UK Housebuilding Sector in 2018

- Stick and Reasons -

By Tony Williams, Hardman & Co Analyst

Winter 2019

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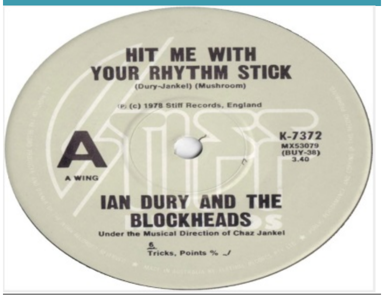
Stick and Reasons



Source: Creative Commons

'From the deserts of East Ham to the gardens of Cottenham', the UK Housebuilding Sector was whacked to the tune of 27% in 2018; and not one share price (out of 18) rose on the London Stock Exchange.

It was also hit 'slowly' rather than 'quick', as the downward momentum gathered tempo, with 4Q (minus 16%) being the worst.

"Ow", as the late, great Ian Dury (1942-2000) sang in one of his most famous songs (and his sole number one): 'Hit me with your Rhythm Stick'.

But his was/and is a capricious business, just like housebuilding. For example, from 252 trading days in 2018, 52% were 'up' and 48% were 'down'. Similarly, the maximum rise and fall in a single day was plus 5.0% and minus 6.3%, respectively.

But there are 'Reasons to be Cheerful', too, and for Mr Dury they came in threes – "a bit of grin and bear it, a bit of come and share it. You're welcome we can spare it". He was one of few true originals of the English music scene.

And UK Housebuilding can also enjoy its own jocund, musical treble, even with the dissonance of an off-key No-Deal-Brexit Big Bopper:

A prospective yield of 7% plus

1: December was the only month in 4Q to see a rise in value (+1%), the nine-day trading period over Christmas added a further 2.2% and then the first four trading days of 2019 plus 3.2%;

2: earnings are to be flat, based on a consensus of forecasts, in 2019 but will increase (at least) 5% next year; and

3: a prospective yield of 7%.

2018: the Sector has had its worst year.

2018 value

In 52 weeks, the Sector's value declined in 28 of them

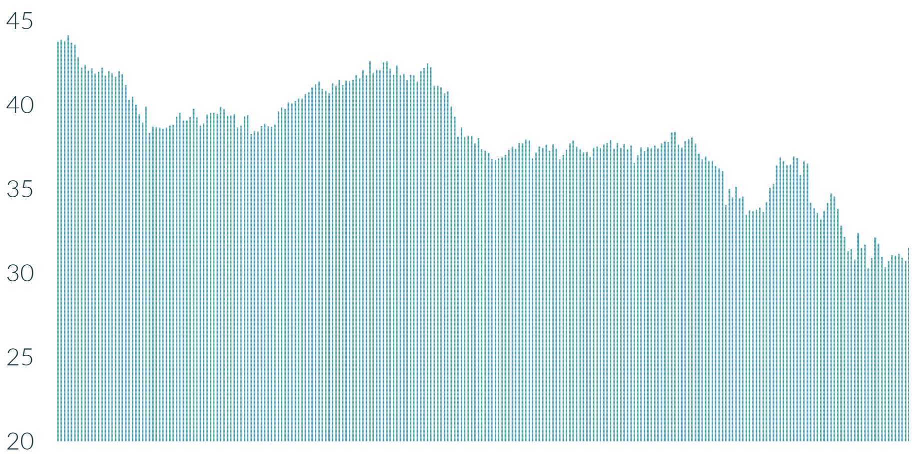
In the calendar year, the stock market value of the UK Housebuilding Sector declined by 27% or £11.8bn (which compares with a treble clef of plus 43% in 2017). Note, too, that the Sector's best chart placing of the year came on 5 January and the lowest on 17 December.

2018 also closed 29% off its all-time peak tone level from 24 October 2017.

In 52 weeks, too, there was a rhythmical rise and fall ratio of 46:54.

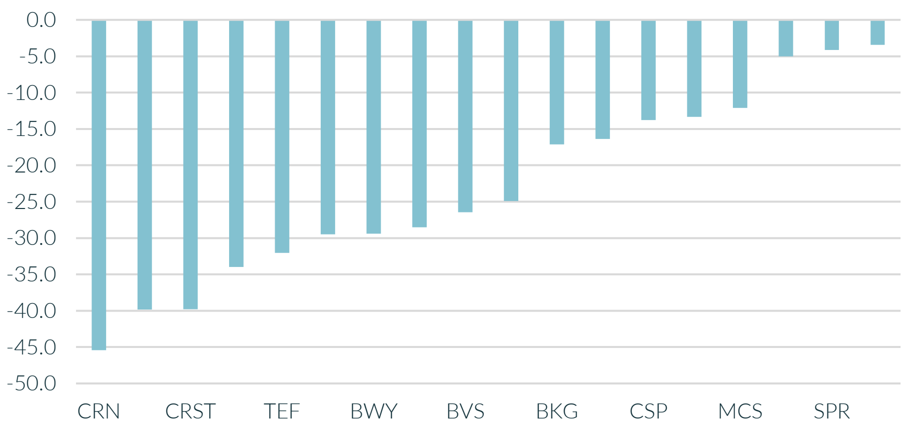
There were also only four individual months when the Sector rose in value (and only one of these turned up the volume): April (+6%); May (+1%); September (+1%); and December (+1%).

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



Note: 2018 high YTD on 5 January; 2018 low on 17 December
Source: Hardman & Co Research

Share prices in 2018 (annual % change)



Source: Hardman & Co Research

2018 – perspective

4Q of 2018 saw the biggest drop of the year at minus 16%

All four quarters in 2018 were negative too, especially 4Q with minus 15.9% against 3Q (that said, 2Q was down just 0.8%).

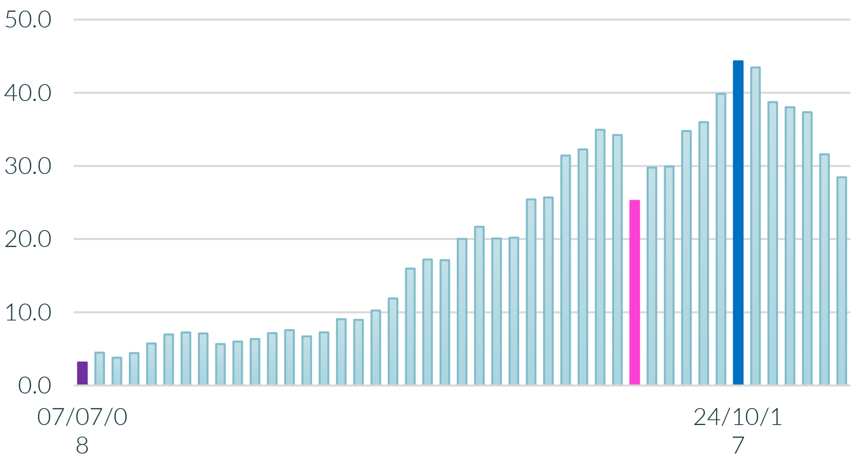
Meantime, the best and worst week were strangely close i.e. Week 44 with plus 9.7% and Week 48 with minus 9.9% – loud music.

The best and worst days were also audibly near each other: 5 December with plus 5.0%; and 30 November with minus 9.9%.

Looking back to the Sector's trough (7 July 2008), the rise has been more than 1,000% (£28.5bn), even after 2018's refrain; and the Sector is still 25% above where it was in the immediate aftermath of the Brexit referendum wall of sound.

