UK Housebuilding Sector in 3Q 2018...

...trains, cows and beyond

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The wit of Mauricio Pochettino

Source: Creative Commons

"It's like the cow that every single day during 10 years sees the train crossing in front of it at the same time. And if you ask the cow what time is the train going to come, it's not going to have the right answer. In football it's the same".

Such was the Delphic comment from Tottenham Hotspur's Argentinian Manager in September coming off back-to-back losses in the Premier League.

By way of elucidation, too, Pochettino added: "experience on its own is not going to help you in the future".

Isn't it the same in the beautiful game of Housebuilding in the 2018-19 season?

The majority of us on the field or in the stands are weathered; and we played through the Global Financial Crisis. Perspicacity to spare, if you will (and substitutes). But, like the bovine and the rail timetable, it might not be enough.

Take 3Q and the stock market value of housebuilders where, on 64 match days, the Sector rose on 35 but fell on 29. Similarly, from a tally of 13 weeks in the third quarter, four were up and nine down.

"Experience on its own is not going to help you"

And, month-by-month, it was as follows: July (minus 0.9%); August (minus 0.8%); and September (+0.9%). In a single day, too, the movement can be 2% or 3% up or down.

Equally, old fashioned English centre-forwards Tony Pidgley and Stevie Morgan want a result, not extra time.

Tony: "in essence, this is a market that lacks urgency and London remains constrained by high transaction costs, restrictive income multiple limits on mortgage borrowing and prevailing economic uncertainty, accentuated by Brexit".

Stevie: "there is no doubt that clarity over Brexit and the future of Help to Buy would improve market sentiment. Given that clarity, we will continue to deliver".

Similarly, cultivated centre-half Charlie Gallagher at Abbey speaking post-match said: "the level of uncertainty with which we have to cope, continues to rise. By this time next year, the UK will likely be outside of the EU and facing a higher risk premium on all UK investments. A disruptive Brexit will also impact unfavourably on the remaining 27".

3Q aside, the stock market value of the UK Housebuilding Sector is sliding from top left to bottom right and, in 2018 to date, the Team has lost 15% in pound notes, in the transfer market, and 10% in average share prices. Similarly, only two players (Springfield and Abbey) are higher in 2018 so far.

A long season is in prospect.

Value in the second quarter

In the 13 weeks of 3Q, only four saw a rise in value with nine lower...

In the third quarter of 2018, the stock market value of the UK Housebuilding Sector dipped 0.9% to £37.8bn (which compares with +10.8% in 3Q 2017).

It was also 15% or £7.4bn off its high, which was recorded in Q4 of last year on 24 October 2017 (£44.3bn); albeit still 7% above its pre-Brexit level. Nor were there any new peak values in the third quarter of the 2018 game.

In total, too, there were 64 trading days in 3Q and the Sector scored higher values on 35 of them and fell on 29.

Weekly, though, from a tally of 13 weeks in the quarter, only four were up and nine down; and month-by-month it was as follows: July (minus 0.9%); August (minus 0.8%); and September (+0.9%).

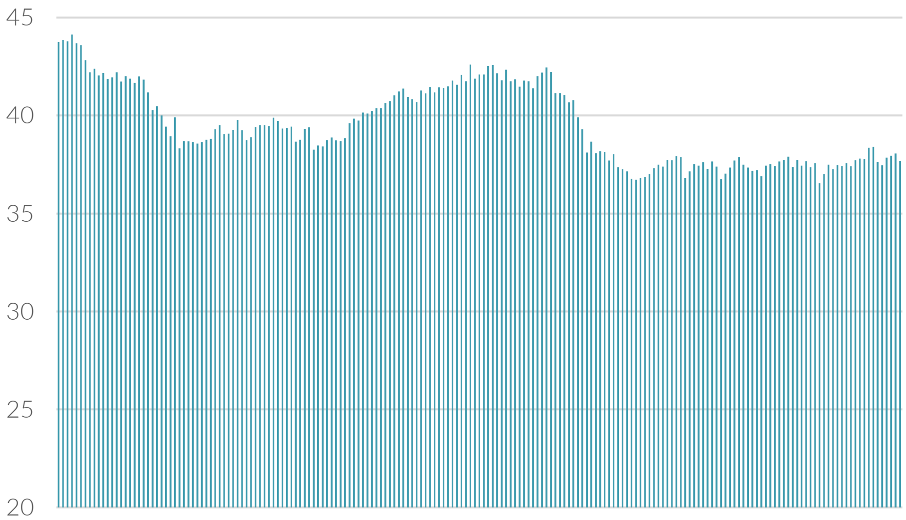
Best week was Week 28 (+2.1%) while the worst was Week 27 (minus 3.4%).

The best match of the day was 19 September (+1.5%) and the worst 23 July (minus 2.8%).

Since the Sector's performance trough (7 July 2008), too, the rise has been 1,090% or £34.2bn; and the Brexit vote in June 2016 – when Housebuilders lost 40% of their value in two days – remains a blip.

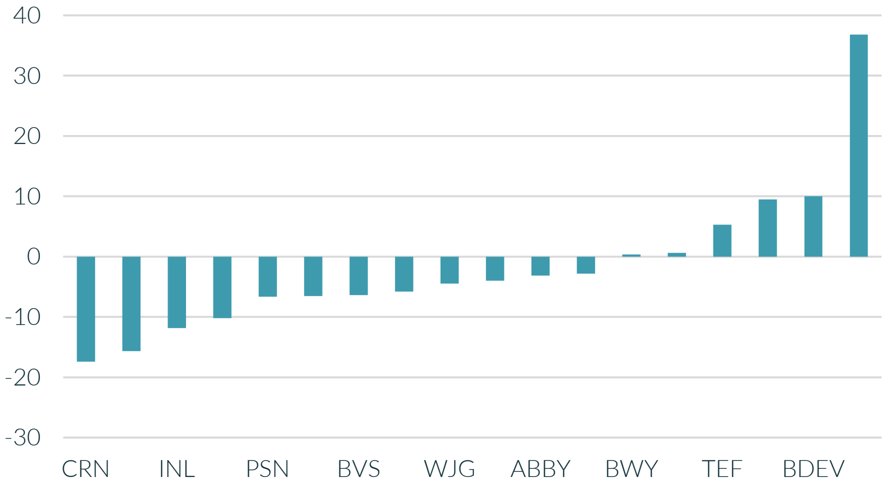
And yet, the Sector still trades on a single-digit PER against the premiership FTSE Indices running at 12.5x to 15.7x on a trailing 12-month basis. There is a lack of trust amongst the fans.

UK Housebuilding Sector market value – daily – in 2018 to date (£bn)



Note: 2018 high YTD on 5 Jan; and 2018 low on 4 Sep
Source: Hardman & Co Research

Share prices in 3Q 2018 vs. 2Q 2018 (% change)



Source: Hardman & Co Research

Share prices in the third quarter

Share prices dipped 1.8% in 3Q 2018…

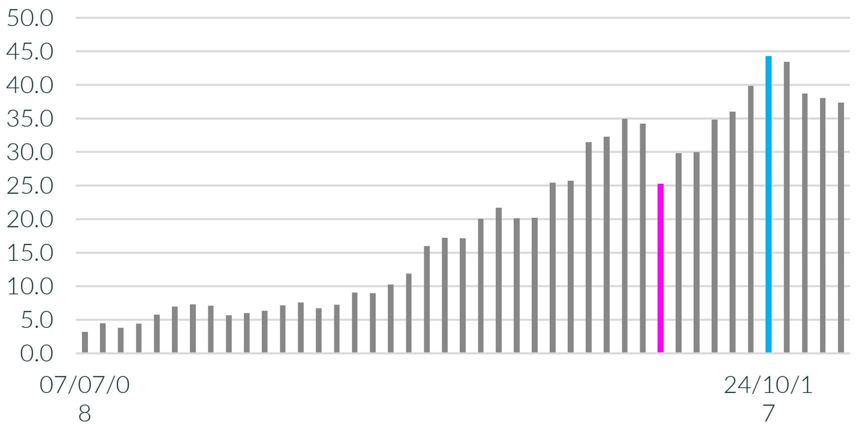
Turning to Housebuilders' actual share prices (as opposed to pounds notes), the average 3Q movement was minus 1.8% on an actual basis and minus 0.9% weighted by market capitalisation (in 3Q 2017 these scores were +7.6% and +11.0%, respectively).

