4 July 2018

UK Housebuilding Sector in 2Q 2018…

…and beyond (the World Cup)

Summer 2018

Source: Creative Commons

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Video Assistant Referee (VAR)

Source: Shutterstock

This VAR was conceived in 2010 by the Royal Netherlands Football Association (KNVB) but it was seven years later, in April 2017, that it had its professional club competition debut in the A-League in Australia in a match between Melbourne and Adelaide.

About the same time, at the beginning of the 2017-18 season, it was introduced to top-flight European football by the Bundesliga and Serie A; and, in the UK, in a third-round FA Cup game in January 2018 (between Brighton and Crystal Palace).

In March of this year, the International Football Association Board (IFAB) wrote VAR into the Laws of the Game; albeit its use remains optional for competitions (for example, it is not likely to be used in the English Premier League next season). Thereafter, FIFA officially approved the use of VAR for the 2018 FIFA World Cup in March and the first World Cup penalty awarded – after consultation with a VAR – occurred in France's 2-1 win against Australia on 16 June.

But it has not had an easy birth and it is accused of "creating as much confusion as clarity" and of interrupting the flow of 'the beautiful game'. It was the same in rugby union, when the Television Match Official, or TMO, was introduced. Pandemonium at first and now we can't live without it.

Isn't it better to have (as near as damn it) confirmation rather than doubt and debate? And FIFA says VAR scores 99.3% accuracy against 95.0% for a human.

Expect more intervention in UK in the second half

It is the same in the UK Housebuilding Sector, where share prices have clearly been adjudicated by a more empyreal VAR.

In Week 20, Crest Nicholson issued a gloomy Trading Statement and its shares fell 15% followed by confirmation of same in Week 24 with its interim results; following a VAR review, the shares fell another 6%.

On 12 June, Bellway promulgated a Trading Update and its share price fell 4%; and by the close of 2Q – 13 trading days later – the shares had dropped another 9%.

On 18 June, McCarthy & Stone promulgated a profit warning in all but name and its shares fell 17%; and, again, by the end of 2Q, they had lost another 9%.

It was the same with Berkeley which published excellent final results on 20 June and confirmed its earlier statement that the current year would see a cyclical 30% fall in pretax profits. Its shares fell 6% on the day despite this not being new news; and, by 29 June, they had fallen 3% more.

The football VAR standard for overturning a referee's original decision is: "has there been "a clear and obvious error"?

The Sector VAR has embraced this methodology and we believe that the reviews to date have been correct i.e. the initial share price falls were not enough, given the standard of play.

Expect more intervention – and yellow cards – in the second half.

Value in the second quarter

The Sector still trades on a single-digit PER

In the second quarter of 2018, the stock market value of the UK Housebuilding Sector lost 2% to £38.4bn at the final whistle (which compares with minus 11% in 1Q 2017).

This was also 14% or £6.3bn off its pre-World Cup high which was recorded on 24 October 2017 (£43.6bn); albeit still 6% above its pre-Brexit level.

Nor were there any new peak values in 2Q (or hat tricks).

In total, too, there were 63 training days in 2Q and the Sector scored on 37 of them and didn't on 24; and there were no nil draws.

Similarly, in 13 weeks, nine were up and four were in the dugout; and, month-by-month, it was as follows: April (plus 6%); May (plus 1%) and June (minus 9%).

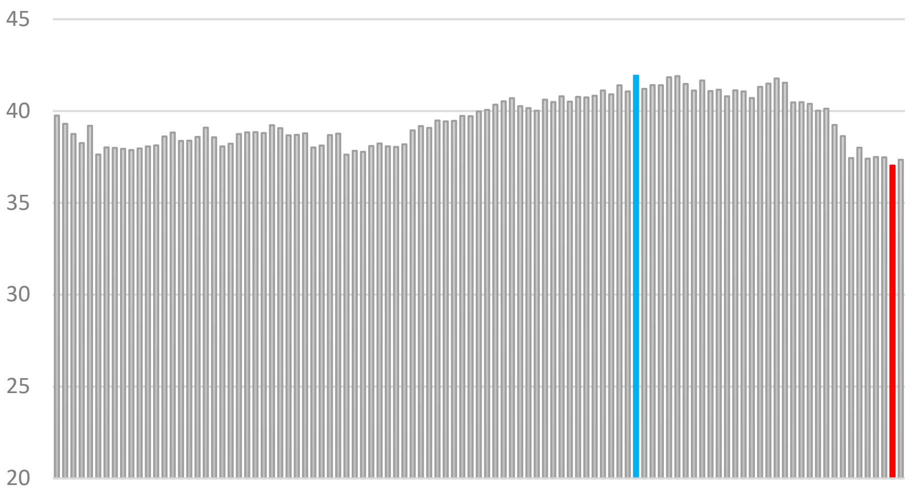
The best weekly player was Week 14 (+2.3% in value), while the worst was Week 25 (minus 5.1%).

The best goal day was 15 May (+2.1%) and the worst on 21 June (with minus 3.1%).

Since the Sector's performance trough (7 July 2008), the rise has been 990% or £34.2bn; and the Brexit own goal from June 2016 – when Housebuilders lost 40% of their value in two days – is happily a distant memory.

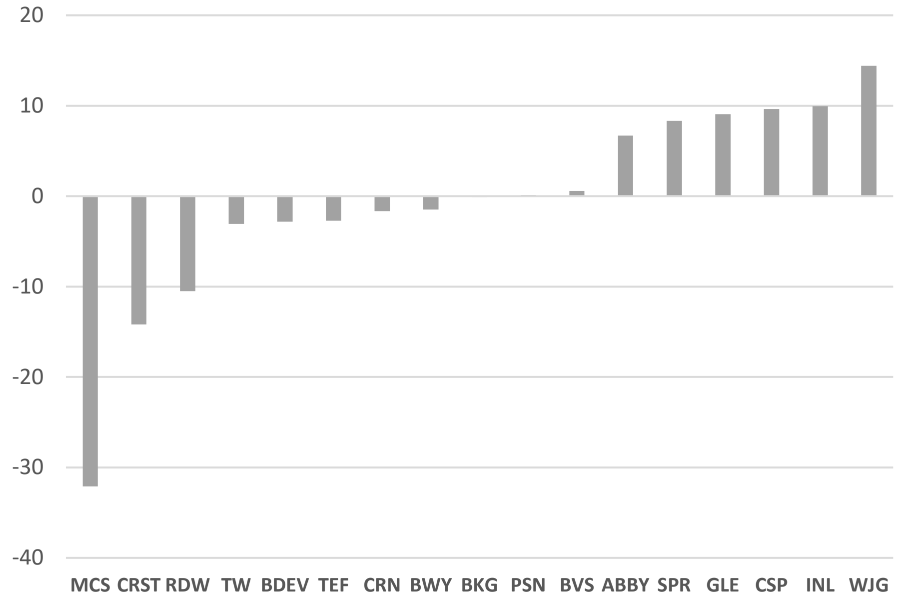
And yet, the Sector still trades on a single-digit PER shirt a year out.