Similarly, the Sector has achieved higher notes in 24 of the last 36 quarters – and seven of the last 10 years.

UK Housebuilding Sector: market value (£bn): 3Q'08 to 4Q'18



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

Share prices in 2018 and 4Q 2018

Share prices fell by an average of 23% last year

Housebuilders' share prices fell by an average of 23% last year actual, or 27% weighted by market capitalisation; in 2017, these numbers were +37% and +43%, respectively.

Abbey, the UK and Irish player, sounded the most positive note, even though this was minus 3.4% with support from the rhythm section of Springfield (minus 4.1%) and Watkin Jones (minus 5.0%).

Least pleasing were the two other Irish band members (performing in London and Dublin) – Cairn Homes and Glenveagh, which fell 45% and 40%, respectively.

Crest was also off key 40%, with seven others percussively down by between 26% and 32%.

In the fourth quarter of 2018, the stock market value of the UK Housebuilding Sector dropped 15.9% quarter-on-quarter, making it the worst quarter-tone of the year. In 4Q 2017, the Sector conducted a 7.3% rise in value.

November was a particularly difficult month, too, with an 11.3% drop; the worst from the 12-bar of 2018.

There is a strong correlation between the Housebuilders and the Euro/British Pound exchange rate

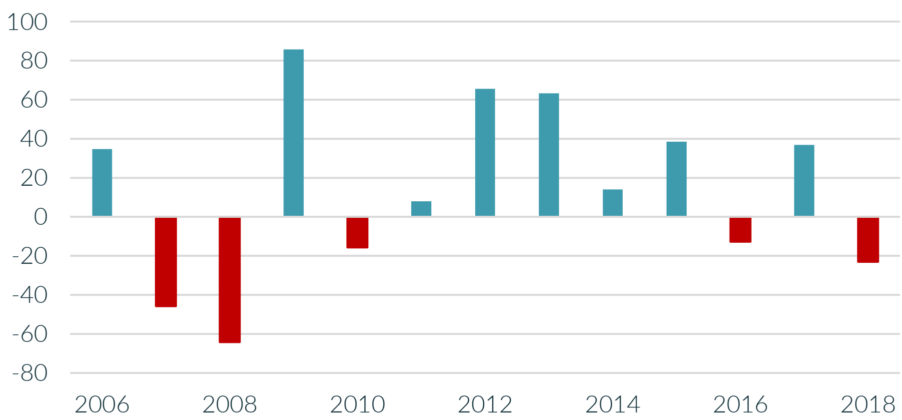
We have also plotted the Housebuilders' rise and fall in value with the Euro versus the British Pound. Both are barometers of future economic climes and there is a jarring harmony between the two – other than in Week 40.

In terms of actual share prices (as opposed to Pound notes) in 4Q, they lost 14.4% actual and 15.4% weighted by market capitalisation. In 4Q 2017, these scores were a tuneful at plus 5.9% and plus 7.1%, respectively.

From 18 Sector companies, only two were lyrically positive in 4Q i.e. Watkin Jones (+6.5%) and McCarthy & Stone (+3.4%). On the same timing, Abbey, Berkeley and Crest were off in single-digit percentages. At the other extreme, though, Telford's share price dropped 31%, with Cairn and Glenveagh both on the down beat of minus 27%.

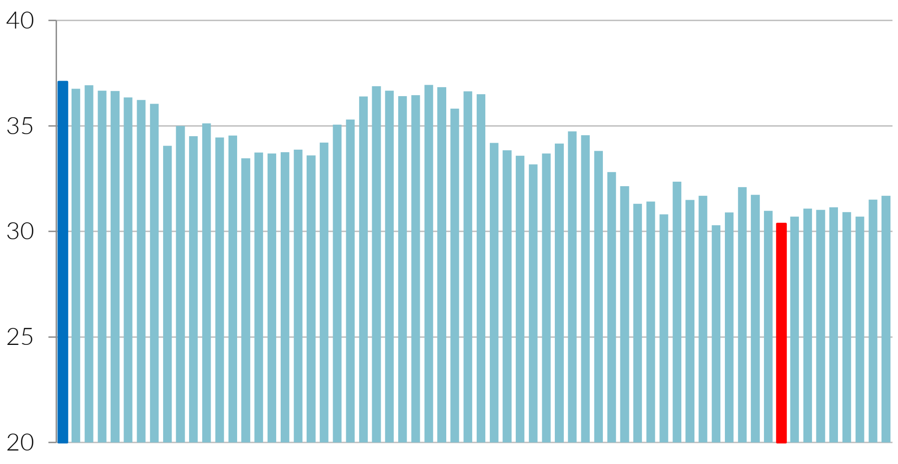
The Sector was also the worst performer in 2018 against the conventional measures of the UK equity market including the FTSE 100 and 250. The same was true versus the Construction and Building Materials Sector and the prime measures of listed UK real estate companies. In 4Q, the Housebuilders were second-bottom; worse only was Construction.

UK Housebuilding Sector annually: 2006-18 (% change in share prices)



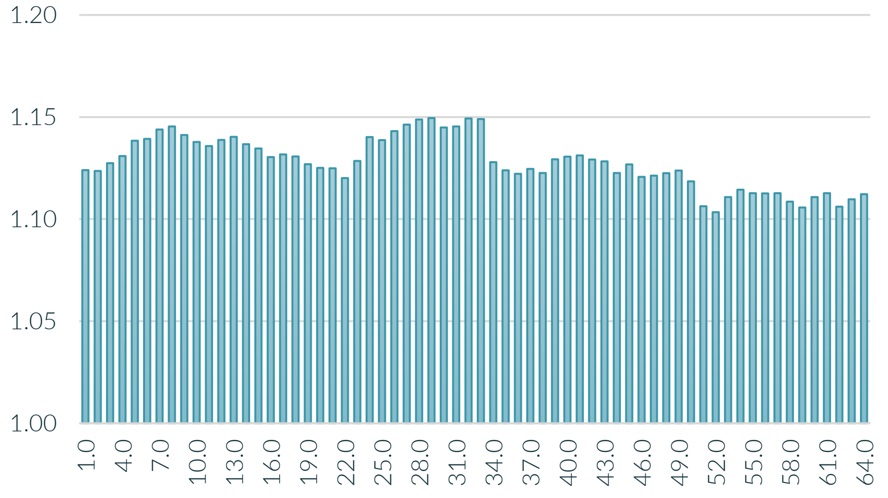
Note: data are weighted average % movement in share prices
Source: Hardman & Co Research

UK Housebuilding Sector market value – daily: 4Q 2018 (£bn)



