placing in November. At this time, too, the Group said it expects to target annual profit before tax exceeding £45 million from 2019 onwards and increasing towards £60 million thereafter.

CEO Jon Di-Stefano said:

"the Board is very confident in the prospects for Telford Homes over the next few years".

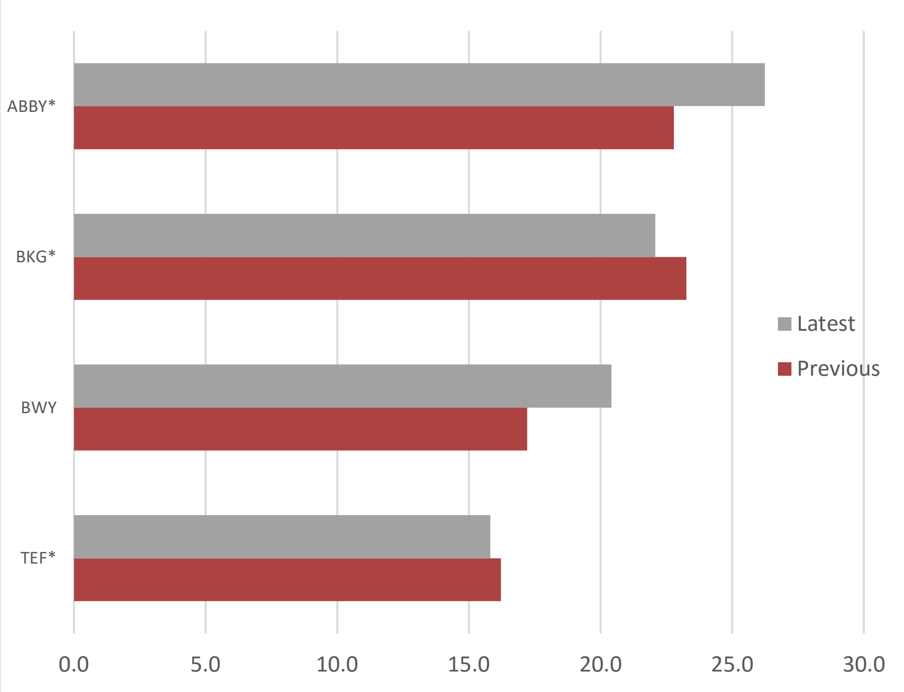
"As expected the double digit sales price inflation observed in London in 2013 and early 2014 has tempered and affordability constraints have ensured a more stable and sustainable market over the last 12 months with increases of circa four to five per cent per annum. Build cost inflation is still evident across the industry but this has also moderated to a similar rate of increase and is in line with the Board's expectations".

Sector revenue (£m) and EBIT margin (%) - reported in Q4 2015



Source: Companies

EBIT profit margins (%) reported in Q4 2015



Source: Companies
** denotes interim results*

Berkeley (Interims - 4 December) where adjusted pretax profit rose 10% to £242 million and EBIT margins were 22.1 against 23.3% last time. More exciting though was the promise to deliver pretax profits of £2.0 billion in aggregate over three years to 30 April 2018.

Similarly positive was the fact that the dividend return programme is to be enhanced by £0.5 billion, from £13.00 per share to £16.34 per share. To date £4.34 has already been paid with the remainder (£12 per share) to be delivered over next six years. All this, too, with money in the bank i.e. net cash of £263 million.

Chairman Tony Pidgley also said:

"delivering more homes of all tenures requires bold action with up to date Local Plans in place in every borough and a mechanism to bring large scale, complex sites into production more quickly. While the will is there, the process is slow and expensive and in this period of cuts, the role of the public sector needs to evolve so that it can become less risk averse and actively enable development.