UK Housebuilding Sector stock market value – daily – in 1H'18 (£bn)



Note: blue denotes 1H'18 high on 15 May; red denotes 1H'18 low on 28 June
Source: Hardman & Co Research

Share prices in 2Q'18 vs. 1Q'18 (% change)



Source: Hardman & Co Research

Share prices in the second quarter

Share prices dipped 1.6% in 2Q'17

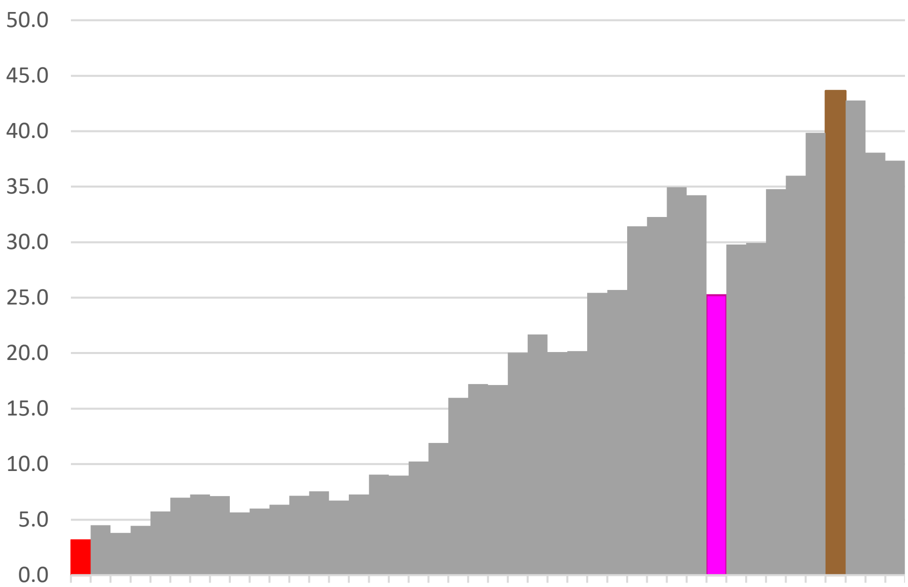
Turning to Housebuilders' actual share prices (pounds and pennies as opposed to pounds million), the average midfield movement in 2Q'2018 was minus 0.6% on an actual basis and minus 1.6% weighted by market capitalisation (in 2Q 2017, these strikers scored +6.1% and +4.3%, respectively).

Note, too, that, from 17 Sector squad companies, eight rose and nine fell in 2Q, with the best player, Watkin Jones (the eponymous and renowned student accommodation developer), up 14.4%.

The worst team member was McCarthy & Stone (minus 32.1%) after a Trading Update which the market took to be a profit warning; a similar fate befell Crest Nicholson, which fell 14.2% in 2Q.

On a more positive note, Countryside, Inland and Springfield all rose by to 9%.

UK Housebuilding Sector: market value (£bn): 3Q'08 to 3Q'18



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

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

Only four were first-team positive in 1H'18

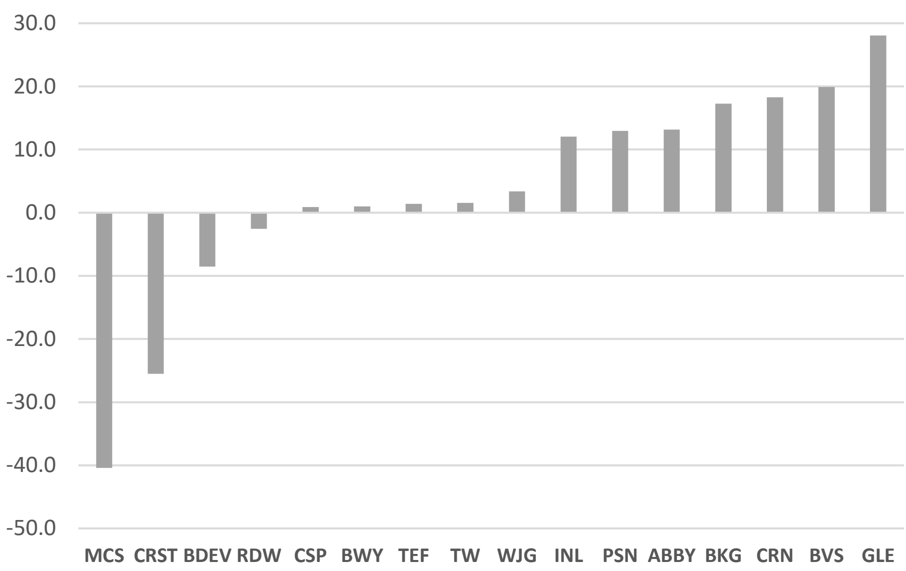
Comparing end-June this year with end-June 2017, Housebuilders' share prices are marginally ahead by 3.3% and 4.8% weighted (a year ago these shirt numbers were 10% and 11% respectively). However, this performance was dragged down by McCarthy & Stone, Crest Nicholson and Barratt. It was similarly positive in the wider equity market and in real estate, albeit the construction sector was lower.

Reducing that time period to the first half of 2018, it is not such a happy result, and Housebuilders' share prices have fallen 7.8% actual and 12.1% weighted against 1H 2017; and only four were first-team positive Abbey, Gleeson, Inland and Springfield. By consolation, a majority of the relevant players in the wider UK equity market were also red-carded; with the FTSE 250 on yellow.

In 2Q 2018, the Housebuilding Sector was the worst relative footballer in equity market competition. For example, on a weighted basis, Sector share prices fell 2% while the centre forwards in the UK equity market rose by 7%-8%. The same goes for the wider construction and real estate sectors.

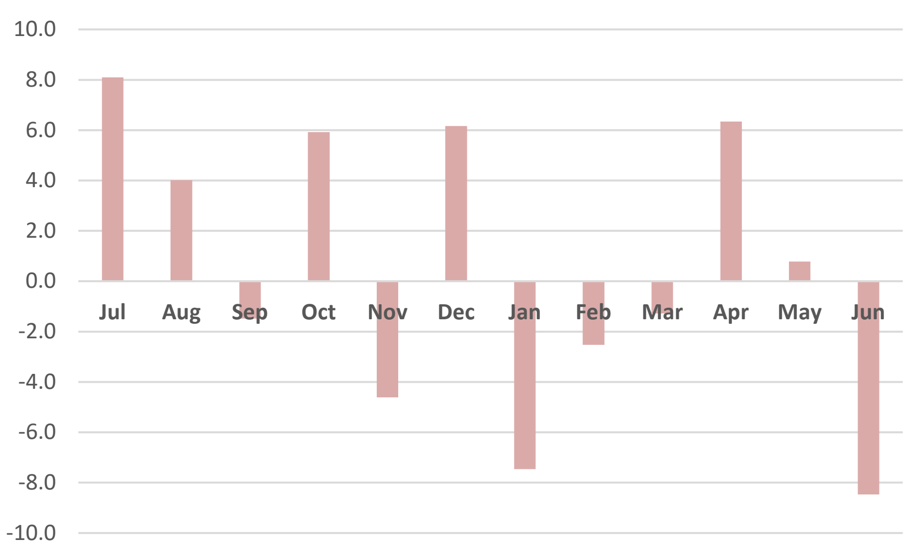
Finally, and looking at the last 34 quarters since 1Q 2010 (i.e. eight-and-half games), the Sector has seen share prices rise in 24 of them – and fall in 10.

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



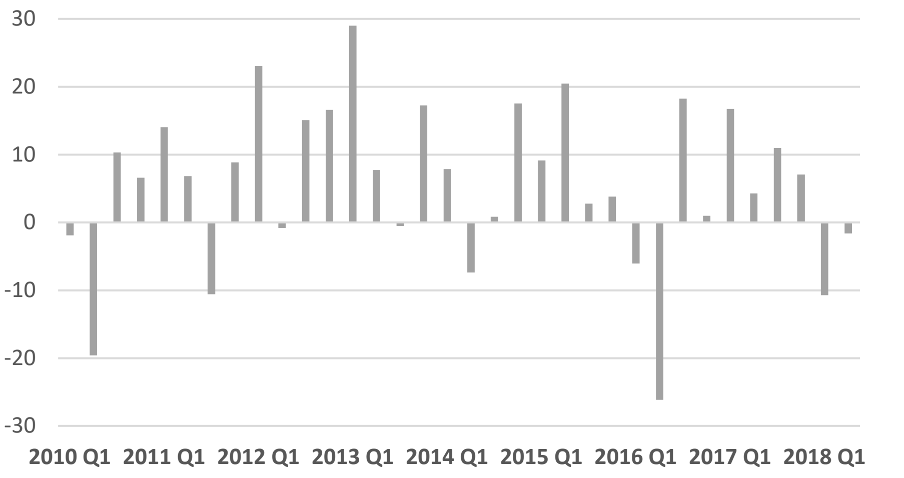
Source: Hardman & Co Research

UK Housebuilding Sector: 12 months to June 2018 (% change in value)