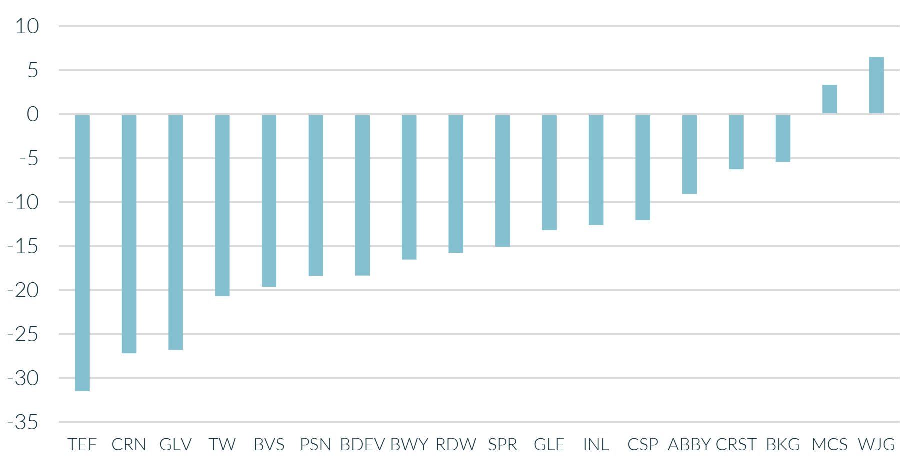
Note: high (BLUE) was on 1 October and low (RED) on 17 December 2018
Source: Hardman & Co Research

Euro to British Pound exchange rate: 4Q 2018



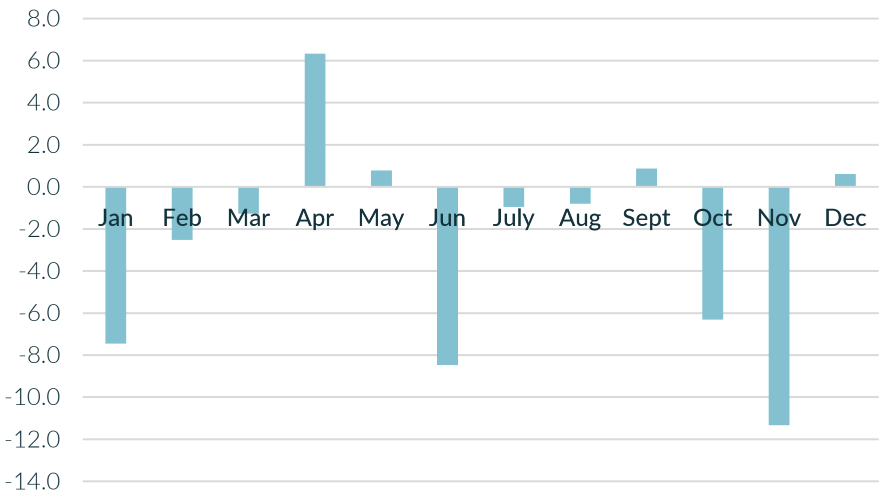
Source: Hardman & Co Research

Housebuilding Sector: 4Q 2018 vs. 3Q 2018 (% changes in share prices)



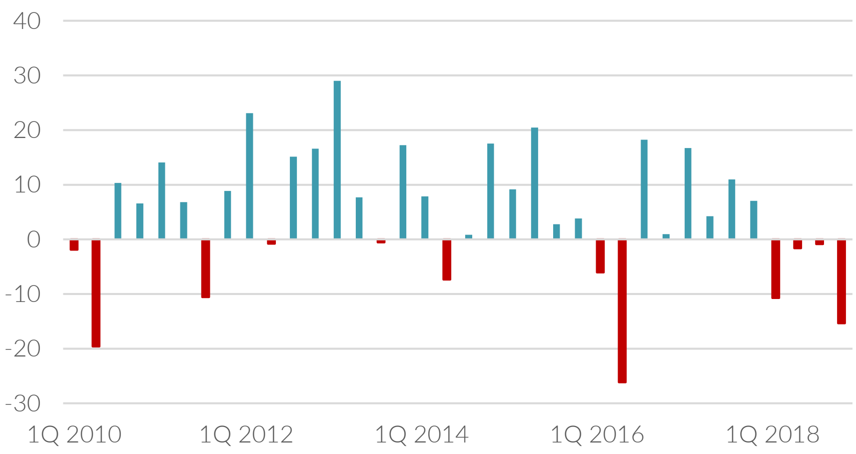
Source: Hardman & Co Research

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



Source: Hardman & Co Research

UK Housebuilding Sector share prices: 1Q'10 to 3Q'18 (% change)



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

Peaks and values

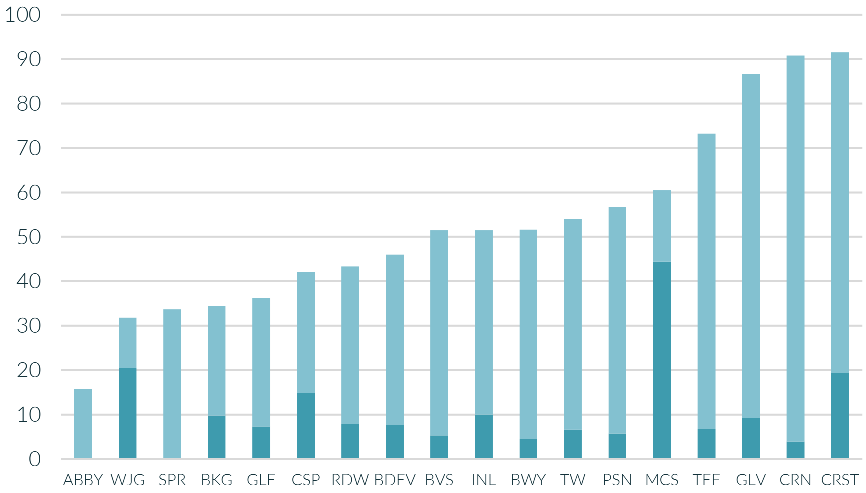
Four players account for 62% of Sector value

At 31 December 2018, Housebuilders' share prices were, on average, 1,400% above the lows of 2008; and 10% up on more recent 52-week lows (weighted, these numbers play 1,900% and 9%, respectively).

However, the Housebuilders were also some 32% below their 2007 recording peaks (i.e. 35% weighted); and 28% and 29% off 52-week highs on an actual and weighted basis.

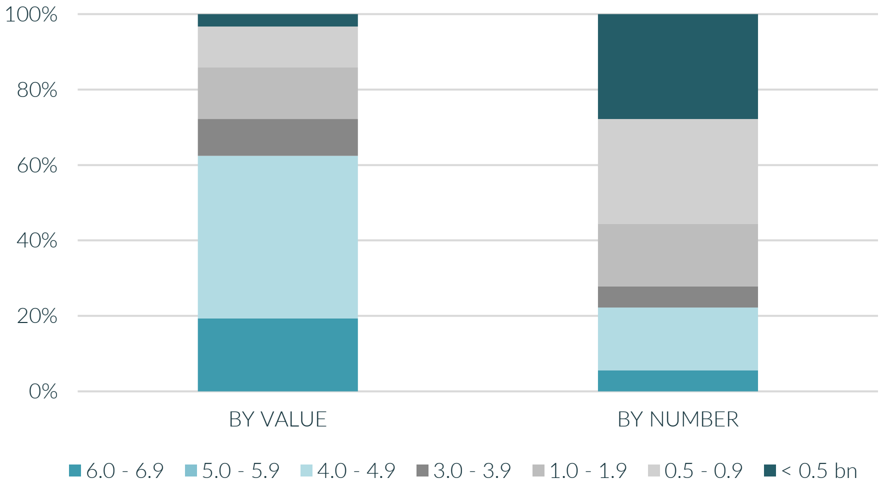
At the same time, four housebuilders continue in the FTSE 100: Taylor Wimpey (number 91 at 31/12/18); Berkeley (90); Barratt (87); and Persimmon (65); and together, these four players account for 62% of Sector label value.