From 18 Sector companies (including Glenveagh for the first time), six rose and 12 fell in 3Q with the best player, by a wide margin, McCarthy & Stone (+37%) – and we have dubbed it 'Renaissance Man'.

Meantime, the worst performer was Cairn Homes with minus 25% with eight others off in double-digit percentages.

More positively, the men of the match, Redrow and Bellway, increased by ca.10%.

UK Housebuilding Sector: market value (£bn): 3Q 2008 to 3Q 2018



Note: low (red) was on 7 July 2008 and high (blue) was on 24 October 2017; post-Brexit is pink
Source: Hardman & Co Research

Share prices year-on-year and year-to-date

Only two positives in 3Q 2018...

In 2018 to date, Housebuilders share prices have fallen 10.2% actual and 13.5% weighted; and only two are positive i.e. Springfield and Abbey.

Comparing end-September this year with end-September in 2017, Housebuilders' share prices are 4.5% lower actual and 7.2% weighted – albeit this performance was dragged down by Crest Nicholson's minus 37%.

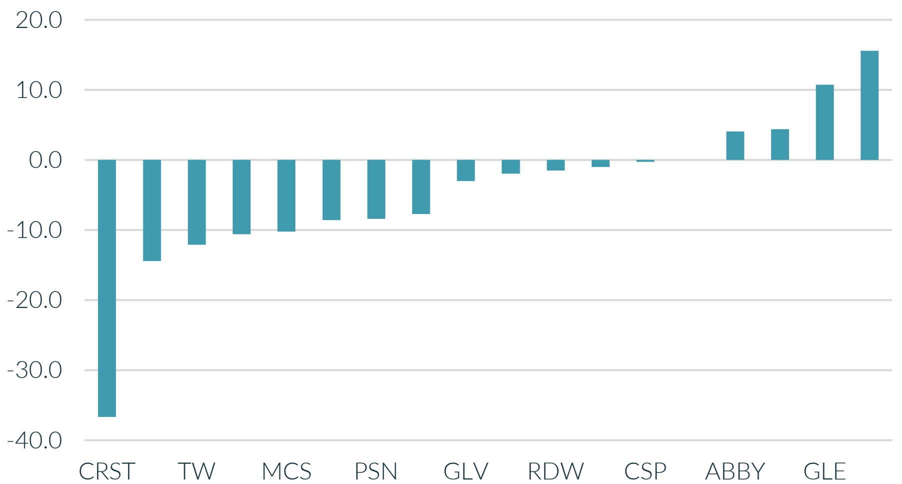
More broadly, and looking at the past 35 quarters (or eight and three-quarter games) since 1Q 2010, the Sector has seen share prices rise in 24 of them – and fall in 11.

In 3Q 2018, the Housebuilding Sector was the best in an awful team playing in equity market competition. On a weighted basis, the Sector saw share prices fall 0.9% while the defenders of the UK equity market lost ca.2% and the wider construction and real estate sectors shed ca.6%.

In the year-to-date, however, the Housebuilders (at minus 13.5% weighted) were the worst by a margin.

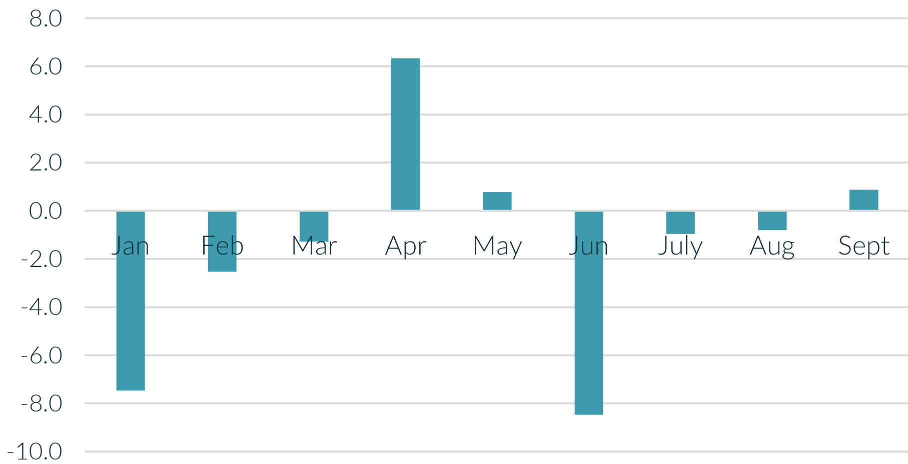
Year-on-year, too, it is similar with only Construction (minus almost 10%) worse than the Housebuilders at minus 7.2%.

Housebuilding Sector: Sep 2018 vs. Sep 2017 (% changes in prices)



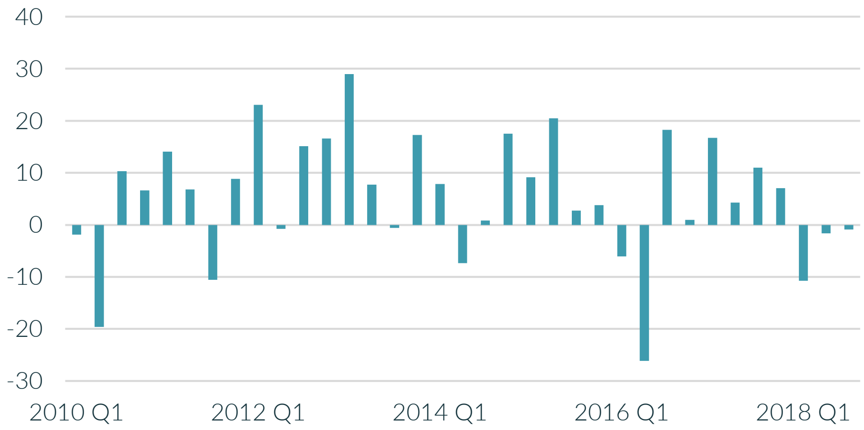
Source: Hardman & Co Research

UK Housebuilding Sector: monthly in 2018 to Sep (% change in value)



Source: Hardman & Co Research

UK Housebuilding Sector share prices: 1Q 2010 to 3Q 2018 (% change)



Note: weighted % change in share prices quarter by quarter
Source: Hardman & Co Research

Peaks and values

Four players account for 63% of Sector value...

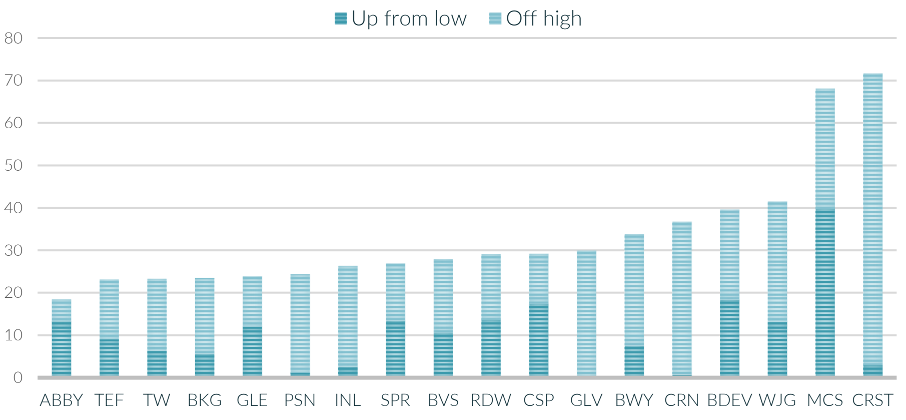
At 28 September 2018, Housebuilders' share prices were on average 1,770% above the lows of 2008; and 10% up on more recent 52-week lows (weighted these numbers are 2,418 times and 9%, respectively).