Source: Hardman & Co Research

UK Housebuilding Sector share prices: 1Q'10 to 2Q'18 (% change)



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

Peaks and values

Four players account for 64% of Sector value

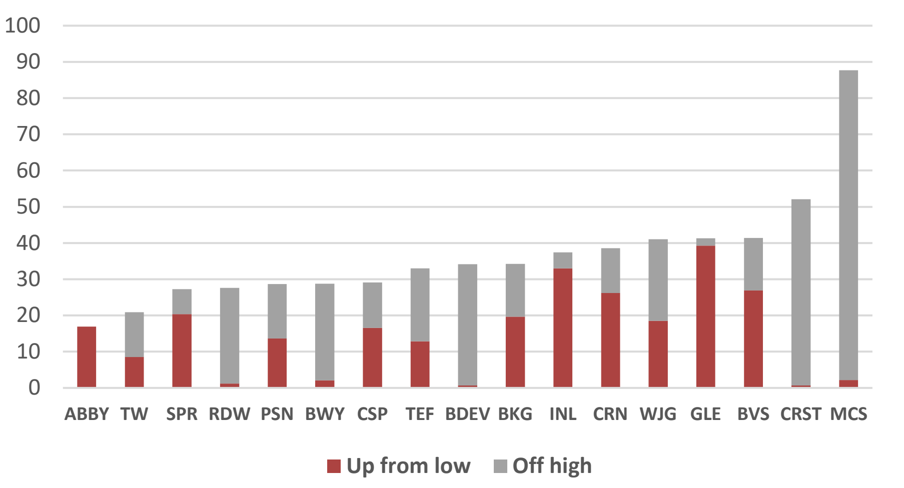
At 29 June 2018, Housebuilders' share prices were, on average, 1,772% above the lows of 2008; and 15% up on more recent 52-week lows (and – weighted – these numbers are 2,426 times and 11% respectively). Note, too, that 2008 was not a World Cup year.

But Team Housebuilders was also some 18% below their 2007 seasonal peaks (24% weighted) and 16% off 52 week highs actual and weighted.

For the record, too, four housebuilders continue in the first team FTSE 100: Berkeley (number 96); Barratt (93); Taylor Wimpey (87); and Persimmon (58).

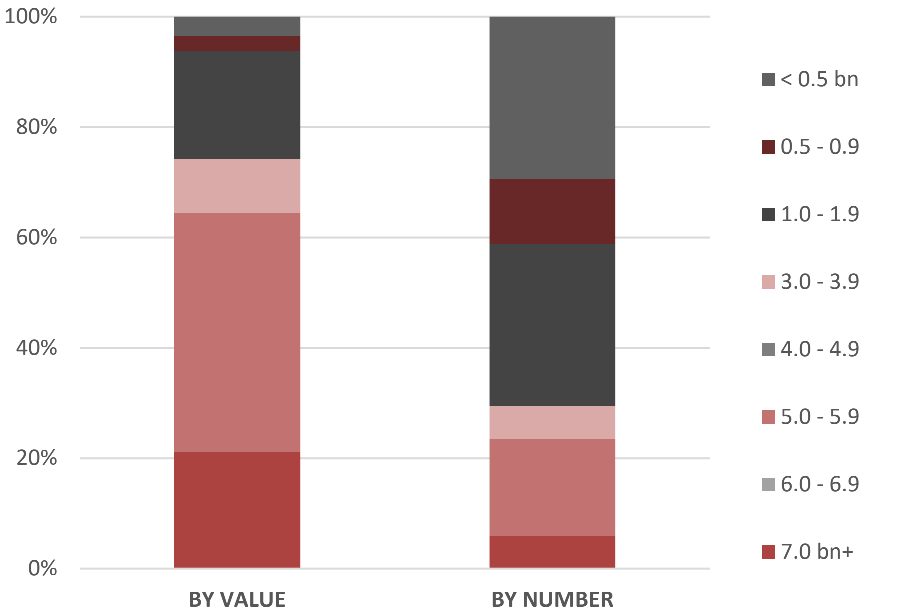
Together, these four players account for 64% of Sector value.

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



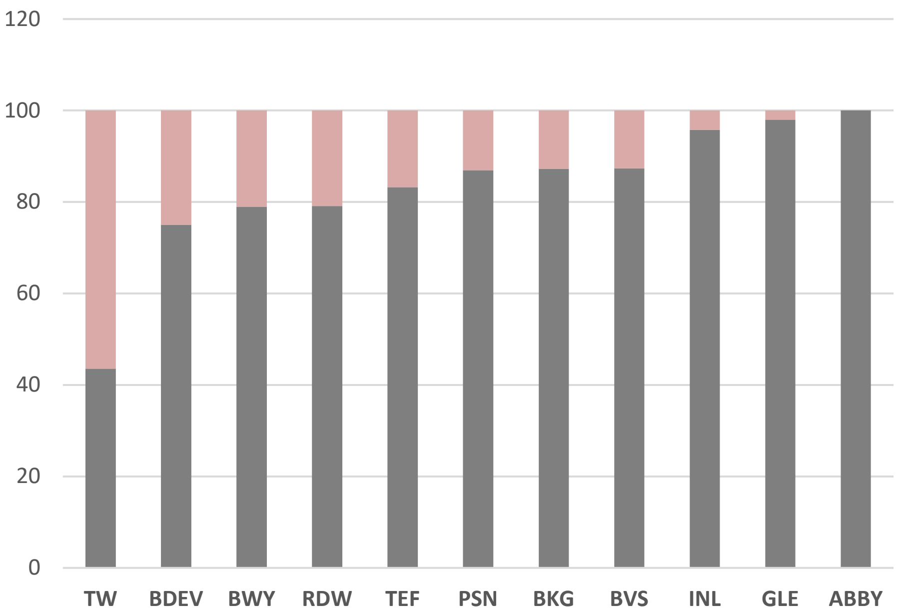
Source: Hardman & Co Research

Sector structure by stock market value: 17 firms worth £37.4bn at 29/06/18



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

Current share price as % of all-time peak level at 29/06/18 (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 is down two-thirds

The Housebuilders' latest average price-to-book (P2B) valuation was 1.67 on 29 June 2018 and 1.88 weighted; a year ago, the transfer fees were 1.78 and 2.03, respectively.

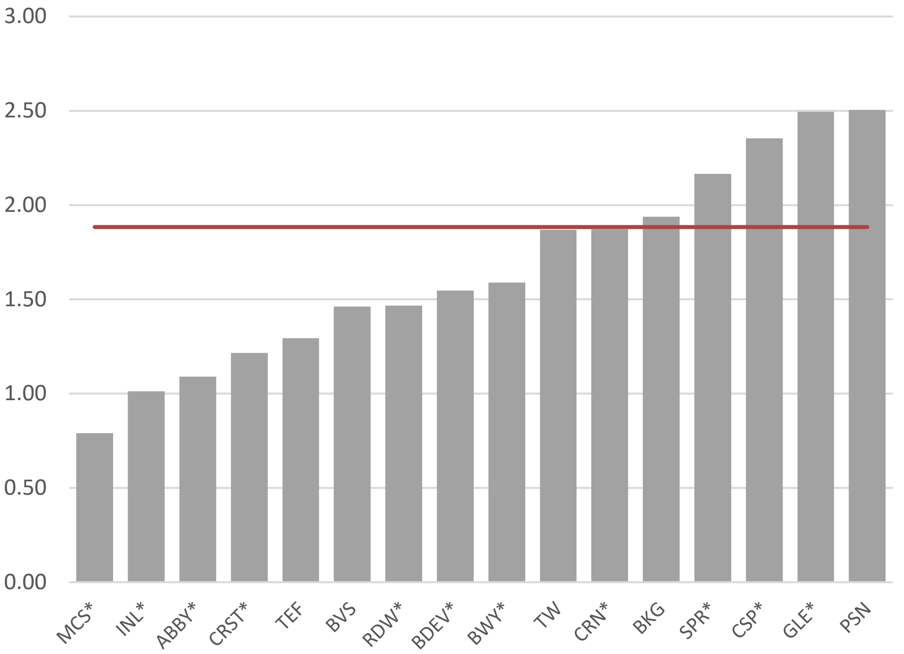
Four out of 16 companies are at 2.0 or better, with Persimmon at 2.50. Meantime, Most Valuable Player (MVP) Watkin Jones has an extraordinary 3.90 price to book ratio which is excluded from the chart and the averages.