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



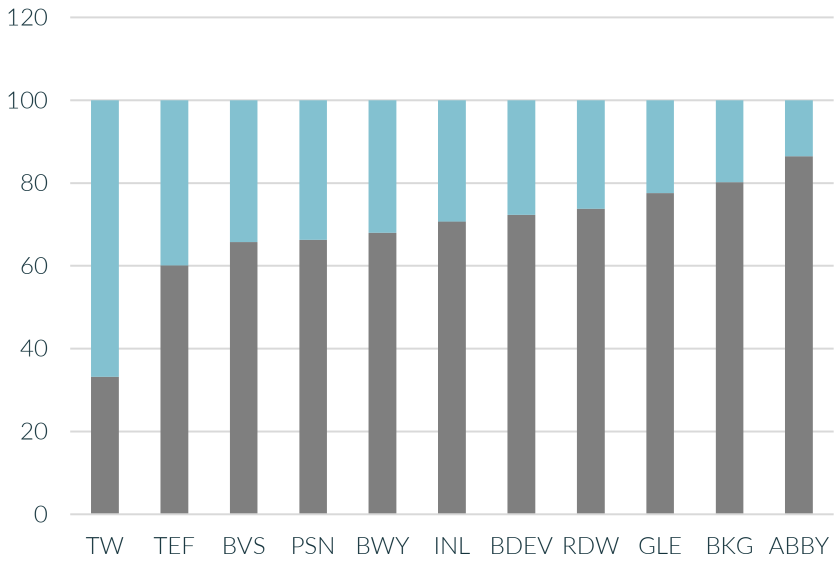
Source: Hardman & Co Research

Sector structure by stock market value: 18 firms worth £31.7bn at 31/10/18



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

Current share price as % of all-time peak level at 31/12/18 (grey shading)



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

Price-to-Book and Total Shareholder Return

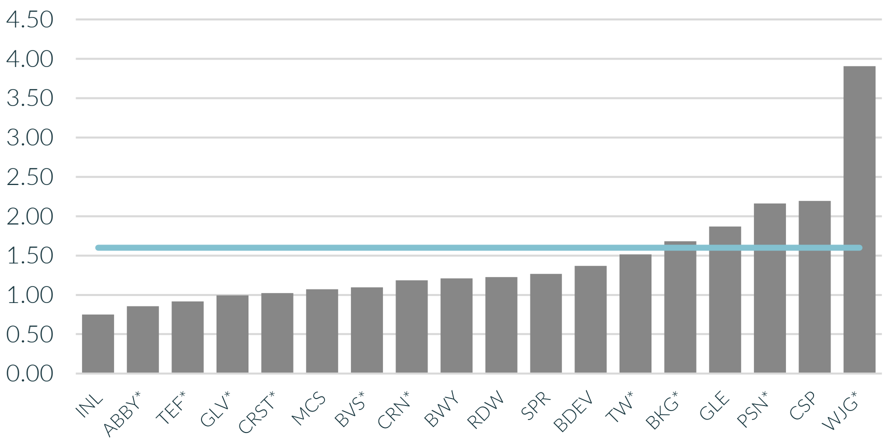
The average Total Shareholder Return in 2018 was minus 19.3%

The Housebuilders' latest average Price-to-Book valuation was 1.46 on 31 December 2018 and 1.60 weighted. A year ago, these ratios were louder at 1.94 and 2.31, respectively. Note, also, that two (Cairn and Countryside) out of 18 companies are at 2.0 or better; with Watkin Jones at an extraordinary F-sharp 3.9.

Total Shareholder Return (TSR) for the Sector in 2018 was minus 19.3% and minus 21.9% weighted. This compares with positive notes of 42% and 51%, respectively, in 2017.

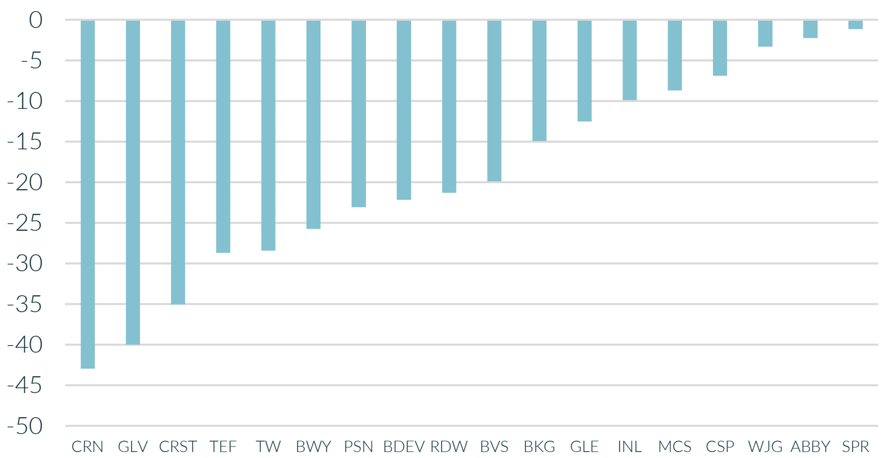
In the latest 12 months, no individual TSR was positive: Springfield was the best artist with a-just-negative 1.2%; with Cairn Homes worst at minus 42%.

Price-to-Book at year-end/latest interims; priced at 31/10/18



**denotes interim results; weighted average is 1.60 (see line); and actual average is 1.46*
Source: Hardman & Co Research

Housebuilders' TSR in 12 months to 31/12/18 (annual %)



Source: Bloomberg; CSP is estimated

Valuation

Consensus earnings growth in 2018/19 is forecast to be late, with recovery beckoning in 2020

The Housebuilding Sector's prospective PERs are 8.0x in 2018/19, followed by 7.6x in 2019/20, based on consensus forecasts.

Average earnings growth is forecast as modest (i.e. +1%) in 2018/19 but at +5% in 2019/20 at this very early stage.

Note, too, that Berkeley's prospective sharp drop in its current fiscal year (i.e. 25%) in pre-tax profit – guided by the Group – also impacts the average in 2018-19.

For the record, trailing-12-month PERs for the FTSE 100, All Share Index and FTSE 250 range from 11.2x to 14.9x; which compares with the Sector's 8.6x on the same basis.

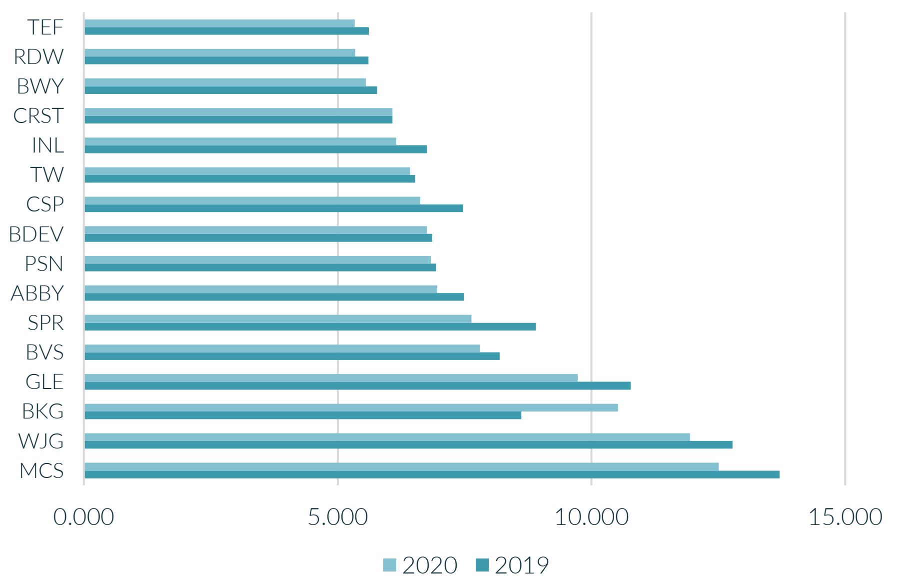
In 2018/19 and 2019/20 seasons, the UK Housebuilding Sector yields, on average, are forecast at 7.1% and 7.5% – with dividend cover at 2.1x in both instances.