But, the Housebuilders was also some 18% below their 2007 seasonal peaks (i.e. 25% weighted); and 18% off 52-week highs both actual and weighted.

Four housebuilders also continue in the FTSE 100: Berkeley (number 95); Taylor Wimpey (87); Barratt (85); and Persimmon (61).

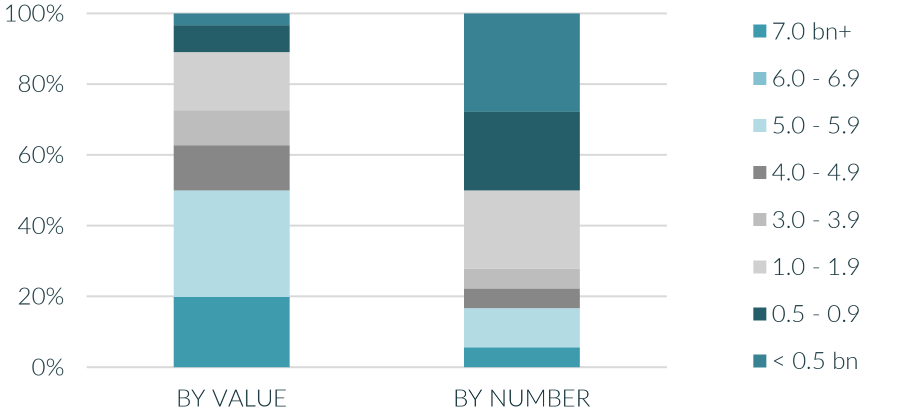
Together, these four players account for 63% of Sector value.

Movement against 52-week lows and highs (% change)



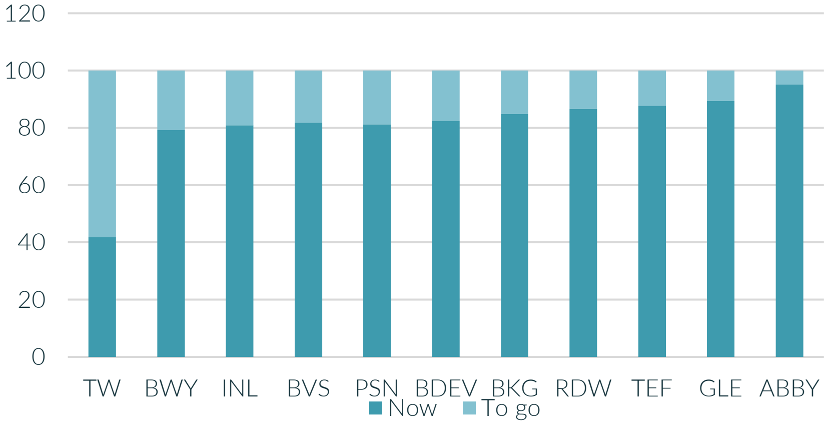
Source: Hardman & Co Research

Sector structure by stock market value: 18 firms worth £37.4bn at 28/09/18



Note: Legend is in £bn
Source: Hardman & Co Research

Current share price as % of all-time peak level at 28/09/18 (dark grey shading)



Note: except Abbey in Euro cents; and ex-Crest and all newcomers
Source: Hardman & Co Research

Price-to-Book and Total Return

Total Shareholder Return over 12 months was negative...

The Housebuilders' latest average Price-to-Book valuation was 1.70 on 28 September 2018 and 1.91 weighted.

A year ago, these ratios were 2.06 and 2.26, respectively.

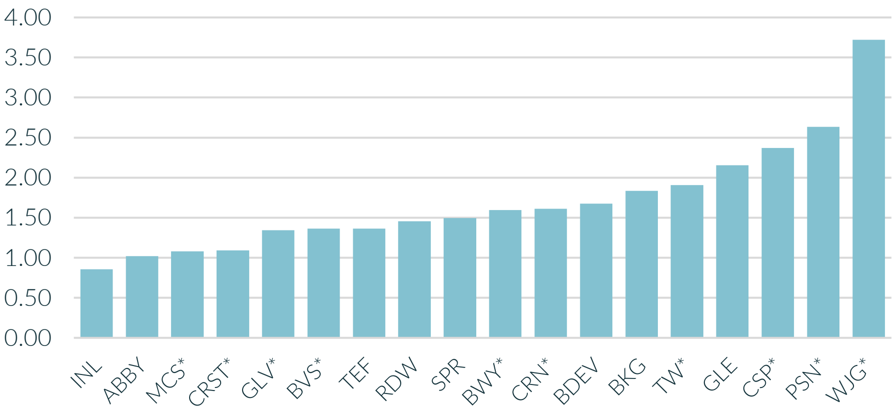
Four out of 18 companies are at 2.0 or better with Watkin Jones at an extraordinary 3.7 and on its own up front.

Total Shareholder Return (TSR) for the Sector in the 12 months to 28 September 2018 was a negative 1.3 and 2.1% weighted.

This compares with positives of 1.9 and 2.2%, respectively, in the 12 months to 28 September 2017.

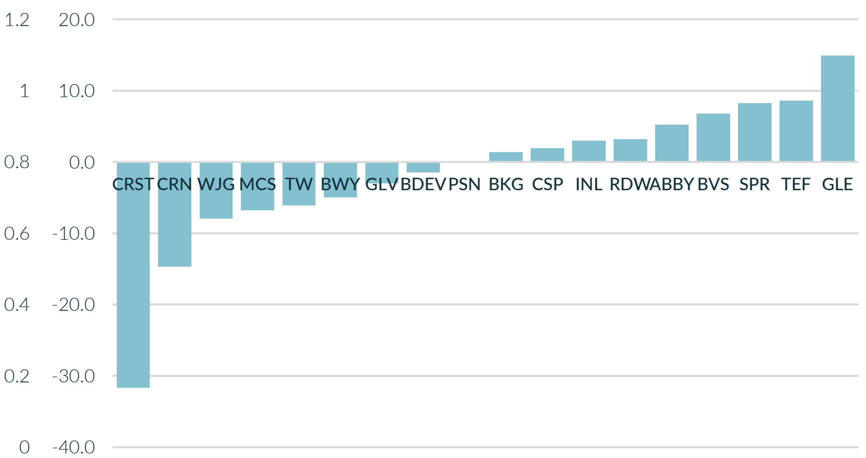
In the latest 12 months, Gleeson was best with a positive 14.9% and Crest Nicholson worst with a negative 31.7%.

Price-to-Book (P/B) at year-end/latest interims*; priced at 28/09/18



** denotes interims; weighted average is 1.91; and actual average is 1.70*
Source: Hardman & Co Research

Housebuilders' TSR in 12 months to 28/09/18 (annual %)



Source: Bloomberg; CSP, GLV and SPR are estimated

Valuation

Average earnings growth in 2018/19 is forecast at 1.5%...

The Housebuilding Sector's prospective PERs are 9.1x in 2018/19E followed by 8.6x in 2019/20E.

Average earnings growth is forecast as modest (i.e. +1.5%) in 2018/19 and at +5.6% in 2019/20 (maybe).

Note, too, Berkeley's prospective sharp drop in its current fiscal year (i.e. 30%) in earnings – signalled by the group – affects the average in the first of the two prospective years shown here.

For the record, trailing-12-month PERs for the starting line-up of the UK equity market range from 12.5x to 15.7x; which compares with the Sector at 9.2x on the same basis.