Passing to Total Shareholder Return (TSR) for the Sector in the 12 months to 29 June 2018, this was 7.6% and 10.8% weighted; and compares with 20.4% and 43.0%, respectively, in the 12 months to 30 June 2017 (no, this is not a misprint).

In the latest 12 months, too, Gleeson was the top goal scorer with a TSR of 32.9% with assists from Berkeley, Bovis and Persimmon (all above 20%).

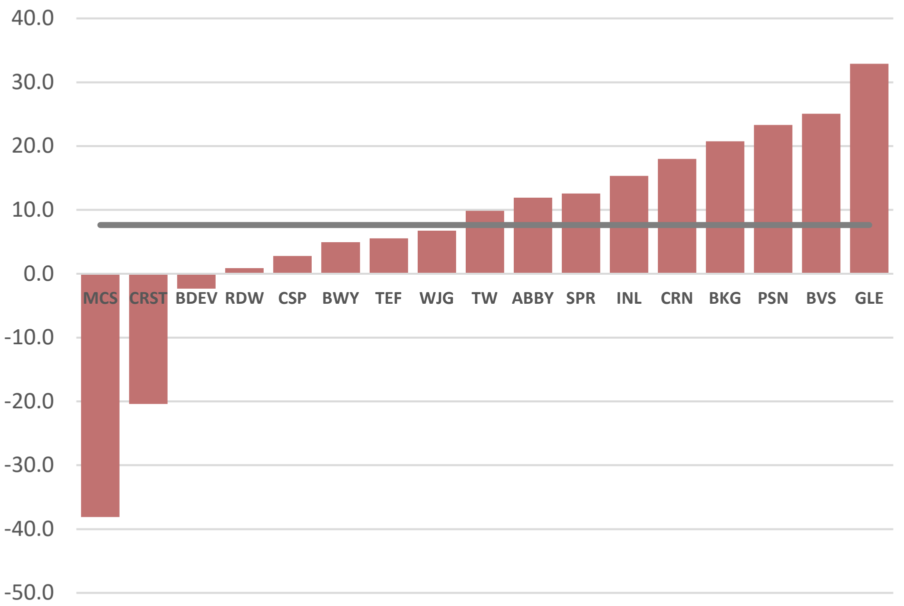
However, three companies were negative: Barratt, Crest Nicholson and McCarthy & Stone (the latter two especially so). Ex-the red cards, though, the average TSR over the 12 months to 29 June 2018 was 13.6% and 15.0% weighted.

Price-to-Book (P2B) at year-end/latest interims*; priced at 29/06/18



** denotes interims; weighted average is 1.88; and actual average is 1.6; ex-Watkin Jones at 3.90*
Source: Hardman & Co Research

Housebuilders' TSR in 12 months to 29/06/18 (annual %)



Source: Bloomberg; Springfield (SPR) is estimated

Valuation

Average earnings growth is flat in 2018

The Housebuilding Sector's prospective season PERs are 9.4x in 2018 followed by 8.8x in 2019.

Average earnings growth is forecast as flat (i.e. plus 0.8%) in 2018 and at plus 5.6% in 2019 (to which we would hold a yellow card).

Note, too, that Berkeley's prospective sharp drop (i.e. 30%) in earnings – sanctioned by the Group – impacts the average.

For the record, too, trailing-12-month PERs for the UK's first team equity market indices range from 13.3x to 15.2x which compare with the Sector's 9.4x on the same basis.

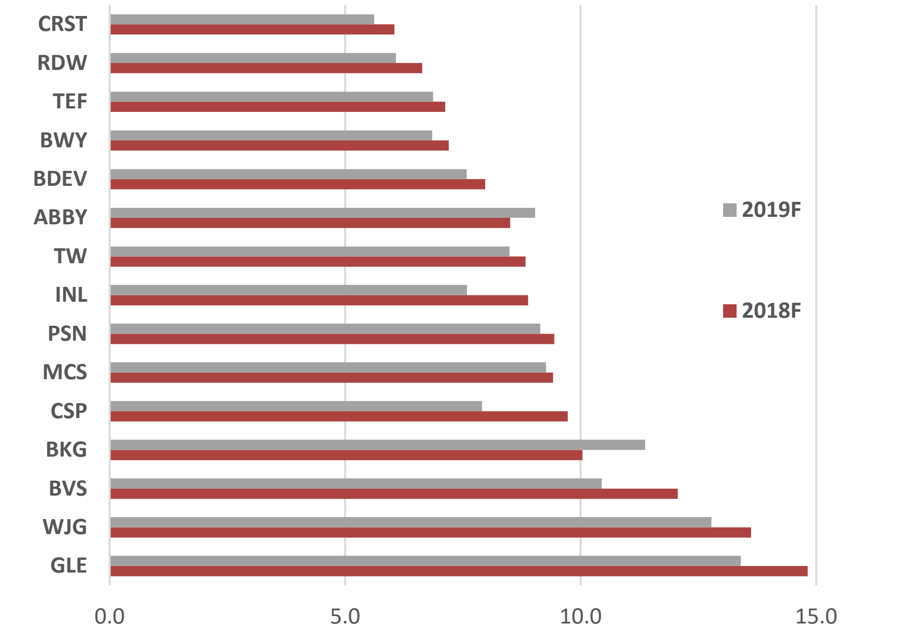
In 2018 and 2019, the UK Housebuilding Sector yields, on average, are a prospective 5.4% and 5.8%, respectively – which are pitch-covered 2.8 and 2.6 times.

Note, too, that a number of companies has committed to enhanced dividend payments which means Barratt, Bovis, Crest Nicholson, Persimmon and Taylor Wimpey are forecast to be yielding 8% or 9% in both years.

For the record, the UK equity market yields between 2.7% and 3.8% historic with average cover of 2.1x.

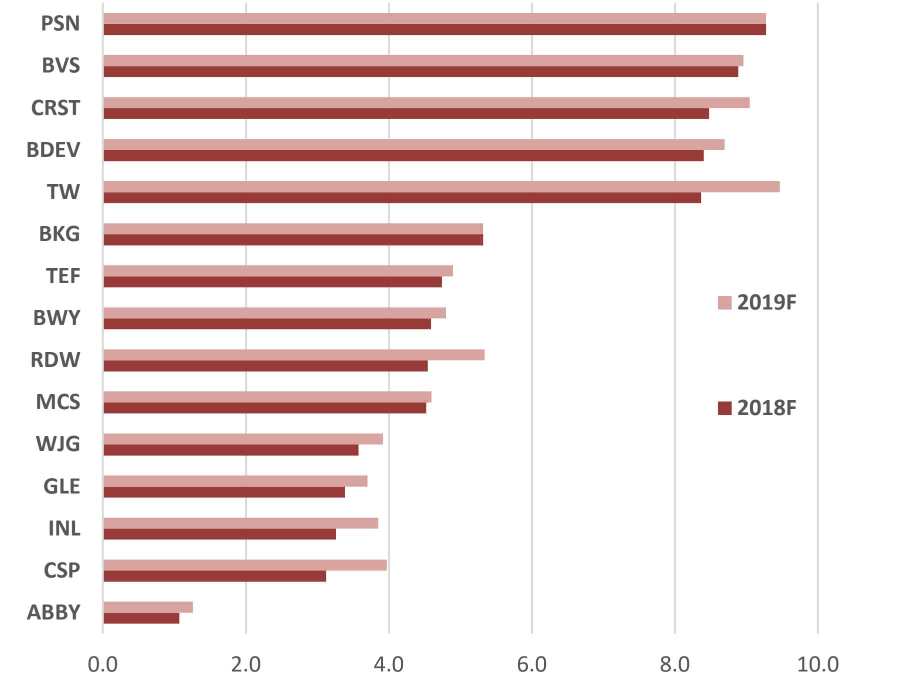
All calculations are made at the London Stock Exchange (LSE) close on 29 June 2018.