Note, too, that a number of companies has committed to enhanced dividend payments, which means there are three or four companies with double-digit prospective yields.

For the record, the UK equity market yields between 3.4% and 4.7% historic with average cover of 1.9x.

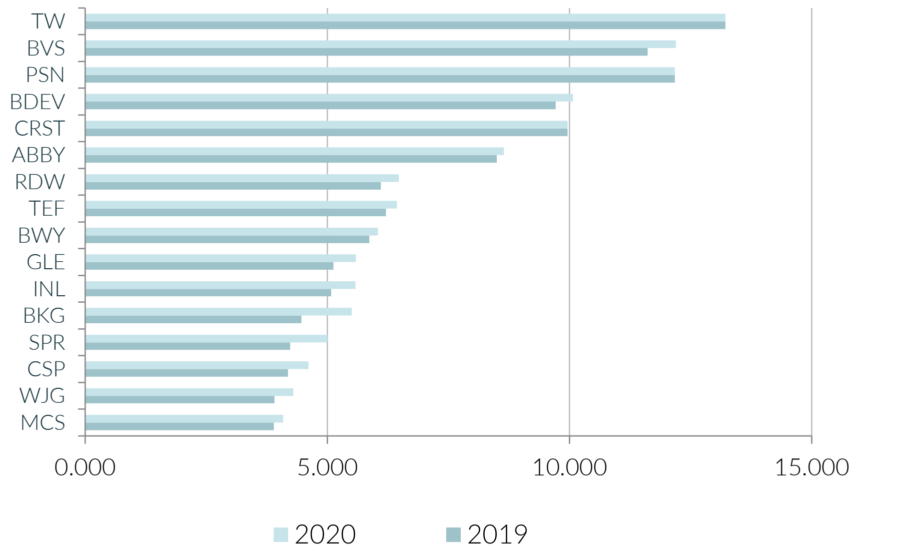
Here, the FTSE 100, 250 and All Share represent the UK equity market; and all calculations are made at the London Stock Exchange (LSE) close on 31 December 2018.

Housebuilding Sector PER: 2018/19E (8.0x) and 2019/20E (7.6x) as at 31/12/18



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

Housebuilding Sector yield: 2018/19E (7.1%) and 2019/20E (7.5%) at 31/12/18



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

Results/trading announcements, 4Q

In 4Q, there were six sets of final results, four interims and more than 15 trading-related announcements from 18 Sector companies.

Average individual pre-tax profits for the 4Q reportees rose 1%, while average individual EBIT margins declined from 19.8% to 17.3% – on revenue 11% larger at £6.74bn.

Dividends raised 12%, on average, in 4Q

EPS were flat, on average, while dividends were raised 12% (ex-the Abbey special) with average individual cover easing from 3.0x to 2.6x (again ex-Abbey).

Orders dipped by an average 2%; from a sample of three.

'Average individual RoCE' reduced from 20.5% to 18.9% with Capital Turn also little changed at 1.03x (versus 0.95x).

Profit & Loss data

Date	Company	Event	Period ending	PBT (£m) Previous	PBT (£m) Latest	PBT % chg.	EBIT margins (%) Previous	EBIT margins (%) Latest	Orders % chg.	DPS % chg.	DPS cover (x) Previous	DPS cover (x) Latest
07-Dec	Abbey (Euro)	Half Year	31-Oct	23	24	2	25.9	21.6	-	1,038	11.1	1.0
07-Dec	Abbey (GBP)	Half Year	31-Oct	21	21							
16-Oct	Bellway	Full Year	31-Jul	561	641	14	22.3	22.1	8	17	3.0	3.0
07-Dec	Berkeley	Half Year	31-Oct	511	401	-22	29.7	24.3	-	7	3.0	2.3
21-Nov	Countryside	Full Year	30-Sep	155	201	30	16.1	17.2	-11	29	3.2	3.1
13-Nov	McCarthy & St.	Full Year	31-Aug	94	62	-34	14.6	10.1	-4	0	2.6	1.7
27-Nov	Telford	Half Year	30-Sep	9	10	16	10.2	8.6	-	6	1.2	1.3
Total (£m)				1,350	1,336							
Individual average change (%)/cover (x)						1			-2	12	2.6	2.3
Sector average change (%)/cover (x)						-1				12	3.0	2.6
Individual average margin (%)							19.8	17.3				
Sector average margin (%)							22.3	20.3				

Notes: (i) PBT numbers are net of exceptionals and subject to adjustments where required
(ii) EBIT is Earnings Before Interest and Tax; DPS is dividend per share
(iii) Abbey is Irish-domiciled, but only GBP included in totals; 100 cents special DPS announced in 1H – DPS increase/cover excluded from totals
(iv) Bellway metrics are ex-£5.9m Grenfell exceptional
(v) Berkeley's revenue and profit from sale of ground rent is excluded: 2018: nil (1H 2017 £28.4m); special DPS of £10.34 paid to date
(vi) Telford's revenue (and profit) are gross of its share JVs in 1H 2017-18: £10.9m (£1.5m) and 1H 2016-17: £12.7 (£1.6m)
Source: Hardman & Co Research

Balance sheet data

Date	Company	Event	Period ending	Net assets (£m) Previous	Net assets (£m) Latest	Net (Debt)/Cash (£m) Previous	Net (Debt)/Cash (£m) Latest	Gearing (%) Previous	Gearing (%) Latest	RoCE (%) Previous	RoCE (%) Latest	Capital Turn (x)
07-Dec	Abbey (Euro)	Half Year	31-Oct	315	356	90	95	-28	-27	14.8	13.4	0.6
07-Dec	Abbey (GBP)	Half Year	31-Oct	277	316	79	84					
16-Oct	Bellway	Full Year	31-Jul	2,191	2,557	16	99	-1	-4	25.7	25.5	1.2
07-Dec	Berkeley	Half Year	31-Oct	2,352	2,671	633	860	-27	-32	35.4	26.3	1.2
21-Nov	Countryside	Full Year	30-Sep	631	624	77	45	-12	-7	26.1	33.5	1.9
13-Nov	McCarthy & St.	Full Year	31-Aug	676	696	33	6	-5	-1	14.1	9.0	0.9
27-Nov	Telford	Half Year	30-Sep	206	235	-61	-123	29	52	6.7	5.8	0.3
Total (£m)				6,333	7,099	777	970					
Individual average change (%)						13						
Sector average change (%)						12						
Individual average RoCE (%) adjusted										20.5	18.9	1.0
Sector average RoCE (%) adjusted										25.9	23.4	0.9
Individual average gearing (%)									-7	-3		
Sector average gearing (%)									-12	-14		

Note: RoCE is return on capital employed and adjusted where required for half year, etc.
Source: Hardman & Co Research

Performance and outlook

Bellway (Finals – 15 October)

Bellway had flagged its results back in August and the fact that it had built and sold over 10,000 units for the first time (this also marks nine consecutive years of volume growth). Prices were also good with private units rising 9.3% to £323,400. Gross margins, however, dipped 40 basis points to 25.5% on revenue of almost £3bn (+16%) with EBIT profitability also easing – here by 20 basis points to 22.1%.