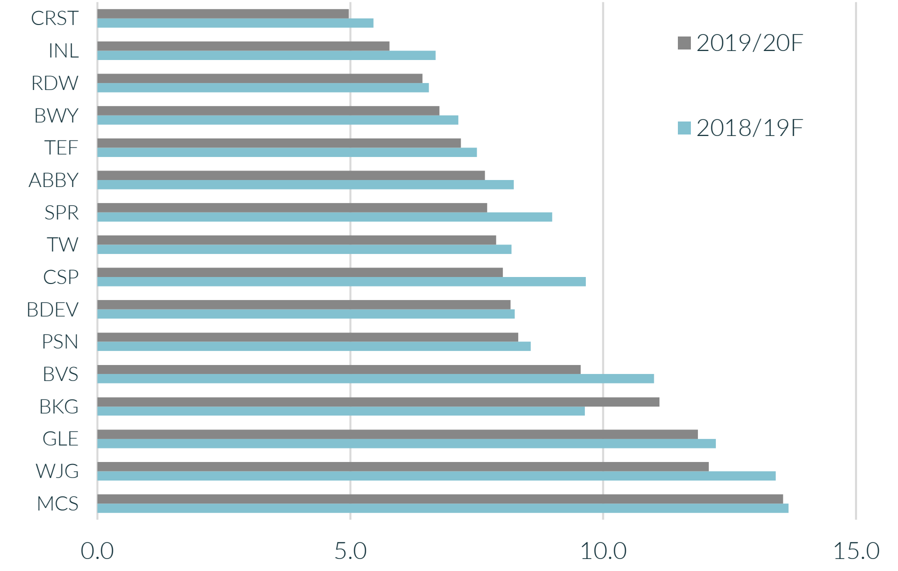
Turning to future income, in the 2018/19 and 2019/20 seasons, the UK Housebuilding Sector yields, on average, a prospective 5.6% and 6.0% – with cover in both years at 2.7 times, respectively.

Note, too, that a number of companies has committed to enhanced dividend payments, which means there is a sniff of double-digit yields.

For the record, the UK equity market yields between 2.9% and 4.0% on a trailing 12-month basis with average cover of 2.1x.

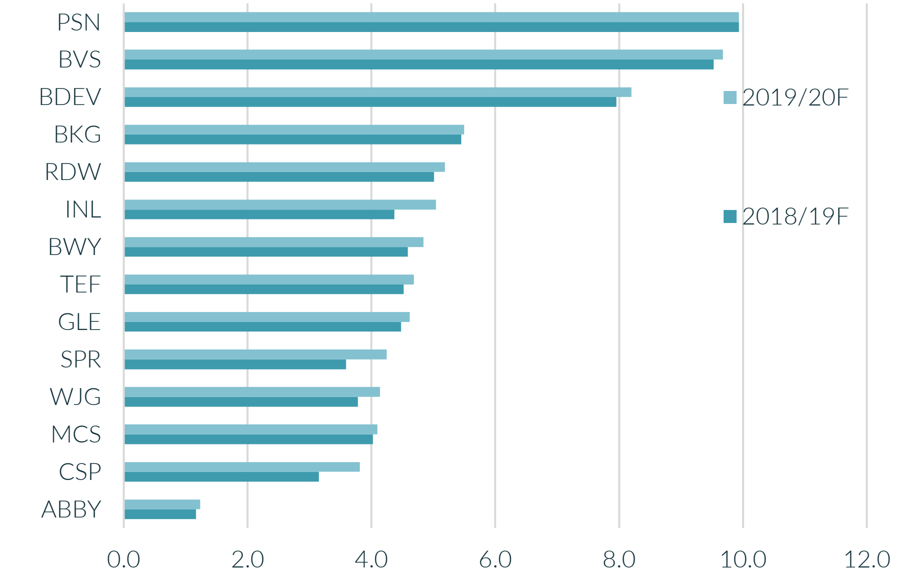
All calculations are made at the London Stock Exchange (LSE) close of business on 28 September 2018.

PER: 2018/19E (9.1x) and 2019/20E (8.6x) as at 28/09/18



Source: consensus forecasts from Digital Look; Hardman & Co Research

Yield: 2018/19E (avg. 5.6%) and 2019/20E (6.0%) at 28/09/18



Source: consensus forecasts from Digital Look; Hardman & Co Research

Results and outlook in 3Q 2018

In 3Q, there were six sets of final results, five interims and more than a dozen trading related announcements from the 18 Sector companies.

Average individual pre-tax profits for the 3Q reportees increased by 24% (or +8% ex-exuberant rookie Springfield) while EBIT margins dipped from 20.0% to 18.9% on revenue 16% larger, at £11.5bn.

EPS rose by 11%, on average, while dividends were raised by a third (yes +33%) with average individual cover dipping from 4.0x to 3.2x (and, note, that this is ex-Abbey's mid-teen shirt number).

Orders, meantime, rose by an average 6% – from a sample of five.

Average individual RoCE was flat at 19.6% (vs. 19.5% last time) with capital turn also virtually unchanged at 1.03x.

Profit & Loss

Date	Company	Event	Period ending	PBT (£m)		PBT	EBIT margins (%)		Revenue	Orders	DPS	DPS cover (x)	
				Old	New	% chg.	Old	New	% chg.	% chg.	% chg.	Previous	Latest
11-Jul	Abbey (Euro)	Full Year	30-Apr	63	58	-8	28.1	26.8	1	N/A	13	16.1	13.4
	Abbey (GBP)			54	52	-4			5		18		
31-Jul	Taylor W.	Half Year	02-Jul	335	331	-1	20.0	20.1	0	2	20	0.7	0.5
21-Aug	Persimmon	Half Year	30-Jun	463	521	13	26.2	28.2	5	6	74	0.9	0.6
05-Sep	Redrow	Full Year	30-Jun	315	380	21	19.4	19.9	16	11	65	4.1	3.0
05-Sep	Barratt	Full Year	30-Jun	774	843	9	17.4	17.8	5	11	5	1.5	1.5
06-Sep	Bovis	Half Year	30-Jun	49	60	23	12.2	14.6	1	N/A	27	2.0	1.9
17-Sep	Gleeson	Full Year	30-Jun	33	37	12	20.6	18.7	23	N/A	33	2.0	1.7
18-Sep	Springfield	Full Year	30-Jun	7	10	46	7.1	7.6	27	N/A	N/A	N/A	2.9
20-Sep	Inland	Full Year	30-Jun	20	19	-2	28.8	15.9	63	-1	29	4.6	3.5
TOTAL (£m)				2049	2252								
Individual average change (%)						13			16	6	33	4.0	3.2
Sector average change (%)						10			6				
Individual average margin (%)							20.0	18.9					
Sector average margin (%)							19.6	20.1					
Extras				**Euros**									
03-Sep	Glenveagh	Half Year	30-Jun	-	-8.166	-	-	-	-		-	-	-
04-Sep	Cairn Homes	Half Year	30-Jun	0.108	8.952	-	7.4	13.9	216	8	-	-	-

Source: Hardman & Co Research

Balance sheets

Date	Company	Event	Period ending	Net Assets (£m) Old	New	Net (Debt)/Cash (£m) Old	New	Gearing Old %	New %	RoCE Old (x)	New %	Capital Turn (x)
11-Jul	Abbey (Euro)	Full Year	30-Apr	308	342	96	83	-31	-24	19.6	17.1	0.64
	Abbey (GBP)			260	288	81	70					
31-Jul	Taylor W.	Half Year	02-Jul	2,779	2,951	429	525	-15	-18	23.0	23.0	1.06
21-Aug	Persimmon	Half Year	30-Jun	2,711	2,836	1120	1155	-41	-41	36.7	39.3	1.39
05-Sep	Redrow	Full Year	30-Jun	1,235	1,483	-73	63	6	-4	23.4	25.1	1.26
05-Sep	Barratt	Full Year	30-Jun	3,430	3,706	711	791	-21	-21	23.1	22.3	1.25
06-Sep	Bovis	Half Year	30-Jun	1,014	1,061	-32	43	3	-4	8.3	11.4	0.78
17-Sep	Gleeson	Full Year	30-Jun	171	188	34	41	-20	-22	19.2	19.6	1.05
18-Sep	Springfield	Full Year	30-Jun	32	79	-33	-15	102	19	10.6	9.8	1.29
20-Sep	Inland	Full Year	30-Jun	131	142	-68	-80	52	56	11.6	9.0	0.56
TOTAL (GBP)												
Individual average change (%)				11763	12734	2168	2593					
Sector average change (%)					24							
Individual average RoCE (%) adjusted						8				19.5	19.6	1.03
Sector average RoCE (%) adjusted										16.9	17.2	0.86
Individual average gearing (%)								4	7			
Sector average gearing (%)								*-18*	*-20*			
Extras				**Euros**								
03-Sep	Glenveagh	Half Year	30-Jun	-	633.709	-	154.303	-	24	-	-	-
04-Sep	Cairn Homes	Half Year	30-Jun	716.123	730.276	-69.051	-176.324	-10	-24	0.3	1.9	0.13

Source: Hardman & Co Research

Performance and outlook

Uncertainty continues to rise...

