12th April 2016

hardman&co

UK Housebuilding Sector

Q1: Spring 2016

"Eat My Shorts, Man!"

The Simpsons, as if you didn't know, is an American animated sitcom created by Matt Groening for the Fox Broadcasting Company. It is a satirical depiction of a working class lifestyle epitomised by the family members Homer, Marge, Bart (our hero), Lisa, and Maggie. The show is set in the fictional town of Springfield and parodies American culture, society, television and many aspects of the human condition.

Since its debut on 17 December 1989, the series has broadcast 591 episodes over 27 seasons and, in 2009, surpassed 'Gunsmoke' as the longest running American scripted prime time television series.

In the UK, shorts are what one wears on holiday; and maybe not even then. In the US, they are under-pants. In the financial markets, shorts are a means by which one sells a borrowed security, commodity or currency with the expectation that the asset will fall in value. If it does, the investor buys it back and makes a profit; and if it does not, the opposite.

Berkeley Group, in a blunt proxy for the London residential market, has been the most heavily shorted stock in the Capital; and its share price fell 13% in Q1 - twice the Sector average.

First-off we think this is inefficient, secondly - wrong - (other than the self-fulfilling part of it) and we agree with Bart Simpson and his most quotable quote: "eat my shorts".

Analyst

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Prologue

Bart Simpson,Source: Creative Commons

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For sure, the tide has ebbed at the top end of the London residential market - and Berkeley has said so. Similarly, Berkeley's chief script writer, Tony Pidgley, has gone liquid twice before; and he has been right twice before. This time, though, the Group is sustaining work in progress.

After 27 seasons, since its inception in 1989, The Simpsons is embedded in US culture. Berkeley was floated in 1984. "Don't have a cow".

Berkeley included, though, it has not been a banner start for any equities in 2016 and, specifically, the Sector has shed 6% of its value; albeit this is net of two IPOs in Countryside (encore) and Watkins Jones - and both followed McCarthy & Stone from November last year. This is encouraging. All three stocks are included in our coverage, too, and we have also added Gleeson and Inland Homes (we probably should have done so earlier).

We are not breathlessly bullish but nor do we believe the credits are rolling either. We are still watching.

Share prices in Q1

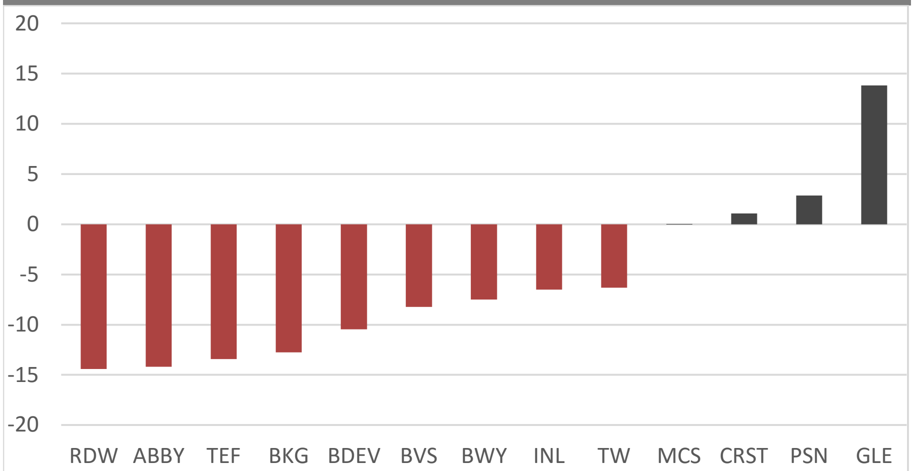
Housebuilders' share prices fell by an average 6% (both actual and weighted by market capitalisation) in Q1. Only 4-from-13 were in positive territory: Gleeson; (+14%), Persimmon; Crest; and McCarthy & Stone (marginally).

Q1's deficit was also the first one in the last eight to be negative quarter-on-quarter (previously Q2 2014 with minus 7%); and only the seventh out of the last 25.

It is a happier show year-on-year with Q1 seeing annualised share prices rise 20% led by Gleeson (+51%) with animated support from Crest and Bellway (each on +32%). And, here, the sole negative voice Q1 2016 on Q1 2015 was Telford (minus 15%) with Bovis flat.

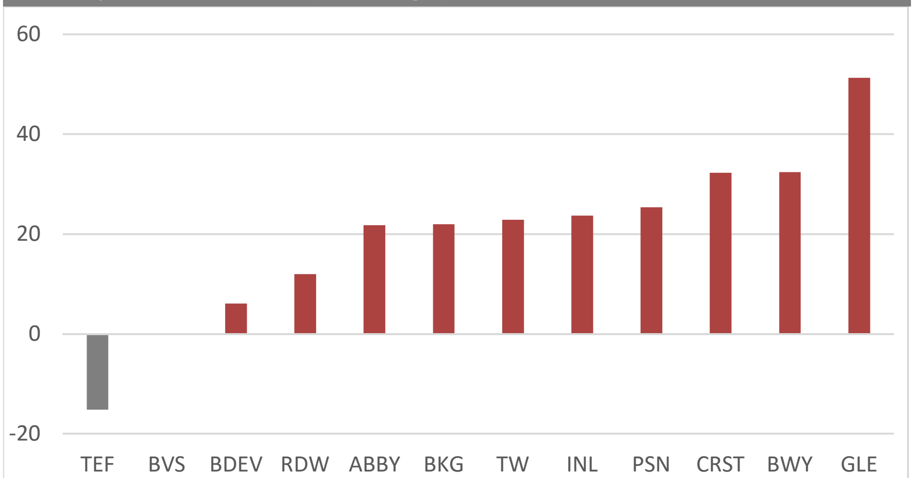
In terms of pound notes, the Sector lost £2.1 billion of value or 6% on a net basis in Q1; or if the new IPOs are included the dip was £750 million or 2%.

Shares prices in Q1 2016 (% change)*



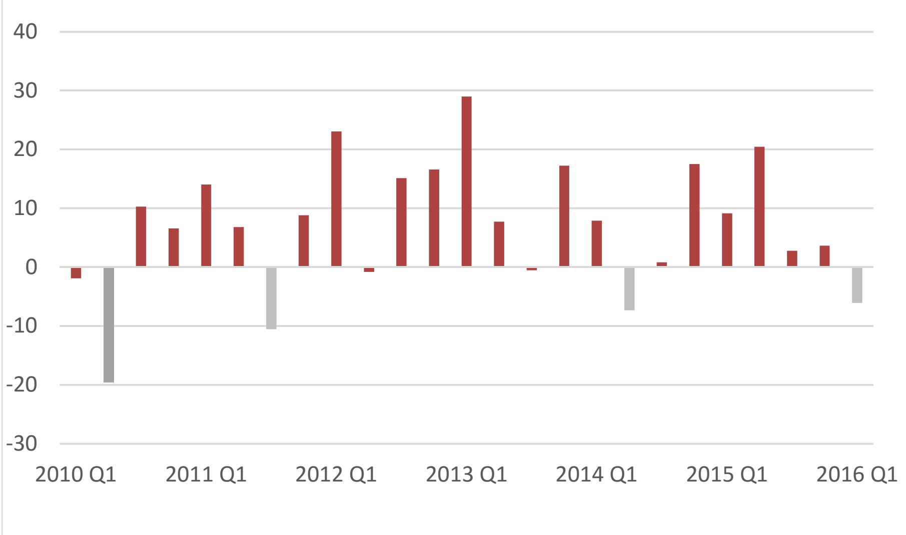
**newly listed (green); Inland Homes and Gleeson (pink); high/low (grey/dark red)*
Source: Hardman & Co Research