Pre-tax profits (after a net Grenfell-related provision of £5.9m) were struck at £641m, up 14%. EPS also rose 14%. The dividend was ahead 17% with cover at 2.96x (versus 3.04x), and this is also the intended, ongoing cover commitment for the foreseeable future. Interestingly, average net debt over the year ran at £191.5m (2017: £170.8m), albeit Bellway ended the year with net/gross cash of £99m (i.e. borrowings were eliminated) versus net cash of £16m (after deducting £30m of debt).

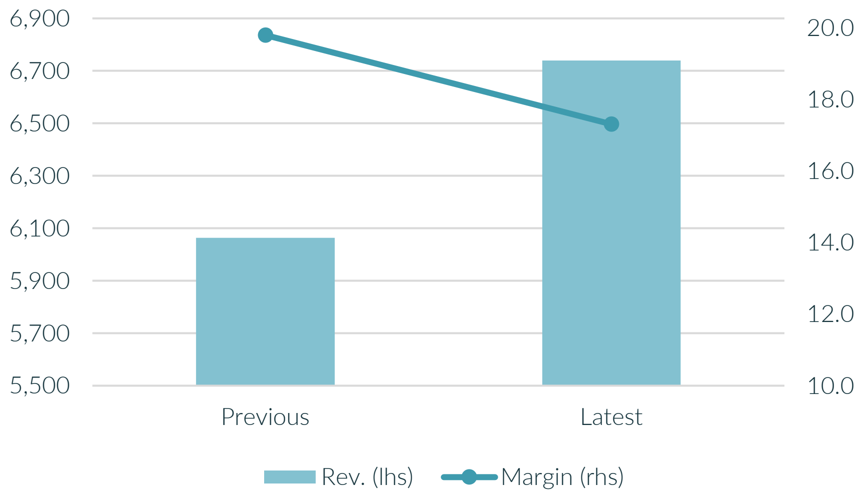
In terms of outlook, Bellway did highlight "a risk to consumer confidence posed by the forthcoming exit from the EU". It also spoke about challenges in accessing experienced personnel and skilled construction labour resources, and noted certain materials remained a challenge, but overall, while these constraints may frustrate the rate of growth and, as housebuilders continue to increase output, there remains upward pressure on build costs throughout the industry.

It also said that a shortage of skilled labour "remains the greatest constraint to growth" and noted "a shortage of key materials, such as structural timber, plastics, bricks and blocks, with these exacerbated due to capacity issues in the broader building materials sector". The Group candidly added, too, that the rate of house price inflation has moderated and although it is still running ahead of cost increases, "the net inflationary enhancement to the margin, which has augmented results over recent years, is beginning to abate".

There was a spectacular increase in orders between 1 August and 30 September

All that said, the Group had an extraordinary first nine weeks of its new fiscal year from 1 August (and we have confirmed this with Bellway). For example, it started the current financial year i.e. on 1 August, with an order book of 4,841 units and a value of £1.301bn, which represented respective gains of 1.9% and 0.4% year-on-year. However, at 30 September, the unit order book was at 5,380, up 6.9% annualised, with a value of £1.47bn, which is a gain of 7.9%. This means that, in the first nine weeks of fiscal 2019-20, it increased its order book by 89% in terms of units against the first nine weeks of fiscal 2017-18 and 158% in value on the same basis. Extraordinary.

Sector revenue (£m) and EBIT margin (%) reported in 4Q



Source: Hardman & Co Research

Crest Nicolson (Trading Update – 17 October)

Crest announced a Trading Update a month or so ahead of schedule, on 17 October, and to underline the speed issuing this communiqué – it contained at least three typographic errors. Poor show. A wise man once said, too, that "good news sleeps until noon" and, no, this was not 'good news'. In the olden days, it would have been called a 'Trading Statement', which was a euphemism for a profit warning. What's more, the CFO, Robert Allen, has departed.

Sales did not pick up during the traditionally stronger early Autumn selling season

In terms of detail, "the market environment for new homes in London and at higher price points in the South of England is more difficult than previously anticipated, where sales have not picked up during the traditionally stronger early Autumn selling season". This means that, in the fiscal year to 31 October, profit before tax is now expected to be in the range of £170m to £190m, "subject to the timing of completion of some individually significant transactions" (2018: £207m). At the same time, EBIT margins are "now expected to be lower than the previous guidance of 18%", driven by flat pricing and continuing build cost inflation (2017: 20.7%). A new strategy has been introduced, which will be led by Chairman Stephen Stone and supported by CEO Patrick Bergin.

The Update also said: "the usual Autumn pick up in sales volumes has not been evident during September and October, with many customers putting off decisions to buy whilst current political and economic uncertainties persist". On 12 July, Telford Homes held its AGM and said that, since the results announcement at end-May, it had 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".

Barratt (AGM – 18 October)

Barratt is a peerless salesman and its latest order book is proof of that, especially given the caution espoused by Crest Nicholson and the like. Its total order book at 14 October was up 12.4% in Pound notes at £3.15bn and up 5.1% by volume to 12,903 units. Okay, if we wanted to be picky, the composition of said order book highlights an industry trend towards affordable housing i.e. the value of private orders was actually down 5.3% at £1.7bn while affordable was up 45% at just over £1bn (and not forgetting JVs where the cash gain was also over 40% at £424m). By units, private sales were ahead 2.3% (at 5,446), affordable +10.2% (to 6,615) and JVs off 11.3% (at 842).

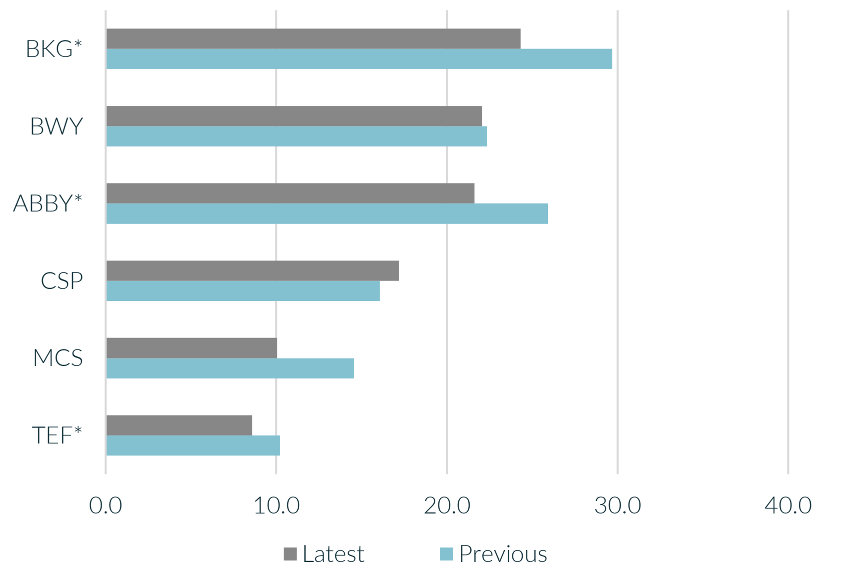
Affordable unit prices are up 31%

These data also show their own story in terms of average selling prices: in the private sector, they are down 7.5% at £312,000. However, in affordable there was a gain of 31% to £155,000 while JVs added 60% at £504,000.