Abbey (Finals – 11 July)

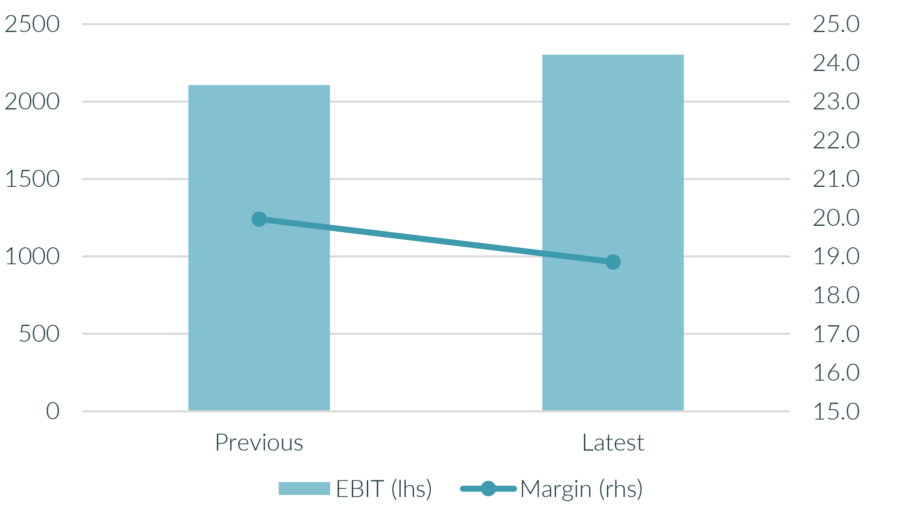
The Dublin and London-listed housebuilder produced a beautifully concise preliminary statement at just 774 words. But it was not a banner year, albeit alright to be getting on with. First off, revenue was flat (minus 2%) at €218.5m; and here, the UK accounts for three-quarters of the total (and it was also flat on a constant currency basis). Turning to group EBIT margins, they were a little lower at 26.8% (2017: 28.1%). That said, when your starting point is high 20s, a little slippage is affordable. Within this overall margin, too, it is worthy of note that Abbey scored 30.0% and 31.0% in its UK residential activities in 2016 and 2017 (2018: 27.7%.

At the profit before tax line, the tally €58.6m was down 8% with earnings per share off 5%. Meantime, the dividend was increased 13.3%, which is the same number as the dividend cover i.e. 13.4x; and down from 16.1x last time.

The group builds in: the UK (524 units and up 6%) at an average selling price of £282,000 (minus 5%); Ireland (75 and +95%) at an average of €356,000 (+11%); and Czechia (7 and down from 52) where it also sold some land in the year. And, looking forward, Abbey said that "margins, subject to market conditions, will likely continue to at least gradually fall back from their recent elevated levels. Forward sales are healthy and recent activity has been normal for this time of year. Production is a high priority and tight markets for labour and materials are a significant constraint".

"The level of uncertainty with which we have to cope, continues to rise. By this time next year, the UK will likely be outside of the EU and facing a higher risk premium on all UK investments. A disruptive Brexit will also impact unfavourably on the remaining 27".

Sector revenue (£m) and EBIT margin (%) reported in 3Q 2018



Source: Hardman & Co Research

Telford Homes (AGM – 12 July)

Countryside was the most positive...

On 12 July, Telford Homes held its AGM and said that, since the results announcement at end May, it has continued to perform well. Similarly, the London housing market at its typical price point has remained robust i.e. the average price for its open market homes is £539,000. "Our homes priced below £600,000 continue to sell at a steady rate. Above that level we have to work harder with prospective customers, but nevertheless we are still securing sales in line with our forecasts".

Telford is also undertaking more build to rent and it has commenced contractual negotiations for the sale of 257 homes at Equipment Works in Walthamstow to a significant B2R investor. The company has also instructed Savills to assist in this process.

Telford also says it is well-placed to achieve pre-tax profit "exceeding £50m" in fiscal 2019 (2018: £46.3m), "weighted towards the second half as in previous years".

Countryside (Trading Update – 26 July)

This was followed on 26 July by a Trading Update from Countryside Properties for its fiscal 3Q (April to June). This showed that total completions were up 29% to 1,060 units, including Partnerships. However, within this tally, private completions fell 8% to 237 homes (no explanation); and their ASP was down 7% at £376,000 (as expected with underlying sales price growth of 2%).

On a happier note, though, the private forward order book was 20% to the good at £409m. "We continue to see robust demand for our homes across both divisions....and remain on track to deliver expectations for fiscal 2018".

In addition, Countryside has been appointed to deliver a £137m mixed-use regeneration scheme by the London Borough of Brent at Peel Site, South Kilburn. It has also been appointed in conjunction with housing association Home Group.

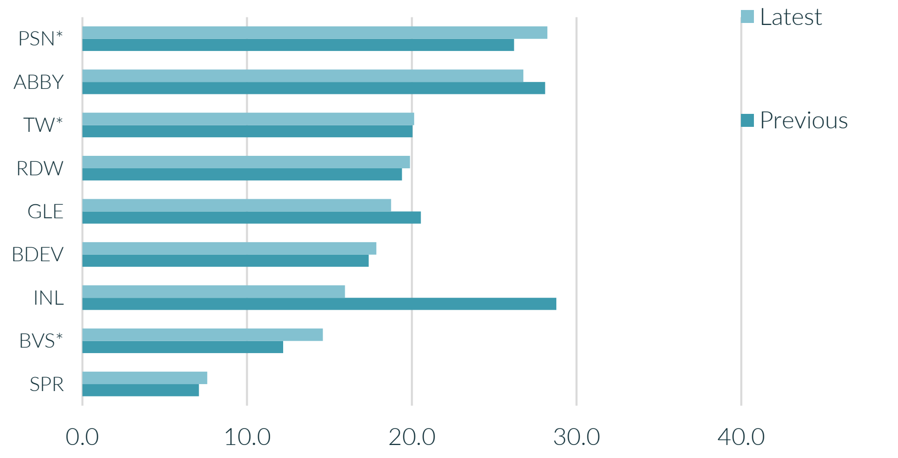
Taylor Wimpey (Interims – 31 July)

On 31 July, it was Taylor Wimpey's turn and plaudits go to reporting interim results to 30 June just a month later.

In the half year, revenue dipped 0.4% to £1.72bn as group unit sales declined 2.3% to 6,497, due to poor weather. At the same time, its UK private average selling price rose 2.8% to £295,000 and both gross and EBIT margins were virtually maintained at 25.9% and 20.1%. Pre-tax profit, however, declined 1.2% to £331m net of exceptional items. This time last year, the group took a £130m charge to do with leasehold houses, while in its last half year it was £30m relating to the potential replacement of ACM (Aluminium Composite Material) cladding on towers, in the wake of the Grenfell tragedy.