Shares prices in Q1 2016 (% change)*



**YTD, ex newcomers*
Source: Hardman & Co Research

UK Housebuilding Sector: Q1 2010 - Q1 2016 (% change)*

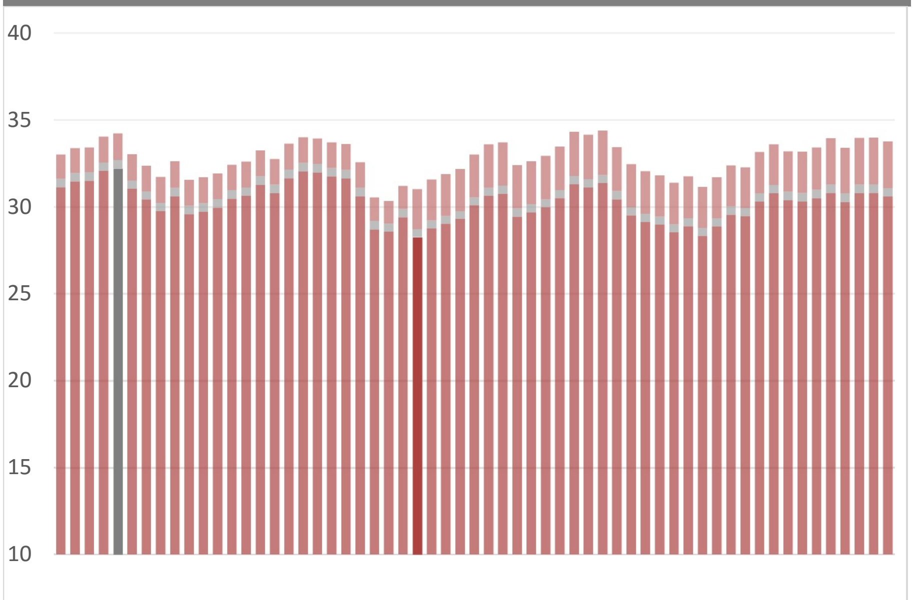


Source: Hardman & Co Research
**weighted % change in share prices quarter by quarter (ex newcomers)*

Quarter by quarter

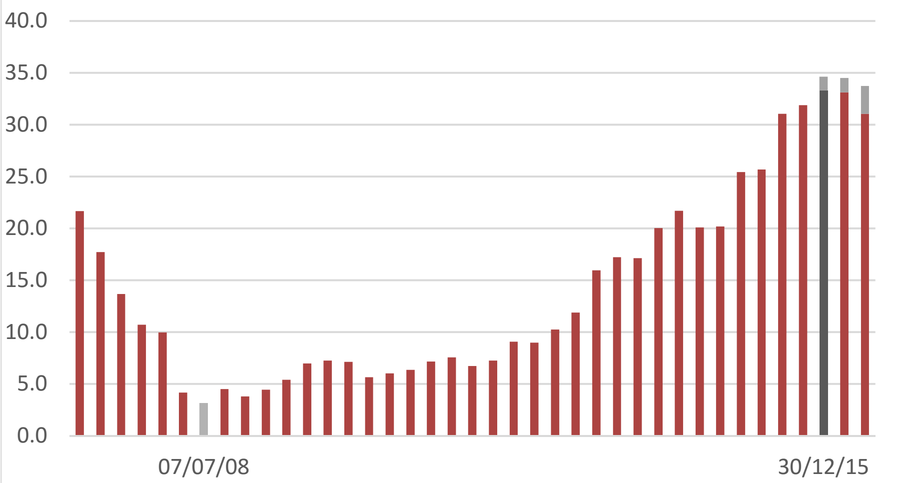
From 62 trading days in Q1, however, the Sector rose on 55% of days and fell on 45%; but there were no new Sector highs in Q1 (in 2015, as a whole, the Sector broke new ground 35 times). Meantime, the best daily score was +2.9% on 19 January and 10 February; with the worst being on 8 February (a Brexit inspired minus 6.2%). Similarly, Week 9 (+6.8%) was the best, with Week 11 the worst (minus 6.7%); and, finally, month by month, all three in Q1 were negative: -1.3; -1.1; and -2.1% respectively.

Housebuilding Sector stock market value daily in Q1 (£bn)*



**newly listed (light grey); Inland Homes and Gleeson (pink); high/low (grey/dark red)*
Source: Hardman & Co Research

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



**quarterly from Q1 2007 to Q1 2016 (new issues in light grey)*
7 July 2008 (low); 30 December 2015 (high)
Source: Hardman & Co Research

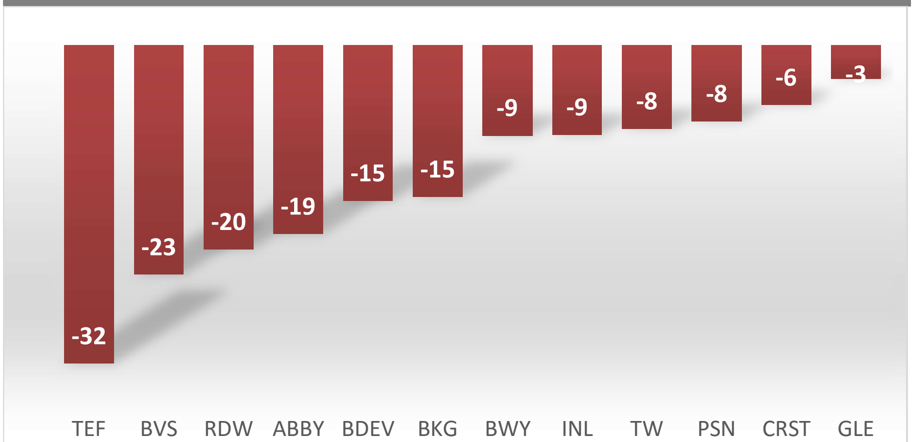
On 31 March 2016, the Sector was capitalised at £33.8 billion including a hattrick of recent IPOs (sans these the tally was £31.1 billion). However, as recently as 30 December 2015, the Sector reached a new all-time high of £33.3 billion or £34.7 billion including McCarthy & Stone (IPO in November 2015); in addition, Countryside (£1.1 billion) and Watkin Jones (£260 million) were floated in Q1 this year.

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

Note, too, we have now included Inland Homes (market cap. of £163 million) and Gleeson (£330 million) in the Sector and adjusted retrospectively.