PER: 2018E (9.4x) and 2019E (8.8x) as at 29/06/18



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

Yield: 2018E (avg. 5.4%) and 2019E (5.8%) at 29/06/18



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

Results and trading in 2Q'18

In 2Q 2018, there were two sets of final results, four interims and 16 trading related announcements from the 17 Sector companies; plus six news-related odds and sods.

Average individual pretax profits for the 2Q reportees rose 6% (or 17% ex McCarthy & Stone), while EBIT margins dipped from 16.8% to 16.6% (or 18.7% ex-McCarthy & Stone), on revenue 3% larger at £4.4bn.

Earnings per share rose by just 7%, on average (or 18% ex McCarthy & Stone – while dividends rose 19% with average individual cover dipping from 2.6x to 2.4x.

There was an average decrease in orders by 9%.

Average individual Return on Capital Employed (RoCE) declined from 21.1% to 19.6% with Capital Turn easing from 1.33x to 1.24x (ex-Watkin Jones, the Sector Capital Turn went from 1.05x to 0.9x).

2Q Profit & Loss

Date	Company	Event	Period ending	PBT (£m)		PBT	EBIT margins (%)		Revenue	Orders	DPS	DPS cover (x)	
				Previous	Latest	% chg.	Previous	Latest	% chg.	% chg.	% chg.	Previous	Latest
11-Apr	McCarthy & St.	Half Year	28'Feb	22	12	-47	10.1	6.1	1	13	6	1.9	0.9
17-May	Countryside	Half Year	31'Mar	63	76	21	16.3	17.2	7	-6	24	3.4	3.3
22-May	Watkin Jones	Half Year	31'Mar	20	24	16	14.7	15.2	18	-	12	2.9	3.1
30-May	Telford	Full Year	31'Mar	35	46	34	12.6	15.0	8	-37	8	2.3	2.9
12-Jun	Crest	Half Year	30'Apr	76	75	-2	19.2	17.2	13	5	0	2.2	2.1
20-Jun	Berkeley	Full Year	30'Apr	812	935	15	27.8	28.8	-1	-20	62	2.5	1.9
Total (£m)				**1,028**	**1,167**								
Individual average change (%)						**6**			**8**	**-9**	**18.6**	**2.6**	**2.4**
Sector average change (%)						**14**			**3**				
Individual average margin (%)							**16.8**	**16.6**					
Sector average margin (%)							**23.3**	**23.6**					

Notes: (i) Profit before Tax (PBT) is adjusted where necessary; and excludes exceptionals
(ii) EBIT is earnings before interest
(iii) DPS is dividend per share
Source: Hardman & Co Research

2Q balance sheets

Date	Company	Event	Period ending	Net assets (£m)		Net (Debt)/Cash (£m)		Gearing (%)		RoCE (%)		Capital
				Previous	Latest	Previous	Latest	Previous	Latest	Previous	Latest	Turn (x)
11-Apr	McCarthy & St.	Half Year	28'Feb	627	667	-28	-76	4	11	7.1	3.7	0.6
17-May	Countryside	Half Year	31'Mar	570	658	-33	14	6	-2	23.3	24.3	1.4
22-May	Watkin Jones	Half Year	31'Mar	113	134	12	38	-10	-29	34.7	33.2	2.6
30-May	Telford	Full Year	31'Mar	204	231	-14	-38	7	17	14.3	14.3	0.9
2-Jun	Crest	Half Year	30'Apr	736	824	-35	-79	5	10	17.5	16.2	0.9
20-Jun	Berkeley	Full Year	30Apr	2,137	2,620	286	687	-13	-26	29.8	26.0	0.9
TOTAL (£m)				**4,387**	**5,133**	**188**	**547**					
Individual average change (%)					**15**							
Sector average change (%)					**17**							
Individual average RoCE (%) + Turn										**21.1**	**19.6**	**1.24**
Sector average RoCE (%) + Turn										**19.3**	**17.3**	
Individual average gearing (%)								**0**	**-3**			
Sector average gearing (%)								**-4**	**-11**			

Notes: (i) RoCE or Return on Capital Employed is adjusted where required; and
(ii) adjustments have been made for Non-Current Assets and Intangible.
Source: Hardman & Co Research

Performance and outlook

Countryside (Interims – 17 May; CMD – 27 June)

The outlook statement was positive

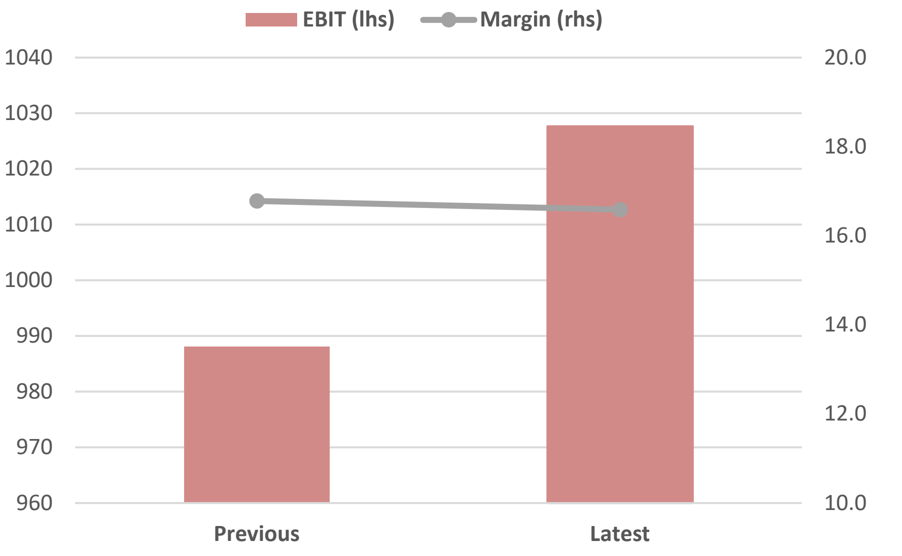
Revenue was up 7% to £468m, with an adjusted EBIT margin of 17.2% (against 16.3% last time).

Meantime, pre-tax profit (of £76m) and earnings added 21%, and the dividend was raised 24%.

Removing some of the cream, though, was a 'Group private forward order book' off 5.6% at £327.6m; and this was described as "strong". Similarly, the net reservation rate per open sales outlet per week was off 2.3% at 0.87 (1H'17: 0.89).

Nonetheless, the outlook statement was positive and, at its Capital Markets Day (CMD) – an increasingly popular forum – on 27 June, the company confirmed that trading was in line with expectations.

Sector revenue (£m) and EBIT margin (%) reported in 2Q'18



Source: Hardman & Co Research

Watkin Jones Group (Interims – 22 May)

Good future visibility on earnings

The renowned student accommodation developer saw revenue up 18% at £158m in 1H'18, with a sustained gross margin of 21.8%.

EBIT was struck at £23.8m and 23% up – with the EBIT margin at 15.1%and down a squeak from 15.4% last time.

Pre-tax profit (to £23.6m) and earnings were also up 16%as was the dividend. The Group is looking towards annual cover of 2.0x ongoing from fiscal 2019.

On Student Accommodation, 15 developments (6,090 beds) are currently forward sold from a total pipeline of 25 (10,300 beds); and the forward sales include all 10 expected site deliveries in fiscal 2018.