Looking forward, as at 22 July 2018, Taylor Wimpey's total order book was just 2.0% to the good at a value of £2.27 bn, excluding joint ventures, which represents 5% more units at 9,612. However, this latter tally comprised affordable unit orders at 4,034 and up 23% which leaves the balancing unit orders (largely private) at 5,578, which was off 5%. This mix tells its own story. That said, total dividends including specials payments were up 20% at 15.3p and the group said that "we remain on track to deliver the Board's expectations for 2018".

EBIT profit margins (%) reported in 3Q 2018*



*denotes interim results
Source: Hardman & Co Research

Bellway – (Trading Update - 8 August)

Bellway enjoyed a banner year...

On 8 August, Bellway issued a trading update for the year ended 31 July 2018 ahead of its preliminary results on 16 October 2018; and it was a banner year.

First off, there was a 7% increase in units sold to 10,307, which is the first time the group has been in five figures. Revenue increased 16% to ca.£3bn and operating margins were sustained at around the 22% mark (2017: 22.3%). Yes, this was all good news, but there were some wrinkles. For example, while reservations per week averaged 200 in the year – an increase of 7% – the second half was flat and, in the previous year, the increase in reservations was 11%. At the same time, the cash order book was flat (i.e. +0.4%) at £1.30bn (a year ago this was +11%) with units ordered at 4,841 and +1.9% (2017: +2.2%).

We also think that some of the wording signals caution i.e. "predominately"; "favourable"; "appears robust"; "sizeable" "should"; "more moderate growth"; and "Bellway retains an ability to be agile and respond positively to opportunities".

Persimmon (Interims – 21 August)

On 21 August, Persimmon promulgated interims and we once said that the group walks on water; and, yes, at the half year, aquatic perambulation continued.

Stepping on the detail, this shows that 1H revenue (to 30 June) nudged up 5% to £1.84bn with the sale of 8,072 units (+4%) at prices 1% higher at £215,813. Similarly, adjusted EBIT margins were 28.2% and up from 26.2% and RoCE (again adjusted) was a remarkable 39.5% vs. 37.0% last time; and RONA is pretty much the same given there is no net debt. For the record, pre-tax profits were struck at £520.7m (adjusted), which was 13% higher – with earnings at +12%. On dry land, too, the group will pay shareholders total dividends, including specials, of 235p this year (2017: 135p). And, the final plaudit, the word count of the interim statement was a mercifully concise 2,835.

Looking forward, the group said that "confidence in the UK economy remains cautious but resilient - uncertainties surround post Brexit trading arrangements". It also said that "sentiment may change in the future - job security, wage growth and interest rates remain important factors". Nonetheless, "the value of our forward sales, including legal completions since 1 July 2018, was 6% stronger than at the same point last year" at a total of £2.12bn (a year ago this was +15%). Translating this to units "we have 6,528 new homes sold forward into the private sale market". However, this number is 2.1% lower year-on-year. Is there a crack in the ethereal aura?

Redrow (Finals – 5 September)

On 5 September, Redrow reported its fiscal year to 30 June 2018, in which revenue rose 16% to a record £1.92bn with units at 5,913 (+9%) and prices 7% better at £332,300 while EBIT margins nudged up from 19.4% to 19.9% (driven by lower operating costs). This led to a 21% increase in pre-tax profit to £380m.

Note, too, that the dividend was increased 65% (with cover still at 3.1x vs. 4.1x last time) as net debt of £73m morphed into net cash of £63m. Looking forward, the orderbook was up by an impressive 11% at £1.14bn ex-JVs (our guess is, though, that including JVs, the orderbook is ahead by less than 4%).

Chief Executive John Tutte also talked about a number of issues including "a continuing weak secondary market that in particular affects sales chains in the upper-end of the price range".

Typically candid, too, was Chairman Steve Morgan: "there is no doubt that clarity over Brexit and the future of Help to Buy would improve market sentiment. Given that clarity, we will continue to deliver". We would highlight the conditionality of "given that clarity" but the market loved it and Redrow shares rose 8.1% in Week 36 to 592p.

Barratt (Finals – 5 September)

60 years in business for Barratt...

2018 marks Barratt's 60th anniversary and, in that time, it has built more than 450,000 houses. This includes its latest fiscal year in which 17,579 units were sold, the second highest in its tenure. And, the average selling price of its core private sector output was £328,800, which was up 5%.

At the EBIT line, adjusted margins were struck at 17.8% (2017: 17.4%) with pre-tax profits 9% better at £842.5m (adjusted) with 5% extra on dividends to 43.8p including specials.

The group's total cash orderbook was also 11% to the good at £3.05bn and its composition spoke of a familiar trend i.e. private sales were off 4.2% at £1.65bn with affordable ahead 35% at just over £1bn and joint ventures jumping 40% to just under £400m.

For good and noble measure, too, Barratt offered – as is its rare wont – detailed guidance to analysts for fiscal 2019 before concluding with: "while political uncertainty continues around the country's departure from the EU...... the Board remain confident in the strong fundamentals of the housing sector and our business".

McCarthy & Stone (Trading Update – 6 September)

"It has been a tough year for the Group" said interim-and-now-official CEO John Tonkiss; and he was right. This latest Trading Update, though, took the issues of this period head-on and the shares saw the week out 5.4% higher at 117.4p (despite its exit from the FTSE 250 Index).

In terms of detail, for the full year ended 31 August, annual revenue is likely to be up a touch (i.e. +1.4%) better at £661m, albeit unit completions have dipped 7% to 2,134 (which meant selling prices were higher at ca.£300,000). In turn, operating profit is expected to be within the current analyst forecast range of £65m to £73m

(2017: £96m) – in June this guidance was £65m to £80m – which would spell margins of 9.7% to 10.8% (2017: 14.5%).

The group also spoke of "continuing economic uncertainty coupled with a slower secondary market and a softening of pricing, particularly in the South, during the second half of the year".

On a brighter note, though, McCarthy's year-end forward order book was ca.23% up at about £174m, supported by 69 sales releases during the year (2017: 52).

Finally, there is little doubt about the burgeoning size of McCarthy & Stone's market place i.e. there are currently 11.8m people aged 65 or over, rising to 17.3m by 2037, representing a 47% increase. Similarly, one in four over 60s is interested in retirement living, yet only ca.162,000 units of specialist retirement housing for homeowners have been built.

Berkeley Group (AGM – 6 September)

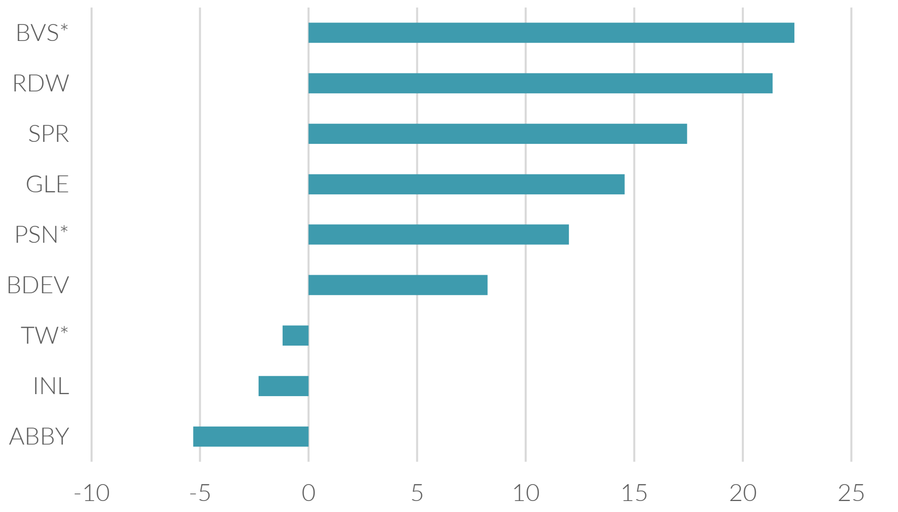
"a market that lacks urgency"

"In the first four months of this new financial year, market conditions in London and the South East have remained consistent with those reported with the full year results in June. Pricing has remained robust as there is demand for good quality, well located homes that enhance communities and meet the local housing need.