The Housebuilders were not alone - as by far the majority of indices in the UK equity market, construction sector and real estate industry dipped into negative territory in Q1 when compared with Q4 last year. It is still a brighter TV picture year-on-year, however, with Housebuilders' share prices 20% to the good and leaving all in in their wake.

Share price deficits from 52 week highs at 31 March 2016*



**ex newcomers*
Source: Hardman & Co Research

Peak value, FTSE 100 and structure

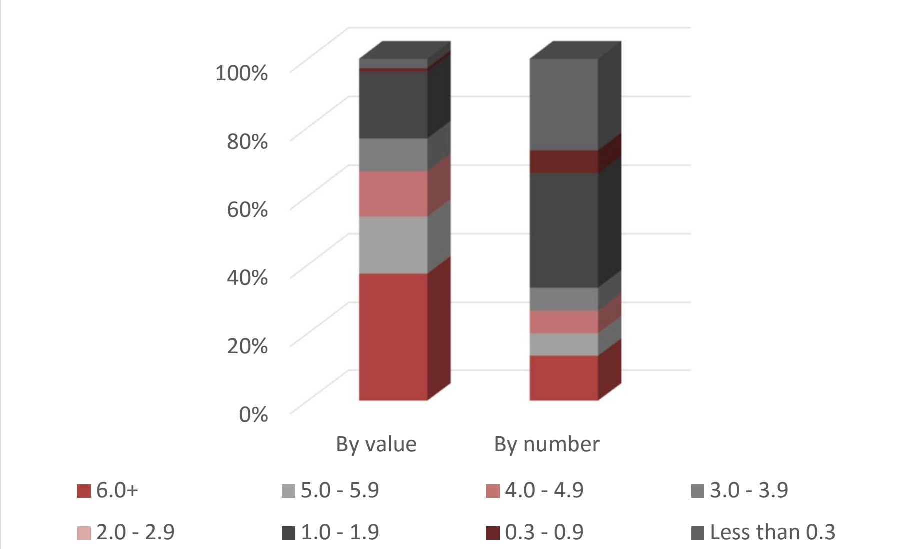
The four major housebuilders in the FTSE 100…

Housebuilders' share prices are, on average, 16 times above their lows of 2008; and 27% up on 52 week lows (weighted these numbers are 27 and 28% respectively). But they are also some 19% below their 2007 peaks (22% weighted); and 14% off 52 week highs (12% weighted).

There also continue to be four housebuilders in the FTSE 100: Berkeley (90), Barratt (68) Taylor Wimpey (64) and Persimmon (59), all at 1 April 2016.

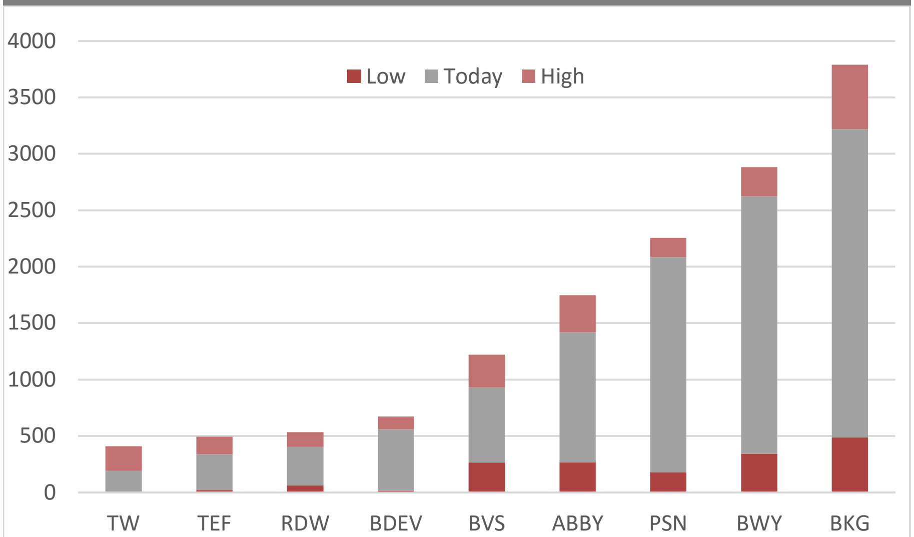
The latter two - above - are worth in excess of £6 billion each in market capitalisation and, together, account for 37% of the UK Housebuilding Sector value; Barratt and Berkeley account for a further 30%.

Sector structure by stock market value



(£33.8 billion at 31/03/16), 16 companies [legend is in £bn]
Source: Hardman & Co Research

Peak share price, today's price (31/03/16) & lows*



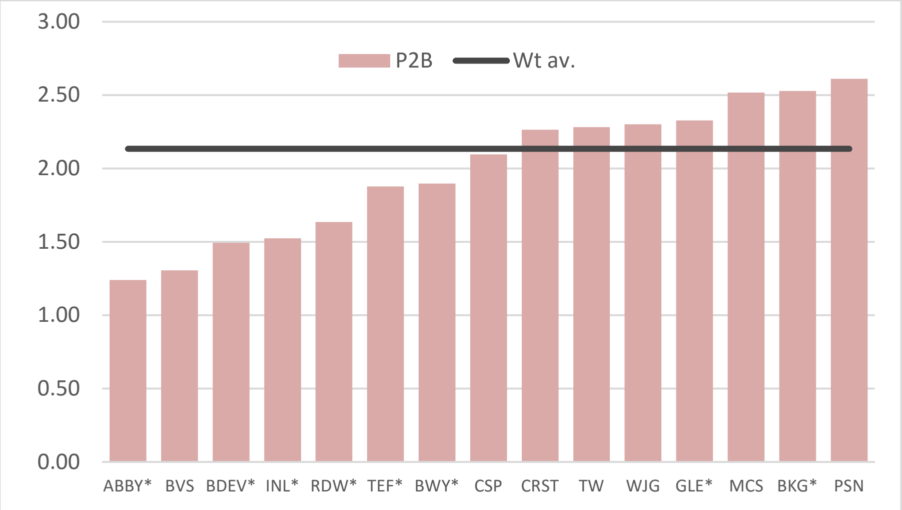
** except Abbey is in Euro cents; and except Crest and all newcomers*
Source: Hardman & Co Research

Price-to-book and Total Return

The Housebuilders' latest average Price-to-Book valuation was 1.99 at 31 March 2016 and 2.13 weighted. A year ago they were 1.88 and 1.97 respectively (ex-guest stars). It is also the case that three out of 15 companies (Persimmon, Berkeley and McCarthy & Stone) are higher than 2.5 while seven are less than 2.0.