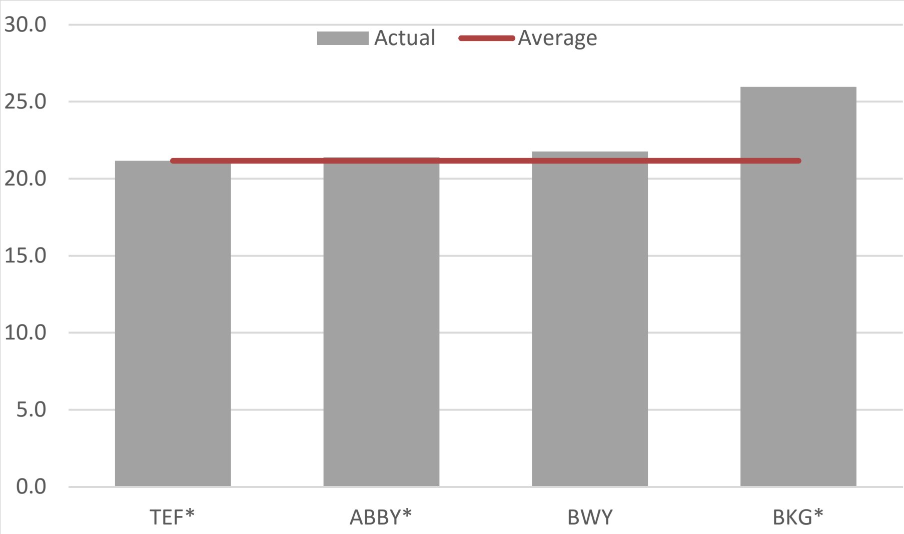
"We welcome the political support for the housebuilding sector in the Chancellor's Autumn Statement but are concerned that the continued changes to property taxation may well result in unintended consequences on the market and not lead to the level of housebuilding required to meet the underlying demand".

Finally, MD Rob Perrins added:

"Berkeley understands the complexity of delivering new homes in London and the South of England and the financial flexibility needed to operate in this market is embedded in Berkeley's strategy.

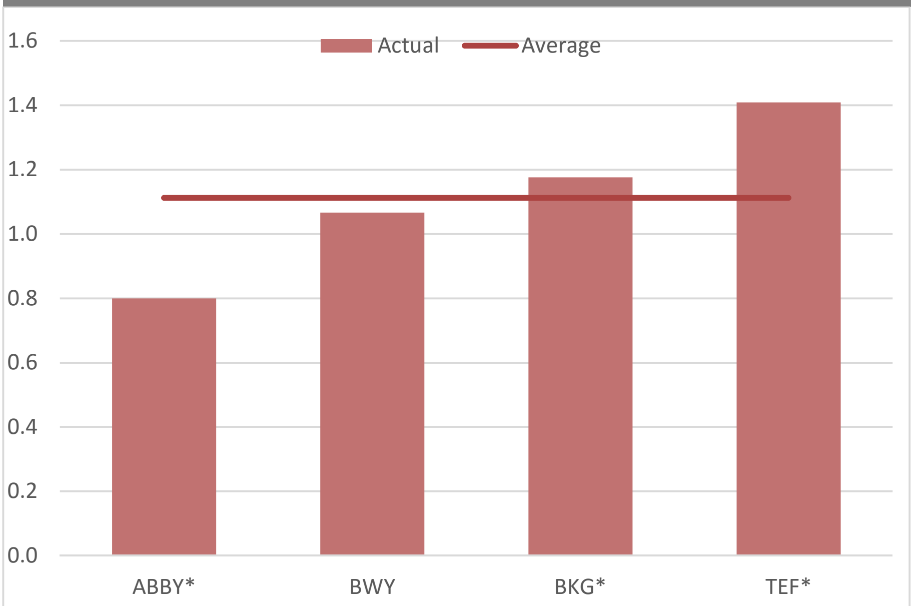
"We are mindful of the cyclical nature of the market with global political and financial uncertainty ever present. Continued GDP growth underpins the World economy but this remains patchy, especially as a result of the slowdown in emerging and European economies. London remains a destination of choice which it must cherish".