"In essence, this is a market that lacks urgency and London remains constrained by high transaction costs, restrictive income multiple limits on mortgage borrowing and prevailing economic uncertainty, accentuated by Brexit. These headwinds affect all segments of the market from home movers to downsizers and investors alike. A functioning housing market, where good new development can deliver much needed additionality across all tenures, requires conditions for growth and low barriers to entry which are currently absent from the housing market in London and the South East".

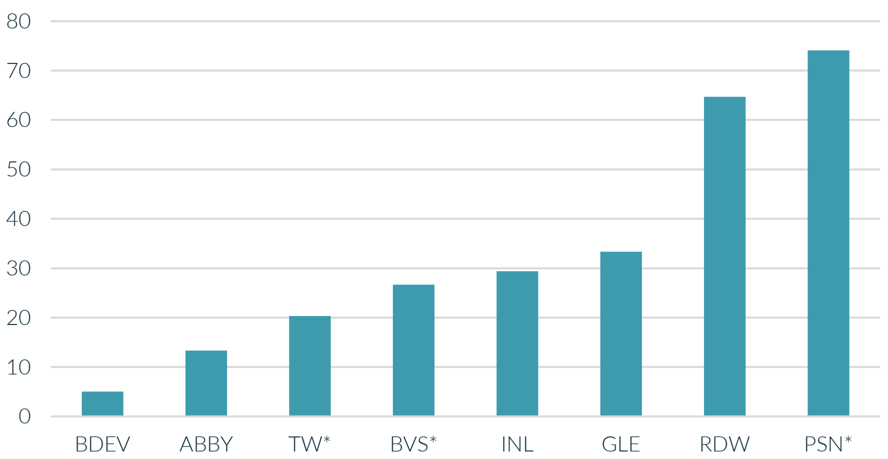
The group also re-affirmed its guidance to deliver at least £3.375bn of pre-tax profits for the five-year period from 1 May 2016 to 30 April 2021, with at least £1.575bn pre-tax profit to be delivered in the two years ending 30 April 2019. Doing the math, though, from the £3.375bn of expected PBT, we have already had £1,750m and – assuming a 30% annualised fall in fiscal 2019 – the tally goes to £2,400m. This leaves a balance of £973m for fiscal 2020 and 2021; which is the amount of profit it made in a single year in fiscal 2018. This graphically illustrates where Berkeley believes the housing market is going; and it has a tip top record here. No one else is doing this; but perhaps should be?

EPS growth* (% change) reported in 3Q 2018



*denotes interim results
Source: Hardman & Co Research

DPS growth reported in 3Q 2018* (% change)



*denotes interim results
Source: Hardman & Co Research

Gleeson (Finals – 17 September)

"Twin track strategy"

"The low-cost housebuilder and strategic land specialist" produced final results in the week. These showed revenue sharply higher, i.e. +23% to £197m, albeit gross margins dipped from 35.4% to 33.2% (unit mix) as did those at the EBIT line: 20.6% to 18.7% and £36.9m (expansion and higher wages in the Homes' Division).

Okay, there was £1m of Gleeson Homes land sales included in 2017 against nil in 2018 – but even excluding this, margins were still lower. As for pre-tax profit, it showed a 12% annualised rise to £37m, with EPS up 15% and the dividend raised by a whopping 33% to 32p with cover at 1.74x (2017: 2.02x). What is more, the company is committed to ordinary dividend cover between 1.75x and 2.75x for the foreseeable future.

Gleeson's "twin track strategy" is the development of low-cost homes for open market sale in the North of England and the Midlands – and strategic land sales in the South. On the former, its aim is to double unit output to 2,000 between 2017 and 2022; and, note, that mortgage payments for its average buyer take up less than 20% of take-home pay. Nor does it build flats. Meantime, on strategic land, Gleeson says its 'portfolio' comprises 61 sites and 22,838 plots.

No orderbook data is given, albeit the CEO said "we are confident the current financial year will be another excellent year for the Group", while the Chairman talked about "significant growth in both revenue and profits in the current year and beyond". Gleeson shares soared 13.5% in Week 38 at 790p.

Springfield (Finals – 18 September)

A splendid set of maiden annual results...

The company produced a splendid set of maiden annual results for the 12 months to the end-May, having come to the market in October 2017.

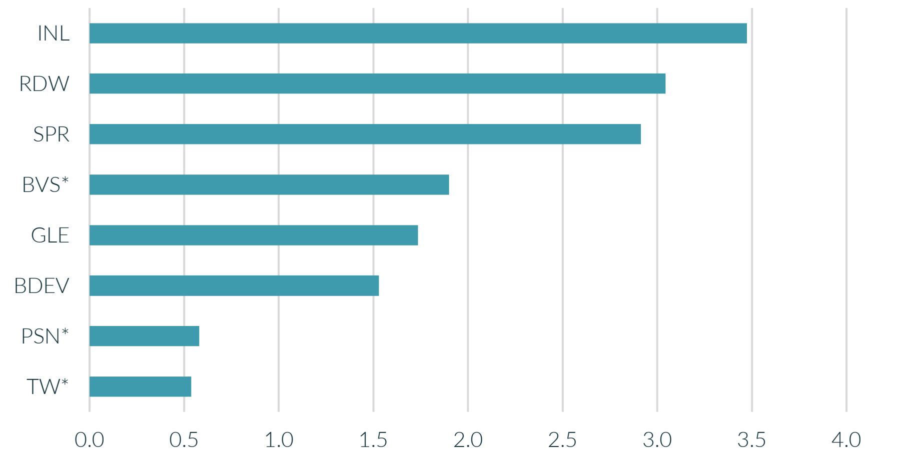
Note, too, that it operates exclusively in Scotland where revenue rose 27% to £141m with its gross margin widening 60bps to 15.7%. At the EBIT line, after a hefty administrative charge, profits rose 36% to £10.7m and a margin of 6.9% (2017: 6.1%). Note, too, we have also excluded IPO and acquisition-related exceptional items of £0.6m).

In turn, pre-tax profit, jumped 46% to £9.8m profit and we regard the company's profitability metrics as work in progress. For good measure, too, the maiden dividend for the year was 3.7p with cover at 2.9x.

Springfield operates a dual-path business in private housebuilding and affordable; and, in the year, it sold 430 private (+5%) at an ASP of £221,500 (+12%) together with 310 affordable at £120,2000 (down 5% due to mix). The gross margin on private is 15.5% (2017: 15.4%) while in affordable it is just 6.4% (3.4%). This latter activity pretty much works on negative working capital and the returns are more akin to that of a (sophisticated) contracting business.

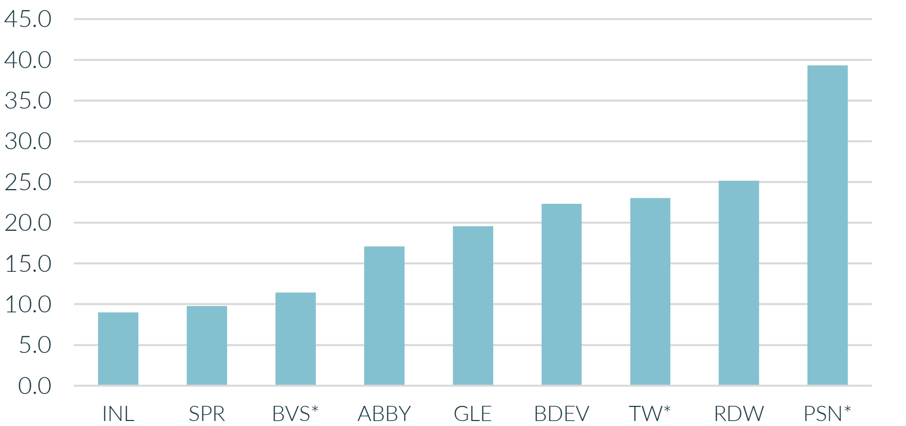
The company also made an acquisition in the year with the mini-me Dawn Homes for £17.5m (in cash and shares) plus £2.5m deferred and planning dependent. Springfield has also embraced the new village concept has five or six either started or percolating; and the two largest will comprise 3,000 units. Typically, these village sites will demand both the private and affordable skills of Springfield and run to 2023. Helpfully, too, the company has produced timelines replete with projected gross margins for its two core businesses i.e. it expects 20-21% in private build and 17-18% in affordable. Who does this? The shares closed Week 38 up 11.1% at 125p.