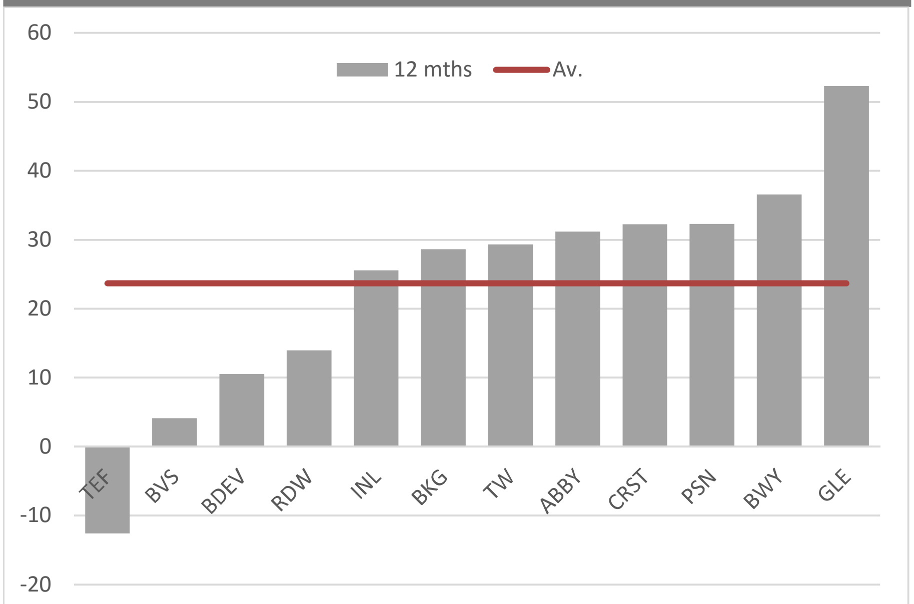
Turning to Total Shareholder Return (TSR) for the Sector, its performance over the past 12 months is a highly creditable 24% (with only one stock negative). However, in Q1 or year-to-date (YTD) it is minus 6% with 9-from-13 stocks negative. For the record, in 2015 the Sector's average TSR was 49%, preceded by 16% in 2014 and an 82% Oscar winner in 2013.

Price-to-book-value at year end/latest interim*



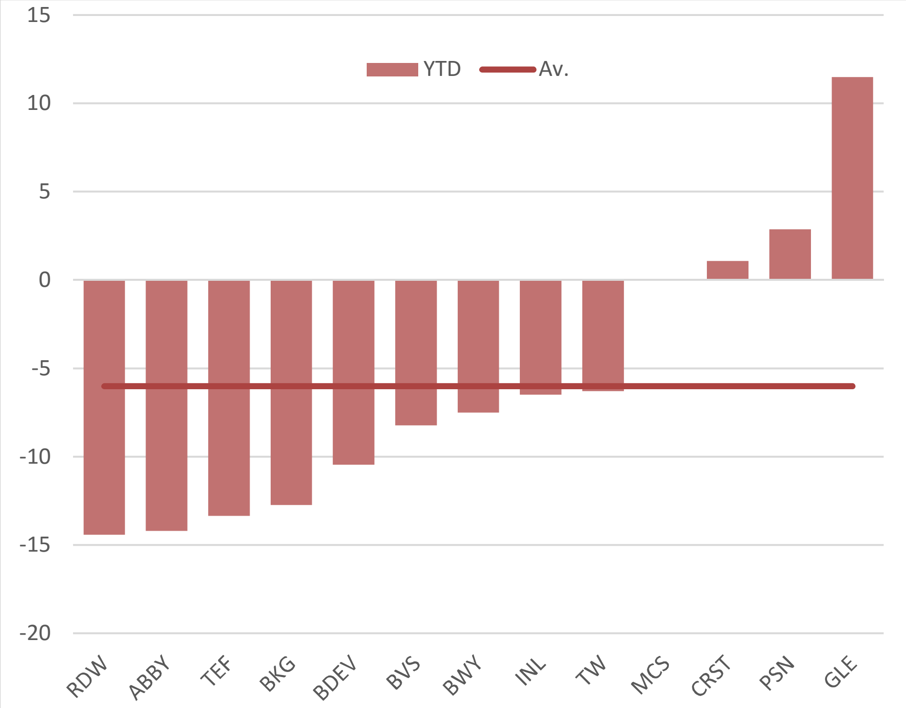
**weighted average is 2.13; actual average is 1.99*
Priced at 31/03/16
Source: Hardman & Co Research

UK Housebuilders TSR in 12 months to 31 March 2016 (%)*



**ex-newly listed*
Source: Bloomberg

UK Housebuilders TSR in YTD to 31 March 2016 (%)*



*includes MCS but not CPS and WJG

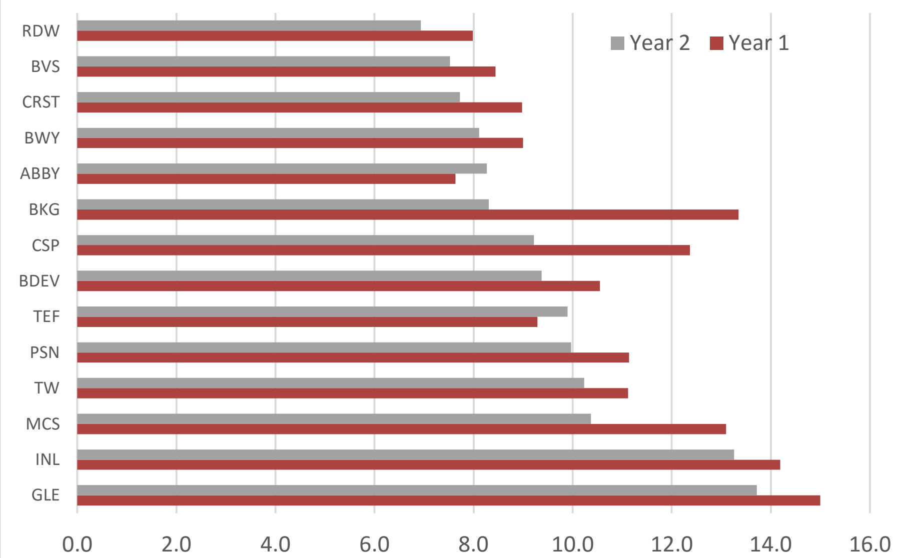
Source: Bloomberg

Valuation

The Sector's historic PER is 11.4x with 10.9x prospective in Forecast Year 1 and 9.5x in Forecast Year 2; this is driven by annual earnings growth of 42% historic - and, respectively, 12% and 15% going forward (based on consensus estimates).

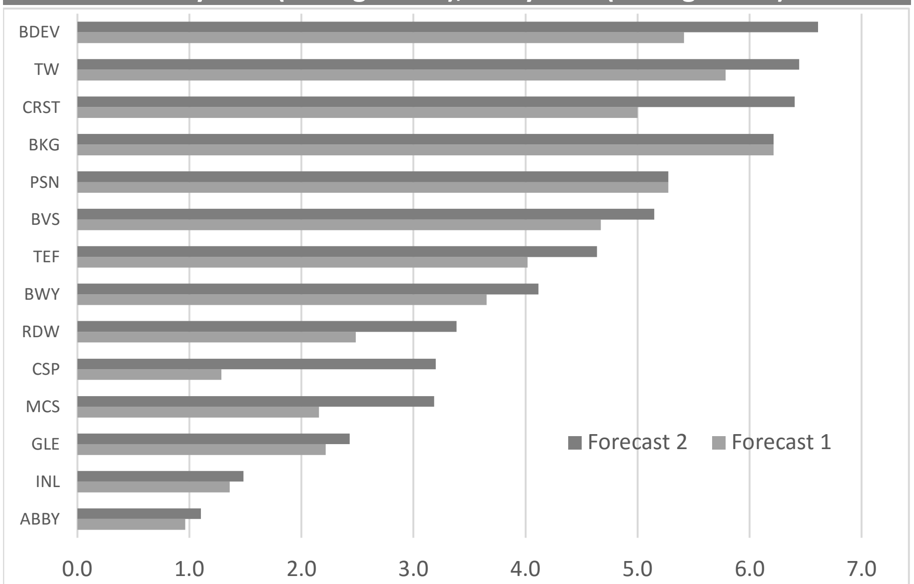
Dividends in the Housebuilding Sector are also gathering momentum (including specials) and the prospective average increase in Forecast Year 1 is +24% which translates to a 3.6% average yield and cover of 3.8x.