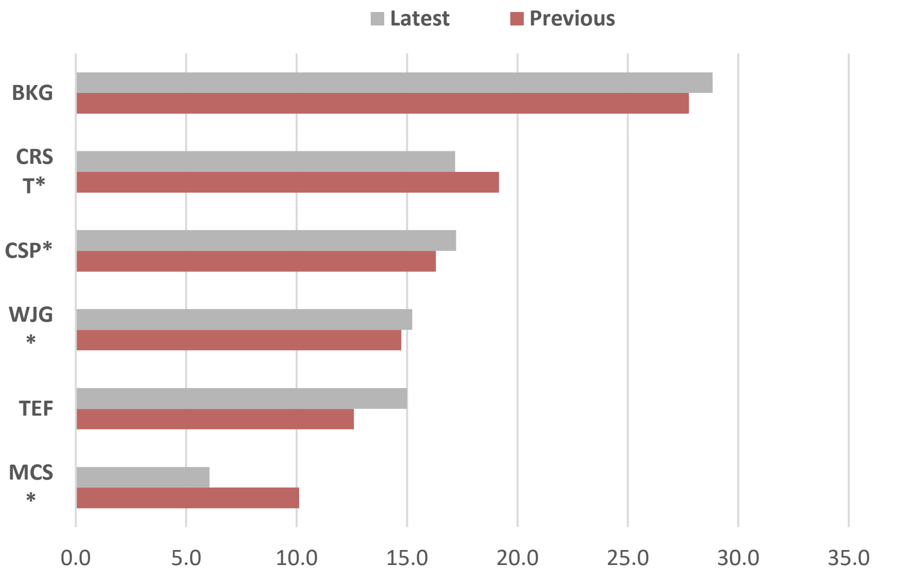
Build to Rent (B2R) is going very well, too, and the Group expects to deliver over 1,500 apartments in the next five years. In addition, the Group is looking at establishing a B2R investment unit, which may be listed and which would act as a prospective acquirer of its developments.

Meantime, Fresh Property Group is contracted to manage 17,053 student beds across 58 schemes by fiscal 2021.

As eponymous CEO Mark is stepping down, the Group has announced that Richard Simpson will join in January 2019. Richard is now Group Property Director at Unite Group plc and is well regarded in the market place.

"The fundamentals for each of the Watkin Jones' business segments remain positive and the market dynamics strongly support the forward sale model, providing good future visibility on earnings and cash flows. The Board is confident in the outlook for the Group".

EBIT profit margins (%) reported in 2Q'18*



**denotes interim results*
Source: Hardman & Co Research

Telford Homes (Finals – 30 May)

A tip-top set of figures

These were a tip-top set of figures, with total revenue clearing £300m for the first time, i.e. +8% to £316.2m.

Telford's gross margin was also significantly ahead at 23.6%, against 19.5% last time, while the net EBIT margin jumped from 12.6% to 15.0% (as Joint Ventures went the other way).

Profit before tax rose by more than a third to £46m, with EPS doing slightly better, up 35%.

The dividend was increased 8% to 17p, which was covered 2.9x (2017: 2.3x). On an ongoing basis, Telford says that it expects to continue to pay at least one-third of its annual earnings in dividends.

“We are well placed to achieve our stated goal of exceeding £50m of total pre-tax profit for the year to 31 March 2019 which will represent a 100 percent increase over four years. The challenge now is to establish the business consistently delivering over £50m of profit every year”.

It added that much of this will depend on the increasing success of the new build-to-rent business; and, at the time of writing, Telford has entered into three new build-to-rent contracts to deliver 387 build-to-rent homes.

The only slight wrinkle in what was a super performance was a total forward sold position that was off 37% at £344m. Yes, there are a number of timing factors at play here, but it is a lot down.

Abbey (Trading Update – 1 June)

Erudite and hubris-free

This communication was erudite, as always, at just 100 words, and, as is its wont, hubris-free.

For the year to 30 April 2018, Abbey has completed 606 house sales: 524 in the UK (-11% on the previous year); 75 in Ireland (+92%) and seven in Czechia (down from 52).

Revenue for the year is at similar levels to the previous one. However, somewhat lower margins mean that operating profit will fall short of last year’s return. Note, too, that in fiscal 2017, operating margins were an extraordinary 28.1%.

Forward sales for the group are satisfactory, and the housing division is on target to build and sell more new homes in the year ahead.

Inland Homes (Transaction – 7 June)

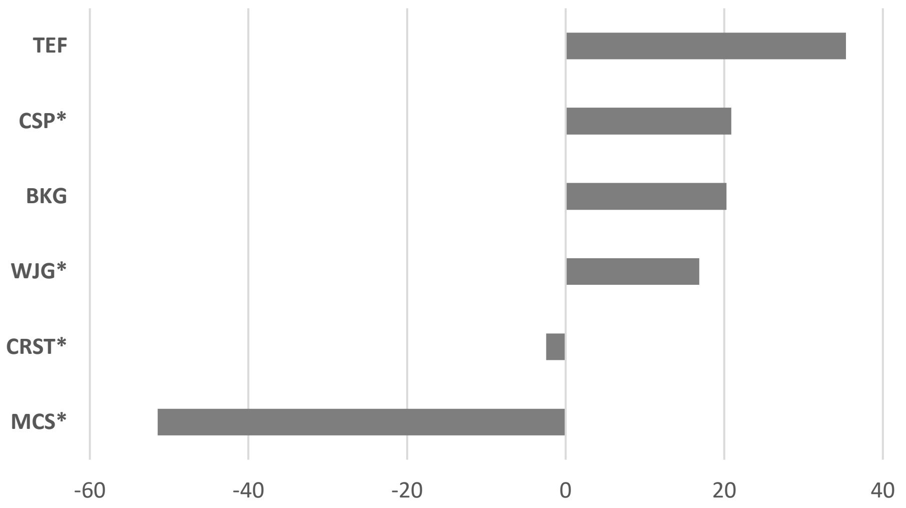
Strategy in motion in Middlesex

In June, the company sold its Brooklands College site in Ashford, Middlesex, to A2 Dominion. The transaction is the largest to date for the Group and is a £95m land-and-build package, with the land element of £30m payable in cash on completion. Inland will also undertake the development phase on behalf of A2.

Expected to take four years, the development will comprise 357 houses, commercial space and a range of other facilities; and, as part of the transaction, the 619 square metres of commercial space will be transferred back to Inland for a nominal sum once construction is complete.

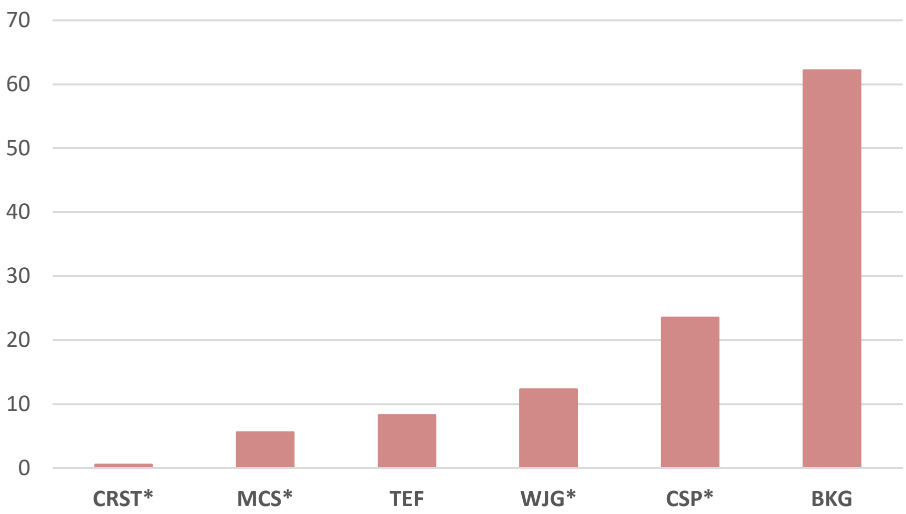
Such transactions allow the company “to recognise land profits while simultaneously securing self-funding, cash positive construction contracts which provide a balance to open market speculative housebuilding”.