Being similarly picky, too, net private reservations per active outlet per average week were at 0.72 (2018: 0.74) ex-JVs in the first 15 weeks of the financial year i.e. this is a dip of 2.7%.

The UK's largest housebuilder "has made a strong start to the year. In [fiscal] 2019, we are focused on implementing our new medium-term targets throughout the business. The Board is confident of delivering a good financial and operating performance in [fiscal] 2019".

EBIT profit margins (%) reported in 4Q'18



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

Watkin Jones (Trading Update – 31 October)

Watkin Jones (Trading Update): with apologies to the late, great Carwyn James: "some sniff the wind of earnings visibility – they created it" i.e. the Group (also Welsh in origins) has already forward sold five of the six student accommodation schemes (and 2,646 beds) scheduled for delivery in fiscal 2019 (Watkin Jones is a September year-end). And, then in fiscal 2020, four (1,844 beds) from seven schemes are forward. What's more the balancing schemes in each year (i.e. four) are also "secured".

It is a similar picture at the Group's burgeoning Build to Rent (BTR) unit, which boasts a secured delivery pipeline of approximately 1,500 apartments across seven sites, with target delivery in fiscals 2019 through 2022. In these endeavours, Watkin Jones is working with M&G and Singaporean investors.

Third is the Group's specialist accommodation management company, Fresh Property Group (FPG), which had 15,421 student beds and BTR apartments under management across 56 schemes – and of these schemes, 52% was not developed by Watkin Jones.

Finally, it also knocked out 175 (2017: 94) houses and apartments for sale in the year.

Excellent future earnings and cash flow visibility

CEO, Mark Watkin Jones, stated: "Trading in the Period has been strong and we are pleased to report that revenues and underlying earnings for the financial year are expected to be slightly ahead of the Board's previous expectations. We have achieved excellent progress on forward sold student accommodation developments, successfully completing all 10 schemes scheduled for delivery in the Period and continue to see strong demand from institutional investors. We are also encouraged by the progress that has been made in the BTR sector, with the agreements for significant developments in Reading and Wembley demonstrating our position as a developer of choice for leading institutions. The Group has a strong development pipeline that provides us with excellent future earnings and cash flow visibility, demonstrating the robustness of our model and ability to deliver significant returns for our shareholders".

Watkin Jones will announce its full-year numbers to 30 September 2018 on 15 January; and it should be a try and conversion.

" We are now fully sold up for the current year"

Persimmon (Trading Statement – 7 November)

Persimmon's 3Q Trading Statement noted that private sales in the period since the reporting of its 1H results on 21 August 2018 had increased 3% from a Group outlet network some 5% larger. "We are now fully sold up for the current year and have circa £987m of forward sales reserved beyond 2018, an increase of 9% on the same point last year"; and prices "remain firm". Persimmon also said that provision of housing to lower- income families was an important component of the sales mix, with more than 2,000 new homes being delivered to housing association partners in the financial year to date.

In addition to its off-site manufacturing unit, Persimmon has invested further in its brick and roof tile manufacturing facilities.

"Persimmon is in a very strong position for the future and whilst we are mindful that there is uncertainty associated with the UK's withdrawal from the EU".

Redrow (AGM – 7 November)

Chairman Steve Morgan said: "For the first 18 weeks of the current financial year, Redrow has traded in line with expectations. We continue to see good demand in our regional businesses with most sites sold well in advance. However, the London sales market has remained subdued affected by excessively high Stamp Duty tax and Brexit uncertainty. The value of net private reservations in the 18 weeks to 3 November was in line with last year at £588m (2018: £586m). The sales rate per outlet per week over the period was 0.64 compared with 0.67 last year, with the slight reduction entirely due to the London market. The average selling price of private reservations for the first 18 weeks is up 4.6% at £388,000 (2018: £371,000). Our total order book remains very healthy at £1.2bn, an 11% increase on this time last year".

Clearly, these latter orders pre-date the first 18 weeks of the new fiscal year. At the time of announcing is full-year numbers in the first week of September, Redrow said its order book was up 11% at £1.14bn ex-JVs (our guess was, at that time, that, including JVs, the order book was ahead by less than 4%).

Redrow also "broadly" welcomed the extension of the Help to Buy scheme but, additionally, urged the government to review the regional price caps that markedly disadvantage the North and Midlands in favour of the South of England.

Steve Morgan is to retire (for the second time) from the business he founded in 1974

It was also announced that Steve Morgan is to retire from the company he founded in 1974. Note, too, that it is exactly 10 years to the day after he returned to the business, at the commencement of the Global Financial Crisis (GFC). CEO John Tutte will become Executive Chairman, while Matthew Pratt is elevated to COO. Matthew is currently CEO of Redrow's Southern businesses. All changes take place at the end of March 2019.

Taylor Wimpey (Trading Statement – 13 November)

Volumes for 2019 expected to be broadly flat, but potential for significant growth from 2020 onwards

It said that the UK housing market "remained stable" through 2H 2018 with a physical order book 11.8% ahead at 9,783 homes and in Pound notes +8.3% at around £2.4bn. These are impressive percentage gains. Similarly, the 2H sales rate per site per week edged up from 0.71 to 0.77 units. At the same time, underlying prices in the period, and in the order book, "remain in line with the first half of the year", while build costs are expected to increase by 3% to 4% this year.

Unusually, the statement included a section headed 'Political outlook', which included candid comments. "Looking ahead, whilst current forward indicators for sales continue to be solid, unsurprisingly due to the heightened political and economic uncertainty, we have seen some signs of customer caution, particularly in the South East. We expect next year's volume to be broadly flat in current market conditions. As we transition to our new strategy, there is the potential for significant growth from 2020 onwards, as previously indicated".

With this in mind, too, the Group has "taken the precaution of increasing the investment margins and returns at which we acquire land."

Finally, in Spain, where the first week in the November order book was at 330 units (2017: 388 homes), another strong operating profit is expected for the year (2017: £26.8m).

McCarthy & Stone (Finals – 14 November)

New CEO John Tonkiss underlined what had been a challenging year for the Group to 31 August; and one in which his predecessor had stepped down. He also talked about "particularly difficult market conditions" and, in case we had forgotten, "UK monthly housing transactions showing a decline of around 40% since 2015".

"During the last financial year, the business continued to face considerable market headwinds including continuing political and economic uncertainty following the outcome of the vote to leave the EU. These headwinds have resulted in a lowering of consumer confidence, a challenging secondary housing market and some softening of pricing in the South East". It was made more difficult by "the continued investment in operating costs in support of our previous growth strategy".

In terms of the scores on the doors, revenue was marginally ahead at £672m (i.e. +2%), which comprised 2,134 unit sales (minus 7%) at an average selling price of £300,000 (+10%). It is also worth remembering that McCarthy & Stone provides care and support services to some 16,900 residents, and this number rose 16% in the year.