Forecast PER: year 1 (average 10.9x); and year 2 (average 9.5x)



consensus EPS, (Abbey = Digital Look); priced at 31 March 2016 - Source: Hardman & Co Research, Morningstar, Digital Look

Forecast Yield: year 1 (average 3.6%); and year 2 (average 4.3%)



**consensus DPS sourced from Morningstar (Abbey = Digital Look); priced at 31 March 2016*
Source: Hardman & Co Research, Morningstar, Digital Look

Result and trading in Q1

In Q1 there were five sets of interim results and four finals, a dozen trading updates and two IPOs.

Average individual pre-tax profits rose 54% whilst average individual EBIT margins stretched from 17.2% to 19.2% on revenues up 18% to £11.5 billion.

Earnings per share rose 32% (ex-Gleeson's +172%) and with them dividends were raised 62% on an individual basis or +36% as a Sector; in turn this saw average individual cover ease from 4.3x to 3.8x.

The average increase in orders was 22% (seven companies)

Average individual ROCE rose from 17.7% to 21.1% in Q1 with Capital Turn rising from an average 0.96 to 0.99.

Profit and Loss

Date	Company	Event	Pre-tax profit (£m)		PBT	EBIT margins		Revenue	Orders	DPS	DPS cover
			Old	New	*% chge*	*Old (%)*	*New (%)*	*% chge*	*% chge*	*% chge*	(x)
26-Jan	Crest	FY Oct	117	154	*32*	*20.1*	*20.3*	*26*	*28*	*38*	*2.5*
09-Feb	Redrow	HY Dec	91	104	*14*	*16.9*	*18.2*	*8*	*51*	*100*	*5.7*
22-Feb	Bovis	FY Dec	134	160	*20*	*17.0*	*17.3*	*17*	*14*	*14*	*2.4*
22-Feb	Gleeson	HY Dec	5	11	*130*	*11.7*	*17.4*	*52*	-	*67*	*3.7*
23-Feb	Persimmon	FY Dec	475	638	*34*	*18.4*	*21.9*	*13*	*12*	*36*	*1.8*
24-Feb	Barratt	HY Dec	210	295	*40*	*14.2*	*16.1*	*19*	*13*	*25*	*4.0*
01-Mar	T.Wimpey	FY Dec	450	604	*34*	*17.9*	*20.3*	*17*	*25*	*206*	*1.6*
22-Mar	Inland	HY Dec	6	7	*31*	*18.9*	*20.0*	*5*	-	*33*	*8.3*
22-Mar	Bellway	HY Jan	159	227	*43*	*19.9*	*21.4*	*31*	*7*	*36*	*4.4*
TOTAL (£m)			**1646**	**2200**							
Individual average change (%)					*54*			*21*	*22*	*62*	
Sector average change (%)					*34*			*17*		*36*	
Individual average margin (%)						*17.2*	*19.2*				*3.8*
Sector average margin (%)						*17.6*	*19.7*				

Notes:

(i) Pre-tax profit numbers are adjusted where necessary and are net of exceptionals

(ii) Inland Homes 'new' pre-tax and EBIT margins exclude £14.0 million investment property revaluation

(iii) DPS is dividend per share includes specials where appropriate

(iv) T.Wimpey recorded a net addition £0.6 million to inventory provisions last year (2014: reversal £18.7 million)

Source: Hardman & Co Research, Company accounts

Balance Sheets

Date	Company	Event	Net Assets (£m)		Net (Debt) /Cash (£m)		Gearing	ROCE^	ROCE^	Capital
			Old	New	Old	New	New %	Old %	New %	Turn (x)
26-Jan	Crest	FY Oct	537	631	-19	-31	5	18.2	19.1	0.90
09-Feb	Redrow	HY Dec	767	909	-140	-183	20	20.0	18.7	1.02
22-Feb	Bovis	FY Dec	879	958	5	30	-3	14.8	17.0	0.98
22-Feb	Gleeson	HY Dec	129	142	8	10	-7	7.7	16.0	0.91
23-Feb	Persimmon	FY Dec	2,193	2,456	378	570	-23	21.6	25.8	1.17
24-Feb	Barratt	HY Dec	3,459	3,764	-134	18	0	12.3	15.3	0.95
01-Mar	T.Wimpey	FY Dec	2,534	2,723	113	223	-8	18.1	22.5	1.10
22-Mar	Inland	HY Dec	65	107	-43	-55	51	16.9	12.4	0.62
22-Mar	Bellway	HY Jan	1,440	1,695	-93	-59	3	20.3	25.9	1.21
TOTAL (GBP)			**12,003**	**13383**	**74**	**524**				
Individual average change (%)				18						
Sector average change (%)				12						
Individual average ROCE (%) adjusted								17.7	21.1	0.99
Sector average ROCE (%) adjusted								16.7	19.2	1.07
Individual average gearing (%)							4			
Sector average gearing (%)							-4			

Notes:

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

Performance and outlook

Gleeson (Interims - 22 February)

Gleeson calls itself "the urban regeneration and strategic land specialist" and it raised half year pre-tax profit by almost two-and-a-half-times to £11.3 million. The half year also included a 500% leap in strategic land EBIT to £4.2 million from four site sales; and, at that time, it was holding 10 sites with planning or a resolution to grant it plus 16 awaiting determination or the outcome of an appeal. Elsewhere, in homes-for-sale, units sold increased 25 to 400 units with an average selling price of £125,000 (+0.3%).