EPS growth* (% change) reported in 2Q'18



**denotes interim results*
Source: Hardman & Co Research

DPS growth reported in 2Q'18* (% change)



**denotes interim results*
Source: Hardman & Co Research

Crest Nicholson (Interims – 12 June)

"Generally flat pricing against a backdrop of continuing build cost inflation"

The company had already alerted the market to issues on 16 May, and its share price fell 15%; on these results, it fell another 6%.

For the half year, revenue rose 13% to £474m, with the EBIT margin lower at 17.2% (versus 19.2% in 1H'17). Profit before tax was struck at £74.8m, which was off 2%. The dividend was unchanged.

Crest repeated the words about "generally flat pricing against a backdrop of continuing build cost inflation" at 3%-4%, and the fact that this has had "an adverse impact on our margins". Typically, too, the 1H margin is ca.1% below the full year, which implies EBIT profitability at some 18% for fiscal 2018.

Crest will also close its Central London office but add an outlet in Kent.

Finally, it said: "sales below £600,000 benefit from inflation. Market above £1 million challenged".

Bellway (Trading Update – 12 June)

Customer interest is less pronounced for large or higher-priced homes

On the same day as its Trading Update, the Group hosted an evening drinks reception in the City. On any other day, the share price would have probably risen; instead, it fell 3.6% to 3,287p. The primary damage, however, was done by Crest (see above), which reported its interim results on the same day. It was a busy 24 hours.

Back to Bellway – for the full year to 31 July, it anticipates 6% unit volume growth to ca.10,244 and a maiden five-figure tally. At the same time, it expects average selling prices to be in excess of £280,000 with an operating margin of around 22% – and, thus, "substantial earnings growth".

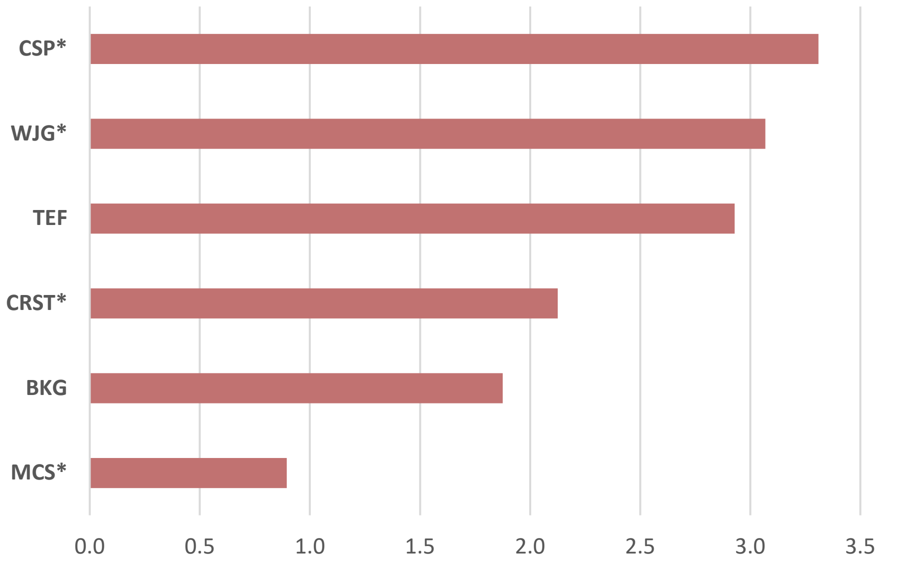
Market conditions are "favourable, stable", and forward sales are up 7.8% to £1,703m; or, by units, the tally was 5.6% up at 6,144. "The pricing environment is firm, with many sites reporting modest, single digit price rises".

On a less positive note, though, was the rate of price increases, which "has moderated compared to last year" and, "in certain areas, where affordability is a greater constraint, customer interest is less pronounced for particularly large or higher priced homes. Accordingly, the use of incentives, whilst low by historical standards, is generally focused towards more expensive properties, where sales rates can be slower".

Demand is most pronounced for affordably-priced family homes countrywide; and "in order to maintain strict capital disciplines, activity in London is focused on the more affordable end of the market".

"Proposals to acquire new sites are carefully appraised to ensure the product mix is appropriate for the location and the financial assumptions are robust"; and the future was caveated: "provided market conditions remain supportive".

Dividend cover (x) reported in 2Q'18*



**denotes interim results*
Source: Hardman & Co Research

McCarthy & Stone (Trading Update – 19 June)

A strategic review to focus on improving margins and RoCE

An update had been scheduled for 4 July but there was clearly a need for an earlier communication; and, as it happened, the shares closed 17% lower on 18 June at 108.2p. A rational man would say the missive did not contain good news, i.e. it was a profit warning in all but name.

Since mid-April ,"there has been a noticeable decline in reservation rates as potential customers have exercised more caution due to ongoing economic uncertainty, a slower secondary market and a softening of pricing, particularly in the South East".

Similarly, legal completions for the fiscal year to 31 August 2018 are now forecast at ca.2,100-2,300 (2017: 2,302), which will mean lower EBIT for the year too – of £65m to £80m (2017: £96m).

Group CEO, 60-year-old Clive Fenton, is to take early retirement at the end of the current fiscal year.

That said, McCarthy & Stone's forward order book – including legal completions – is 11% up at £706m, and a strategic review of the business had already kicked off in April, led by Chairman Paul Lester. This will focus on "improving margins and ROCE (targeting mid-teens over the short to medium term)" and a "right-sizing" of the cost base. It will also be trialling a number of strategic initiatives designed to increase customer appeal and offer a broader choice of tenure options, including rental and part-ownership.

An exemplary record in seeing where the housing market is going

Berkeley Group (Finals – 20 June)

The Group eye-balled £1bn of PBT in its latest fiscal year (i.e. +15% to £935m) and pretty much the same amount in gross cash in a compleat delivery for the year to 30 April.

Add to this an EBIT margin of 28.8% (on revenue of £2.7bn) and a RoNA of 35.7%, and you get the picture. The frame, too, was beautifully crafted; and others would do well to study the varnish.

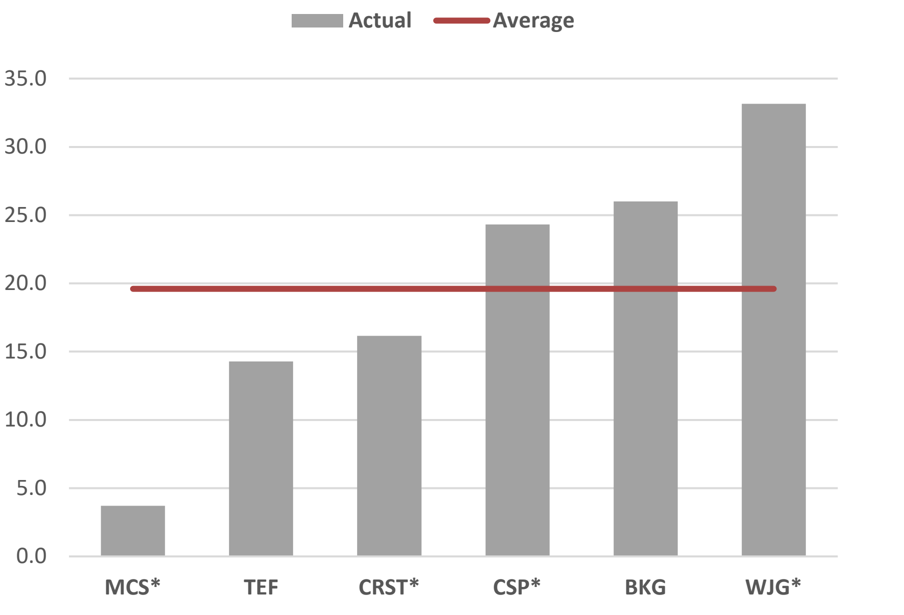
Okay, fiscal 2018 was a self-admitted cyclical peak, which means that PBT is set to fall 30% in fiscal 2019. Note, too, that this is not new news. It had been well-telegraphed ahead of time, which means a 6% fall in the share price on the day of the figures was a surprise. The Group has also added £75m to its guidance of at least £3,375m of profit before tax over the five years commencing 1 May 2016.