Latest reported ROCE (%) in Q4



*(ROCE is return on capital employed; *denotes interims results (annualised data)*
Source: Hardman & Co

Latest reported Capital Turn (x)



*Capital Turn = revenue divided by capital employed; *denotes interim results (annualised data)*

Abbey (Interims - 10 December): pretax profit rose by a staggering 75% to almost Euro 30 million and with it operating margins widened from 22.8 to 26.2% (with ROCE at 21.4%). At the same time, UK unit volumes increased 11% to 294 (in addition there were 15-a-piece in Ireland and the Czech Republic).

"Favourable weather conditions have helped production to keep pace with sales although as ever the final quarter will be critical to the year's results. Skill shortages in all aspects of our business continue to impact our activities.

"The immediate outlook is good. Sales across our business are firm. In the medium term the strong trading conditions being experienced in Southern England will dissipate and we should expect tougher conditions ahead. Meanwhile, the Group is in good heart".

Bellway (AGM - 11 December) where it was said that the Group had made "an excellent start to the current financial year, supported by the strong market conditions". In terms of the reservation rate, too, it had increased by 12% to 165 homes per week in the 18 week period 1 August through 6 December 2015; and, at the same time, prices rose 5.8%.

Housing completions for the full year to 31 July 2016 are expected to increase by around 10% to in excess of 8,500 with an average selling price up by "around 10%" (influenced by London apartment completions). Meantime, the operating margin is expected to rise to at least 21% in the current financial year (up from 20.4% pre-exceptional items).

Persimmon (Trading Update - 7 January 2016) was the first to fly on the New Year and spoke of "another year of strong growth" in 2015 with legal completions up 8% to 14,572 (including a 13% gain in H2) - and prices +4.5% to £199,100.

The value of its forward sales at 31 December 2015 was also ahead 13% at some £1.1 billion (2015's revenue was £2.9 billion); and the Group expects H2 2016 operating margins to rise.

During 2015, Persimmon opened over 250 new sites and acquired some 20,500 plots over 123 sites. It also commented that

"the consistent application of the requirements of the National Planning Policy Framework is supporting improvements in land release for development and the additional initiatives recently announced in the Autumn Statement should help further".

Macro Economics

GDP in Q3 rose 2.1% in volume terms (revised down from 2.3%) on an annualised basis and by 0.4% quarter on quarter which was also revised down (from 0.5%). Meantime, the Consumer Price Index (CPI) in November was +0.1% year-on-year which compares with October's minus 0.1%. This was led by transport, alcohol and tobacco but leavened by clothing.

Unemployment is at a breath-taking 5.2% (in the three months to end October 2015); a year ago it was 6.0%. And, finally, Retail Sales in November, by volume, increased 5.0% year-on-year which was the 23th consecutive month of growth. Average store prices (including petrol stations), however, fell 3.3% in November versus the same month in 2014.

Mortgages

Mortgage approvals in November (44,960) were 20% up on a year ago albeit 1% down on October says the British Bankers Association (BBA) which excludes building societies (i.e. almost a third of mortgages) from its data. At the same time, the Council for Mortgage Lenders (CML) said that gross mortgage lending rose 23% year-on-year in November to reach £19.9 billion, albeit this was 9% lower than October; it also spoke of *"affordability pressures and new supply challenges"*.

And, finally, Bank of England data show that net new mortgage approvals inched up (less than 1%) in November to 70,410 (versus October) although this was just shy of the 19 month high (70,864) in August.

Volumes and prices

The value of Private Housing Output in the UK grew by 24% in 2014 and Experian (where I am an advisor) is forecasting real growth of 6% for last year to be followed by 5% and 3% in 2016 and 2017 respectively. Public Sector Housing Output also had a very good year in 2014 (+30%). However, this looks like it went into reverse in 2015 (i.e. a forecast of minus 8%) to be followed by minus 10% in 2016 before some respite in 2017 with +3%.

Turning to prices, Nationwide recorded a 0.8% rise in December with the quarterly (+3.0%) and annualised (+4.5%) rates even better. It is, however, cautious about London but is still forecasting 3 to 6% national growth in UK house prices in 2016.