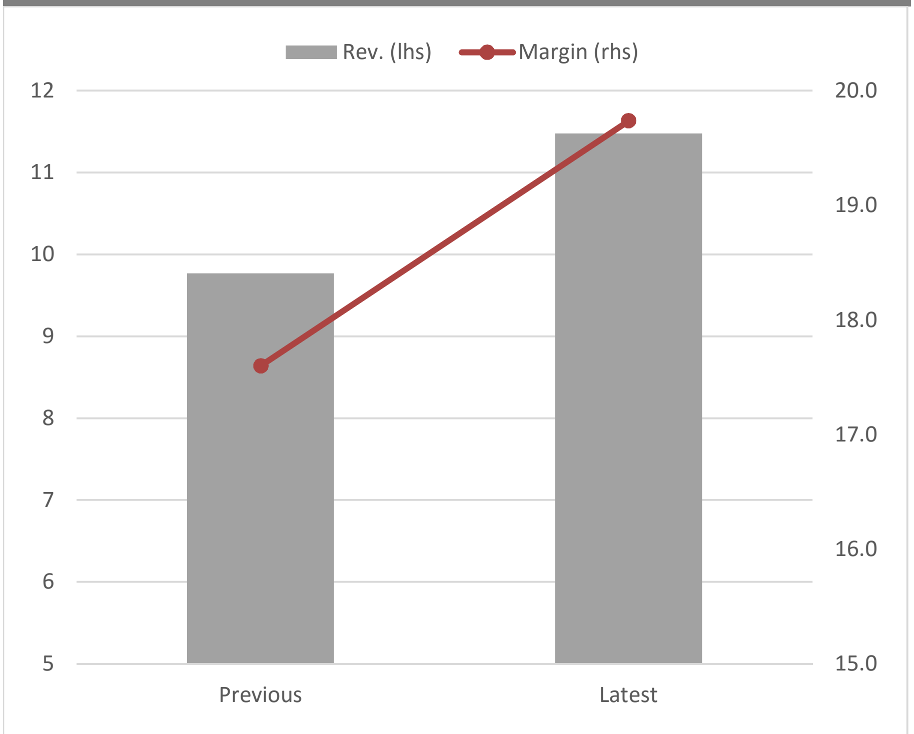
"Land continues to be available at sensible prices and demand for low cost homes remains strong. In Strategic Land, we are seeing a more balanced phasing of sales over the course of the financial year".

Persimmon (Finals - 23 February)

Why does this company persist with such lengthy statements - this time almost 12,000 words (ex-the tables and notes)? In our view, it is a waste of time and a number of trees (this also includes the words "strategy" 30 times and "value" 41). Persimmon has also changed the strap-line on this year's Strategic Report from 'Building value" (good name) to "Building Homes, creating value".

Yes, the Group had an "outstanding" year but let the figures speak for themselves: pre-tax profit up 34% to £638 million; and an ROCE (our definition) of 25.8% (2014: 21.6%). It has also returned £733 million (£2.40 per share) of excess capital to shareholders since 2012.

Sector Revenues (£bn) and EBIT margin (%) - reported in Q1 2016



Source: Hardman & Co Research

Barratt (Interims - 24 February)

Barratt saw revenues rise by almost a fifth in the half year to December 2015 (to £1.9 billion and 7,626 units) and with it operating margins nudged from 14.2% to 16.1%. At the same time, pre-tax profits soared 35% to £295 million.

It also spoke of a positive housing market with transactions in the year to December 2015 increasing by 0.5% - albeit this is still only around 76% of the 2007 figure.

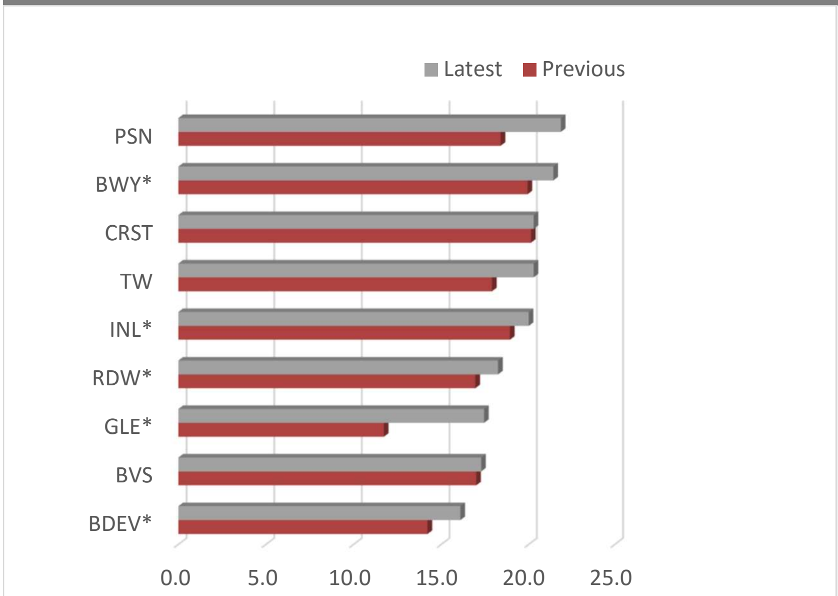
"External indices (also) showed house price inflation moderated in the period, with market house price inflation of around 4.5% in the six months ended 31 December 2015". And "the number of first time buyer completions in the housing market has remained high, just 0.5% below the eight-year high in 2014 supported by favourable economic conditions and ongoing Government support".

Taylor Wimpey (Finals - 1 March)

Taylor Wimpey completed 13,219 homes (ex. JVs) in the UK last year (+7.5%) with +8.0% on total average selling prices to £230,000; and orders are up 25%. Elsewhere, operating margins also finally cracked 20% (2014: 17.9%) and pre-tax profit rose 34% to £604 million.

The Group said the market had strengthened into the beginning of 2016, save for London: "flat prices and sales rates (are) returning to a more normal level". And, "we believe that we are currently operating in the growth stages of the housing market". Materials pricing remains broadly flat too and "we have seen a reduced rate of inflation on labour pricing. We anticipate underlying build costs will increase by 3% to 4% in 2016".

EBIT margins (%) reported in Q1 2016



*Note: i.e. earnings before interest & tax; * denotes interim results*
Source: Hardman & Co Research

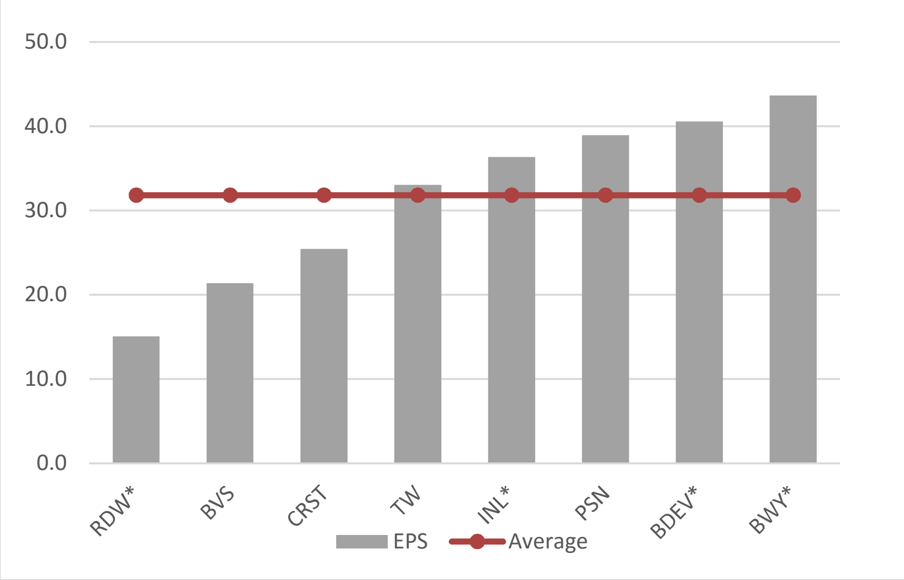
Berkeley (IMS - 19 March):

"The London housing market has remained stable over the period and Berkeley is seeing good underlying demand for its properties. Similarly, "Berkeley remains on course to deliver £2 billion of pre-tax profit in aggregate over the three years culminating in 2017-18".