Post-2018, however, Berkeley expects profitability to return to more normal levels and it is targeting a 20% pre-tax RoNA "over the cycle", depending on its level of cash. Right now, it holds around £400m excess "due to macro uncertainty".

Doing the math, from the £3,375m 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 £973m for fiscal 2020 and 2021, which is the amount of profit it made in a single year in fiscal 2018.

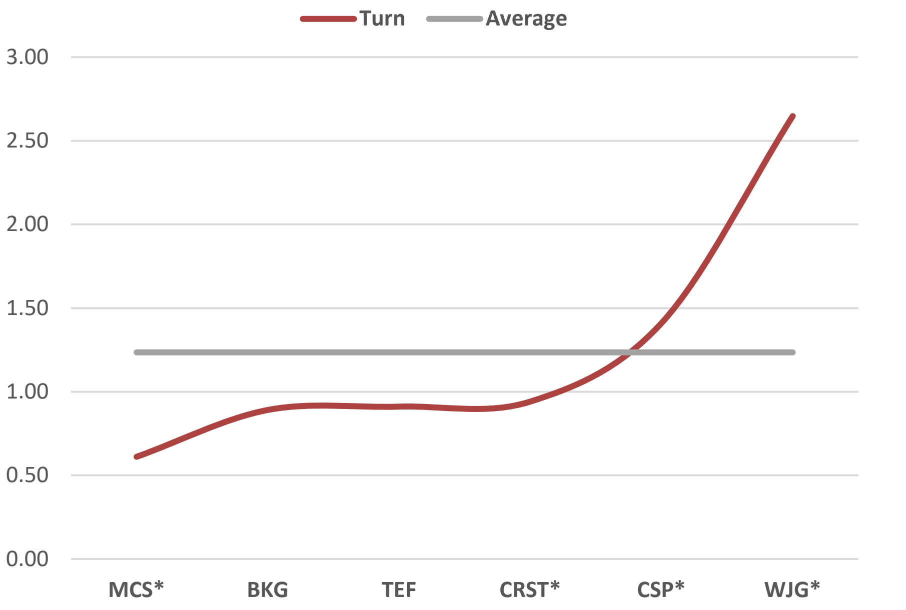
This graphically illustrates where Berkeley believes the housing market is going; and it has an exemplary record here. No one else is doing this.

Latest reported and average RoCE (%) reported in 2Q'18*



**denotes interims*
Source: Hardman & Co Research

Capital turn (x) reported in 2Q'18



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

Macroeconomics

Gross Domestic Product (GDP) growth in the UK was confirmed at 0.2% in 1Q'18 (vs. 4Q'17) and 1.2% annualised. Business Investment, however, dipped 0.4% (with Construction off 0.8%), while Household Spend nudged up 0.2%; albeit there is continuing weakening in consumer-facing activities.

The Consumer Price Index (CPI) was 2.4% in May, which was the same as in April and compares with 2.9% in May last year i.e. nothing to write home about.

Unemployment was 4.2% in the April quarter, which is the joint-lowest level since 1975; a year ago, it was 4.6%. This is truly extraordinary. At the same time, real average weekly earnings increased by 0.4% ex-bonuses and by 0.1% including them over 12 months.

Finally, retail sales in May rose 0.8% compared with April and by a marked 3.9% year-on-year. This latter surge, however, was most probably due to a combination of warm weather and slow annualised growth at the same time last year.

Mortgages

According to UK Finance, gross mortgage lending by high-street purveyors in May was £22.2bn, which was 8.7% higher year-on-year. However, the number of new mortgages for house purchases fell by an annualised 3.8% to 45,549.

It was a similar picture at the Bank of England, where its UK mortgage approvals rose to a four-month high in May of 64,526 (and +2.5% on April). The number of approvals for re-mortgaging also rose – by 8% to 51,000 – marking the highest level since November 2017.

Volumes and prices

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

Elsewhere on actual house prices, the Nationwide reported +2.0% in June, which was the slowest annualised June price rise for five years. Similarly, month-on-month, the rise was just 0.5% and, in 2Q, it was minus 0.1% on 1Q. London did even worse, with minus 1.9% annualised in the month of June and minus 1.0% quarter-on-quarter.

Turning to Rightmove, new-to-market UK houses prices rose 0.4% in June, month-on-month, to £309,439 (a new high) – and by 1.7% year-on-year. But the UK is a country of two halves in terms of the stock of unsold houses i.e. these dipped 4.5% in the North and rose 17.5% in the South. Similarly, prices in London fell 0.9% in June (versus May) to £631,737 and by 1% year-on-year, which makes it 10 negative months in a row in the capital.

Elsewhere, the Halifax said that prices in May were up 1.3% month-on-month but up just 0.2% in the latest quarter against the preceding three months – albeit the annualised gain was still 1.9%. Finally, Reuters Housing Market Poll (to which I contribute) expects a median 1.7% rise in UK house prices in 2018, including minus 1.0% in London, which would be the first dip for a decade.

VAR replay

Source: iStock

Before being co-opted by football, The Var (lower case 'a' and 'r') was – and is – a river and a department in France in the Provence-Alpes-Côte d'Azur region in Provence, and home to Toulon and Saint-Tropez.

More topically, VaR (lower case 'a') is "Value at Risk", which is a statistic that measures and quantifies the level of financial risk within a firm, portfolio or position over a specific time frame.

Like its sporting namesake, VaR is not without controversy and, in particular, it was pilloried in the Global Financial Crisis, i.e. relatively benign VaR calculations understated the potential risk posed by portfolios of subprime mortgages in 2008.

VAR (all capitals) in football – the Video Assistant Referee – is, of course, based more on hindsight or empiricism which, in turn, then drives a temporal or contemporaneous decision. But this adjudication (which is reckoned to be 99.3% accurate) can change the future and even determine a result: a winner or loser.

In turn, the Housebuilding Sector VAR opines on share price movements. Is the change up or down big enough? If not, then, it reviews the play and recommends a second look. It is, however, more about the future beyond 90 minutes.

With Crest, Bellway, McCarthy & Stone and Berkeley, the VAR review pertained to 12 and 24 months hence; and such were its decisions that there was double-dipping in terms of negative share prices.

The VAR, his assistant and video operator plus a hanger-on are also cognisant of the fact that, for the first time in a long time, we have a flat prospective year in terms of earnings growth in 2018. They also believe that a forecast of 5.6% growth in 2019 is optimistic. Yes, 5% plus prospective yields are attractive to players but they could well go higher.

Similarly, first team coach Berkeley has said that a peak in its profitability has passed and that macro uncertainty prevails. It is forecasting a 30% fall in fiscal 2019; and taking its guidance out two more years (see earlier section), it expects to make the same over the two years 2020 and 2021 as it did in one (i.e. 2018).

This graphically illustrates where Berkeley believes the housing market is going; and it has an exemplary record here. No one else is doing this.

Quote:

"Time is only linear for engineers and referees"

Source: Craig Ferguson

Glossary

Name (ticker): share price; market value

Abbey (ABBY): 1590 cents; Euro 341m

Barratt (BDEV): 515.4p; £5,219m

Bellway (BWY): 3004p; £3,694m

Berkeley Group (BKG): 3785p; £5,078m

Bovis Homes (BVS): 1145.5p; £1,544m

Cairn (CRN); 178 cents; Euro 1,356m

Countryside (CSP): 344p; £1,548m

Crest Nicholson (CRST): 389.9; £1,002m

M J Gleeson (GLE): 794p; £433m

Inland Homes (INL): 67.5p; £136m

McCarthy & Stone (MCS): 98.1p; £527m

Persimmon (PSN): 2533p; £7,886m

Redrow (RDW): 533p; £1,971m

Springfield (SPR): 130p; £125m

Taylor Wimpey (TW): 178.9p; £5,862m

Telford Homes (TEF): 395p; £299m

Watkin Jones Group (WJG): 205p; £523m

Note: Share prices at 29 June 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

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(Disclaimer Version 4 – Effective from April 2018)

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The fact that we are commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

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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