Rightmove noted its lowest December dip (-1.1%) since 2006. This also meant that 2015's gain in new-seller-asking-prices was 7.4%; and it is forecasting +6% this year on the same basis.

Next up is the Halifax which said there was a 1.7% gain in December and, annualised, the rate was +9.5%. However, it also spoke of a possible slight softening of prices.

Finally, Hometrack noted a 7.5% annualised rise in house prices in November across the UK and this rose to +10.1% based on its 20 city composite index (and, on this latter basis, it expects a further 7.0% gain in for 2016). It also pointed out, however, that transaction volumes in 2015 look to have fallen 5% last year. Not good.

One, Two, Three, Four

Elasticity, the ability to produce heat, create force fields and summon gargantuan strength come naturally to The Fantastic Four. The full skill set is needed, too, in their war against evil as personified by Doctor Victor Von Doom (aka Doctor Doom) a genius inventor, sorcerer - and rogue fund manager.

Indeed, he is the one who, each year, shouts loud and long that the Housebuilders have had their day in the sun (the Sector has risen in five of the last five years). The Doctor also points to an average price-to-book value comfortably over 2.0 times (with two stocks nudging 3.0); but, as we noted earlier, *"this is armour not an Achilles Heel".*

A year ago, too, the prospective PER Year 1 was 10.9x whereas today it is only marginally higher at 11.9x. This followed historic average earnings growth of 35% in the Sector in its last complete (and adjusted) fiscal year. Similarly, in the current one, earnings growth is forecast to be 14% (Year 1 prospective) as it is in the following one (Year 2 prospective) i.e. +14% encore. And, you can own this on a PER of 11.9 falling to 10.3x - and there is a bit of yield creeping in with an average 3.6 rising to 4.2% based on consensus forecasts. At the same time (also as noted earlier), historic PERs for the UK equity market range from 17.2 to 20.2x, whilst the historic yield is in a band from 2.6 to 4.0%.

No, it is not without risk. For example the Nationwide says that while economic conditions are benign:

"the main concern is that construction activity will lag behind strengthening demand, putting upward pressure on house prices and eventually reducing affordability".

Similarly, Rightmove says:

"increasingly stretched affordability and extra stamp duty on buy-to-let sector will be outweighed by a stark imbalance between supply and demand".

Rightmove also predicts a potential demand and price boost from worker migration out of London to more affordable cities; and suggests that first time buyers may want to wait for a better deal until additional stamp duty on buy-to-let properties gives them an extra edge.

2016 has not started well in terms of the geo-political firmament with the latest spat between Saudi Arabia and Iran expected to have a long tail; and self-styled superhero, Vladimir Putin, has offered to mediate……

Chinese collywobbles continue and the mass exodus of asylum seekers and rapidly closing borders in Europe is another issue, human and socio-economic, hand in hand with a looming Brexit plebiscite. Then, there is the *"dangerous cocktail"* of global threats mixed by our favourite bartender George Osbourne.

This means that an already inexpensive Housebuilding Sector is getting more so - like all equities (5% or so at the time of writing); and even a superhero would be wise to cool his jets, momentarily, before embarking on a new mission.

But life will return to normal - and humans have shown a remarkable ability to survive; when they do, too, food, clothing and shelter is required. Be value vigilant. There will be opportunities to buy and trade in the housebuilders in Q1.

"Truly, there is a spark of divinity in all who live, and think....and strive" - The Silver Surfer

Glossary

Abbey (ABBY)

Barratt Developments (BDEV)

Bellway (BWY)

Berkeley Group Holdings (BKG)

Bovis Homes Group (BVS)

Crest Nicholson Holdings (CRST)

Redrow (RDW)

McCarthy & Stone (MCS)

Persimmon (PSN)

Taylor Wimpey (TW)

Telford Homes (TEF)

- Share prices at 31 December 2015
- Adjustments have been made to comparative changes where required
- Selected stocks are excluded from charts and Sector averages due to extreme movements or for structural reasons

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