The Group has welcomed the Government's intentions to address the "acute" imbalance between housing supply and demand but it is also concerned that factors might stand in the way including a reduction in public sector resources.

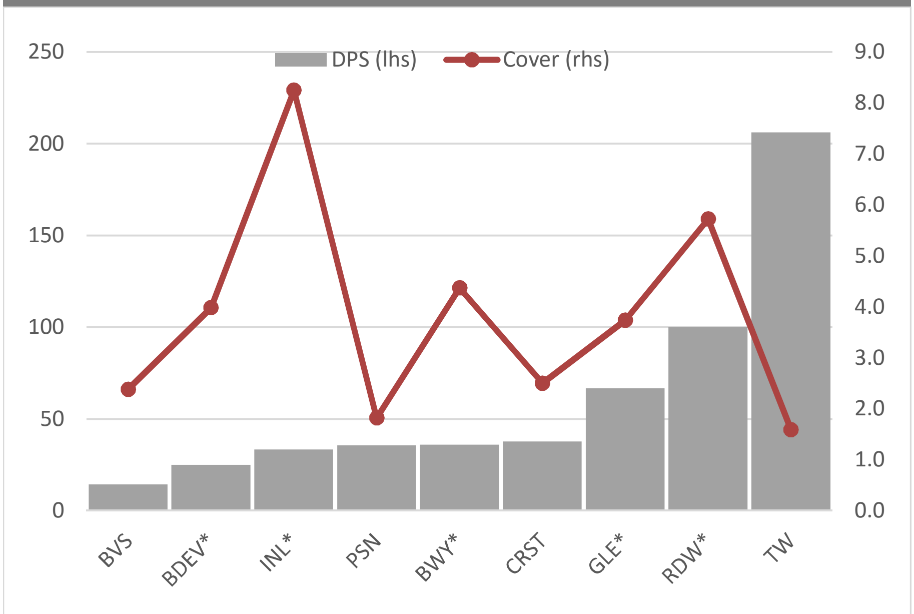
As at the end of February, reservations were some 4% lower year-on-year; and "since the half year, we have sold 62 properties at prices over £2 million - a similar number to the same period in 2014-15, when the market slowed in the run-up to the General Election".

Earnings per share (EPS) growth (%) newly reported in Q1 2016



*- ex Gleeson's +172%; * denotes interims*
Source: Hardman & Co Research

Dividends per share (DPS) in Q1 2016: % change; & cover (x)



** denotes interims*
Source: Hardman & Co Research

Inland Homes (Interims - 21 March)

Inland Homes is the AIM listed housebuilder and brownfield regeneration specialist and it reported bumper pre-tax profits of £21.5 million (2014: £5.7 million) albeit this included £14.0 million of revaluation surplus.

Revenue rose 5% to just over £55 million which included the sale of 93 private homes at an average selling price of £325,000 (+34%) and the sale of 244 building plots.

Current rental income is also at an all-time high at £2.3 million per annum and Inland has invested in a "newly formed premium house building company" called Troy Homes. It also said that "demand for new homes and for land with planning consent remains high in our areas of operation"; and this is particularly true of suburban locations outside central London.

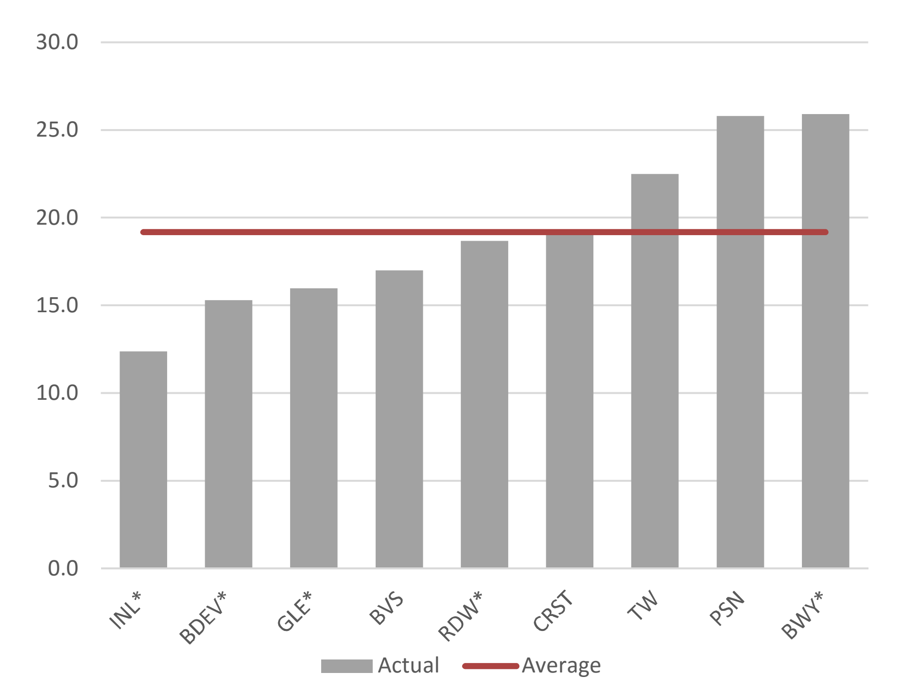
Bellway (Interims - 22 March)

Bellway revenues rose 30%, while pre-tax profit (+43% to £227 million) did even better and the dividend was increased 36%. Operating margins were also over 20% (i.e. 21.4%) and, by our definition, ROCE was nudging 26%. This is an excellent performance.

Unit sales rose 12% to 4,188 and prices by 17.3% to £257,280 (wind assisted by London apartments) with the order book ahead 7% at just over £1.2 billion.

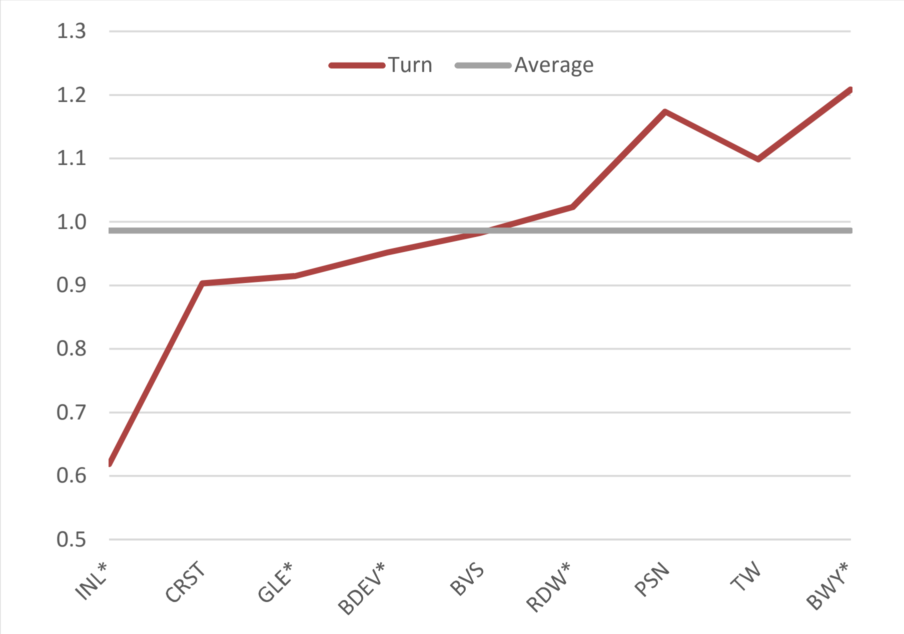
"Trading conditions continue to be favourable, with strong customer demand, assisted by ongoing Government support". In addition, "the pricing environment remains positive"; however, "the industry is still facing a shortage of skilled labour, most notably around London".