Dividend cover (x) reported in 3Q 2018*



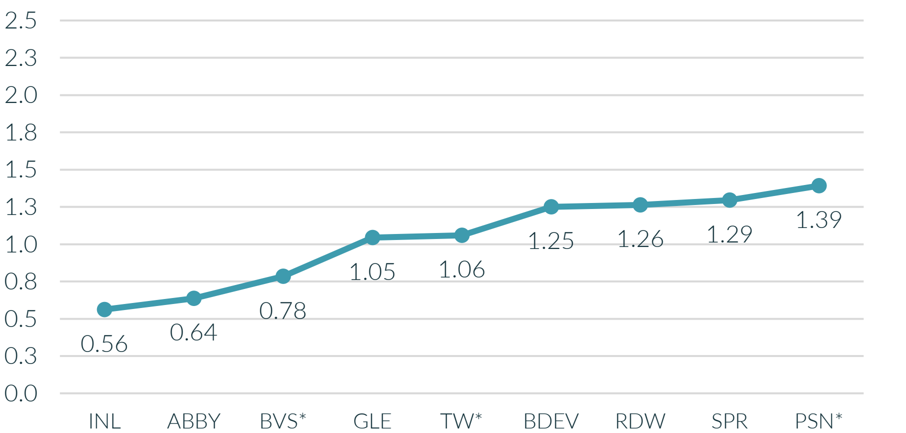
*denotes interim results
Source: Hardman & Co Research

Latest reported and average RoCE (%) reported in 3Q 2018*



*denotes interims
Source: Hardman & Co Research

Capital turn (x) reported in 3Q 2018



*denotes interims; capital turn is revenue divided by capital employed
Source: Hardman & Co Research

Macroeconomics

GDP in the UK grew at 0.6% in the July quarter, which compares with 0.4% in the previous three-month period. Note, too, that Construction Output (in the first seven months of 2018) edged up 1% with Private Housebuilding at +7.5%.

CPI was 2.7% annualised in August, which compares with 2.5% in July but 2.9% in August last year.

Unemployment was an extraordinary 4.0% in the July quarter and a year ago it was 4.3%. At the same time, regular pay on an annualised basis inched up 0.5% in real terms – also in the July quarter.

Retail sales in August rose 0.3% and by 3.3% year on year by volume, which was driven by non-food stores and household goods.

Mortgages

UK Finance said there were 32,600 new mortgages in August, which was off 3.8% annualised; note, too, the average home-mover is 39 years old with a gross household income of £57,000. Elsewhere, re-mortgages soared 23.1% annualised to 46,900.

It is a calmer scene at the Bank of England where its data say that UK mortgage approvals were little changed in August at 66,640 i.e. up 0.4% on July and minus 0.4% when compared with August 2017.

Volumes and prices

Experian (where I am an advisor) says that Private Housing Output rose 9.1% last year to be followed by +3% or so per annum forecast in 2018, 2019 and 2020 (all in real terms) – but slowing over the piece; meantime, the Public Sector is also forecast for ca.+3% p.a. (after +14.0% in 2017); and on a mild upwards trajectory.

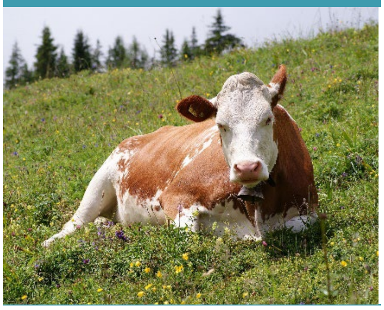
In terms of prices for bricks and mortar, the Nationwide said that house prices dipped 0.3% in September (August -0.5%) which meant that the annualised rate held steady at 2.0%. “Overall, we continue to expect house prices to rise by around 1% over the course of 2018”.

Meantime, Rightmove reported a monthly rise in September of 0.7% (i.e. £2,088) in the price of newly-marketed property which is typical for the month. That said, the annual increase remained muted at 1.2%.

Elsewhere, the Halifax’s view is that that house prices in August were barely positive at +0.1% (July +1.2%) at £229,958. However, annualised, the rise was 3.7% (July: 3.3%).

And, finally, Reuters Housing Market Poll (to which I contribute) expects +1.7% for UK house price inflation in 2018 with minus 1.0% in London – which would be the first dip in a decade.

The train and the cow



Source: Creative Commons

Mauricio Pochettino is 46 (but looks younger) and reputedly earns some £6m a year at Spurs. Prior to this, he managed Espanyol and Southampton and was 18 years a professional player in Argentina, France (PSG) and Spain (for Espanyol).

He claims to be always confident even if he doesn't always look it.

He also once said: "if you are a winner, you have a different mentality. If you are a loser, you always find excuses and try to avoid the responsibility".

The UK Housebuilding Sector is not winning but nor is it looking for excuses. It knows what the issue(s) is (are) – and these have been spoken to by professionals such as Pidgley, Morgan and Gallagher.

In essence, it is all about tough away games; and many more points will be lost.

However, this comes when the industry is also fitter, better managed and more liquid than for many seasons.

Dividends also remain bountiful, which season ticket holders love.

The key to winning is to keep tight control of the transfer cheque book and maintain what is an excellent disciplinary record.

And, yes, the clarity that Stevie Morgan is seeking will emerge.

Quotation:

"Football is about belief"

Source: Mauricio Pochettino

Glossary

Name (ticker): share price; market value

Abbey (ABBY): 1,540 cents; €330m

Barratt (BDEV): 567p; £5,748m

Bellway (BWY): 3,014p; £3,707m

Berkeley Group (BKG): 3679p; £4,810m

Bovis Homes (BVS): 1,072.5p; £1,446m

Cairn (CRN): 147 cents; €1,160m

Countryside (CSP): 346.2p; £1,558m

Crest Nicholson (CRST): 350.2p; £900m

M J Gleeson (GLE): 742p; £405m

Glenveagh (GLV): 97 cents; €845

Inland Homes (INL): 59.5p; £122m

McCarthy & Stone (MCS): 134.2p; £721m

Persimmon (PSN): 2,365p; £7,471m

Redrow (RDW): 583.5p; £2,158m

Springfield (SPR): 122.5p; £118m

Taylor Wimpey (TW): 171.8p; £5,629m

Telford Homes (TEF): 416p; £315m

Watkin Jones Group (WJG): 196p; £500m

Note: Share prices at 28 September 2018
Adjustments have been made to share prices and metrics where required
Selected stocks are excluded from charts and sector averages due to extreme movements or for structural reasons

About the author

Tony Williams leads the Building and Construction team at Hardman & Co.

He has followed the building industry for more than 30 years, working as an analyst and corporate financier at UBS, Morgan Stanley and ING Barings. His industry roles have included Director of Corporate Planning and Strategy at Tarmac plc and Director of Public Affairs at AMEC, as well as a number on Non-Executive Directorships. He is also the founder and CEO of Building Value Ltd.

Tony joined Hardman & Co in 2013. He holds an MSc in Economics from the University of Manchester.

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The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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