Latest and average ROCE (%) in Q1 2016 results



*- i.e. return on capital employed; * denotes interims)*
Source: Hardman & Co Research

Capital Turn (x) in Q1 2016 results



*i.e. revenue divided by capital employed; *denotes interims*
Source: Hardman & Co Research

Macroeconomics

GDP in Q4 and 2015 was better than expected at 0.6% and +2.3% in respective volume terms. However, the OBR has revised its GDP growth forecast down from an average 2.4% to 2.1% per annum over the next five years. More worrying, too, is the highest current account deficit since records began in 1955 at 7.0% of GDP in Q4 and 5.2% for year as a whole. Elsewhere, the Consumer Price Index (CPI) in February was +0.3% year-on-year and unchanged on January with transport down and food up.

Unemployment is at a lean 5.1% for the three months to end January 2016; a year ago it was 5.6%. And, finally, Retail Sales in February by volume increased 3.8% year-on-year which was the 27th consecutive month of growth; but month-on-month sales were off 0.4% and average store prices fell 2.5%.

Mortgages

The British Banker Association (BBA) confirmed that mortgage approvals in February were 26% higher year-on-year at 79,428, albeit down a touch (minus 0.4%) on January as the stamp duty deadline loomed (data here excludes building societies lending and almost a third of mortgages). At the same time, the Council for Mortgage Lenders (CML) reported that gross mortgage lending reached £17.6 billion in February which is the highest tally for 'a February' since 2008 when it reached £24.1 billion.

Last but not least, the Bank of England data showed mortgage approvals up 19% in February (to 73,871) year-on-year but, again, light (+0.3%) on January.

Volumes and prices

Experian (where I am an advisor) is forecasting that Private Housing Output will average 3.7% per annum real growth 2016 through 2018, which is very alright to be getting on with.

Similarly on houses prices, the Nationwide recorded a rise of 0.8% in March with the quarterly (+1.5%) and annualised (+5.7% versus 4.8% in February) growth figure even better. However, it also intimated that a post-stamp-duty rise hangover is beckoning.

Rightmove, which focuses on newly marketed home prices, also reported that prices rose 3% in March to reach the £300,000 milestone. This was also the second highest monthly gain since 2008 as momentum spreads north and west and London stands still.

Next up, the Halifax recorded a dip in February of 1.4%, albeit prices are still 9.7% up annualised (the same as in January) with straws in the wind of tentative supply increases but also of affordability issues.

Finally, Hometrack noted an annualised 8.2% surge in February across the UK with its 20 city composite index at +11.1%; and the latter is up from 8.1% a year ago and is alsothe highest for 18 months.

Springfield

This is the fictional hometown of The Simpsons, mid-sized and in an undetermined US state. It acts as a complete universe in which characters can explore the issues faced by modern society. The geography of the town and its surroundings are flexible, too, changing to address whatever an episode's plot calls for; it sounds a lot like housebuilding.

In Q1, the Housebuilding Sector was in the boondocks with a loss of 6% in share prices and value; and we have all become unaccustomed to seeing red ink. To be fair, Q1 of 2016 has been characterised by force 10 turbulence in the financial markets and a headless oil price; and it remains to be seen whether this is simply a bout of pecuniary dyspepsia or something worse.

The events in Brussels are appallingly familiar, too, and they will continue, perhaps for a generation. As my late Father-in-law used to say "the world is on fire"; and it is. But you can't take to your bed over it; and I remain sanguine.

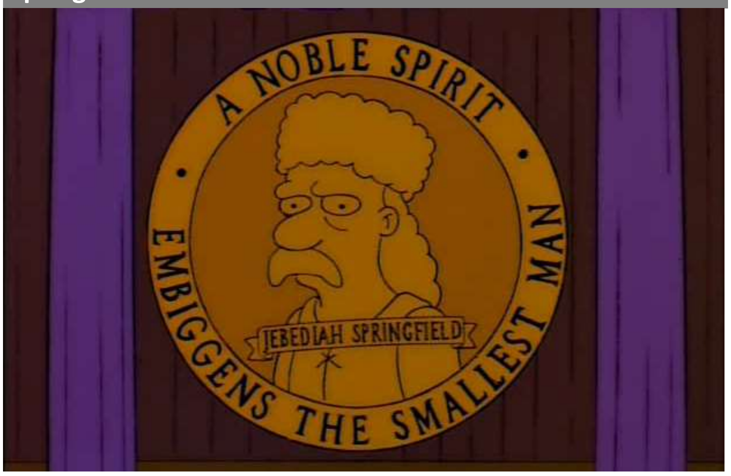
Similarly, Homer Simpson says it is better to travel than to arrive; albeit Marge disagrees and so do I. Clearly, there is no Brexit express for him to climb aboard; and, here, it is the uncertainty generated by the journey to polling day that is actually worse than either result. In one day, for example, in February the Housebuilding Sector fell 6% - purely on Brexit fears.

On a brighter note, interest rates are now expected to stay lower for longer, new housing volumes are up and 'Help to Buy' is working. Similarly, consensus earnings forecasts for the Sector also point to double digit growth, a prospective PER of less than 10.0x a year out and a yield of 4.3%.

Check out the way the Sector undulates, too, and even now it is only 7% or so off its all-time high; it doesn't want a curtain call just yet.

Bart Simpson is noted for his parsimony and I would be inclined to take a leaf out of his book pro tem. But there will be opportunities; and one of them is not in Berkeley shorts.

Springfield town motto



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Glossary

ABBY	Abbey
BDEV	Barratt Developments
BWY	Bellway
BKG	Berkeley Group Holdings
BVS	Bovis Homes Group
CPS	Countryside Properties
CRST	Crest Nicholson Holdings
GLE	M J Gleeson
INL	Inland Homes
MCS	McCarthy & Stone
PSN	Persimmon
RDW	Redrow
TW	Taylor Wimpey
TEF	Telford Homes
WJG	Watkin Jones Group

Share prices at 31 March 2016

Adjustments have been made to share prices where required

Selected stocks are excluded from charts and Sector averages due to extreme movements or for structural reasons

Notes

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