Operating margins slid from 14.6% to 10.1%

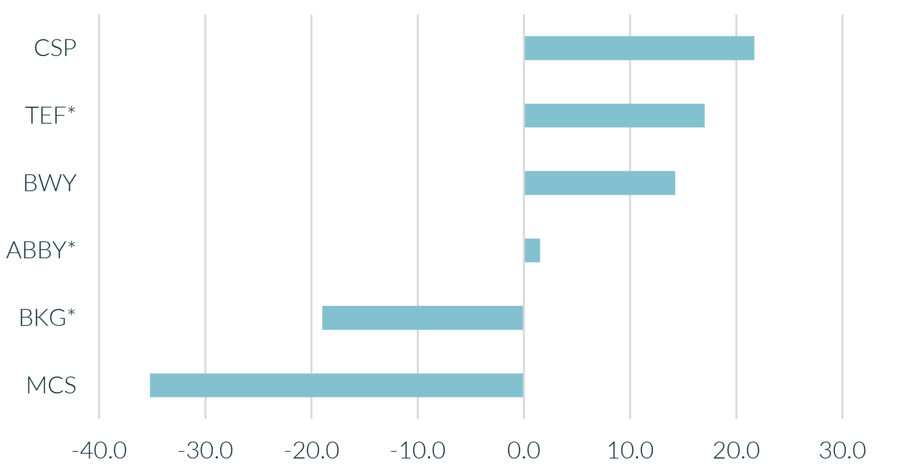
Operating margins, however, did not fare so well, with a slide from 14.6% to 10.1% (note that these exclude exceptional costs of £2m; and there are more to come). Similarly, adjusted pre-tax profit was off 35% at £49.4m, but the dividend was maintained at 5.4p, and is still covered 1.7x by adjusted earnings (2017: 2.6x). The Group held almost £6m of net cash. There is also potential relief on ground rents i.e. the Government is proposing to allow the retirement community sector to continue charging ground rents after they are capped at £10 elsewhere. Watch this space.

The Group has also conducted a strategic review and announced a "transformation strategy". Cynically, this is not before time i.e. the share price is less than 140p per share against a November 2015 IPO price of 180p. For the record, too, the Group's new strategic targets include: steady state volume of ca.2,100 units p.a.; RoCE of over 15% in 2021 and more than 20% in 2023 (2018: 9.0%); an improvement in operating margins to more than 15% by 2021 (2018: 15.6%); and total cost savings in excess of £90m between 2019 and 2021.

Looking ahead, "we are seeing continued resilience within our lead indicators, which are currently running moderately ahead of the prior year on a per outlet basis, but the secondary market remains challenging, especially in the South East, where customers continue to exercise caution due to economic uncertainty". The forward order book as at 9 November (Week 10) is in line with management expectations and currently stands ca.4% behind the prior year at ca.£267m, reflecting four sales releases since 1 September (in the fiscal year 2017, there were 17 sales releases). "Recent trading has also been impacted as expected by organisational changes within our sales function across the last 6 weeks".

The Group is also shifting its year-end from 31 August to 31 October, which will allow a decoupling of its year-end activities from the peak August holiday season and "will serve to accelerate the process of rebalancing workflow and sales volumes throughout the year". It will also mean a 14-month accounting period. After 10 years, too, McCarthy & Stone is changing its auditors from Deloitte to Ernst & Young.

EPS growth (% change) reported in 4Q'18



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

Countryside (Finals – 21 November)

Strong fiscal year to 30 September 2018

Countryside is celebrating the 60th anniversary of its founding by the late, great (and nice guy) Alan Cherry CBE. He died in 2010 aged 76. However, I am certain that he would approve of Countryside Mk2, which was IPOed in February 2016 at 225p per share. Okay, it closed 2018 at 304.4p; although its 52-week high is 387p.

The Group has also completed a very good fiscal year to 30 September 2018. Unusually, our focus is on RoCE, which hit an extraordinary 32.2% in 2018 (2017: 24.5%) on an adjusted basis (i.e. non-recurring items are excluded from the numerator and intangibles from the denominator). Such a super return is driven by an equally super Capital Turn with a Current Ratio of 2.83 in 2018. Okay, Countryside is a master disciple of the capital-light mantra through its partnerships business division. Good job, too, because its Group operating margin (again adjusted) could do better i.e. in fiscal 2018 it was 17.2% (okay it did improve from 16.1% in 2017).

As for the more formal scores on the door, Group revenue rose by a fifth to £1.23bn with EBIT ahead 28% to £211.4m and pre-tax profit up 30% at £200.8m. EPS added 22% and the dividend was hiked 40% to 10.8p, covered 3.1x (2017: 3.2x).

Divisional split:

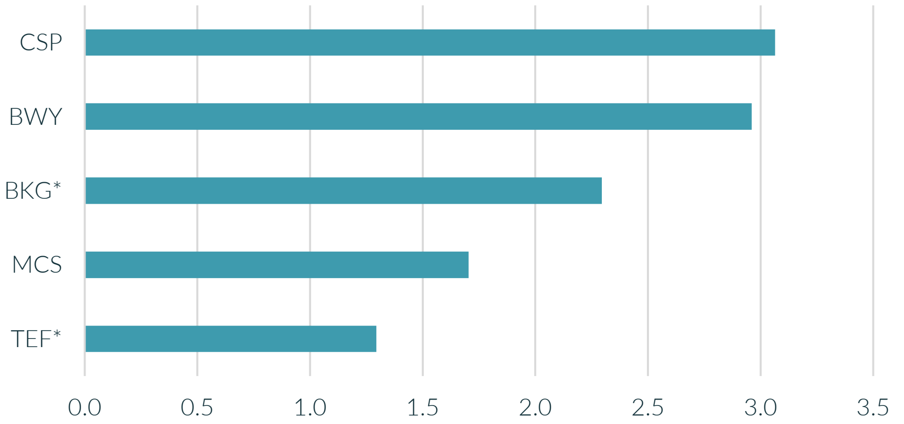
(i) Partnerships: 3,019 completions in the year (+38%) at an ASP of £318,000 (minus 7.0%) with EBIT at £110.6m (+39%); and

(ii) Housebuilding: 1,276 completions in the year at an ASP of £402,000 (minus 6.5%) with EBIT at £109.6m (+20%).

Note, too, that Countryside has been using an open-panel timber frame system in its Northern and Midlands regions to produce standard components offsite for around 40% of its output. From 2019, a new £6m facility in Warrington will take this further and produce more complete units. Ultimately, too, it will produce around 1,500 units per year to serve the Partnerships Division across the Midlands and the North West. This will reduce build time and foundation to completion from 12-14 weeks to 10.

Finally, the Group's forward order book is up an astonishing 40% to £900m; yes, this is astonishing. However, its private unit forward order book is off 11.3% at £215m. "…some stresses in the UK housing market started to emerge during the year, with property sales in the second-hand market slowing, particularly at higher price points as a result of the impact of increased Stamp Duty together with the uncertain macro-economic backdrop….".

DPS cover (x) reported in 4Q'18



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

Telford (Interims – 28 November)

EBIT for six months to end-September rose 10% to £11.1m

The nimble and diminutive London developer posted its interim results on Wednesday 28 November, which were pretty decent. In fact, the shares rose 2.1% to 309p in Week 48 in a Sector which fell nearly 10% in value. The market had expected bad news and the shares fell almost 3% on the day before the numbers.

The expectation of bad news was based on Telford's Trading Update on 10 October, which was candidly cautious; and in Week 41, the shares fell 16.8% to 334.5p (and Telford closed 2018 at 285p). Turning to the results for the six months to end-September, Group revenue rose 31% to £130m with a gross margin of 21.9% (2017: 23.8%) and with EBIT at £11.1m – which was ahead 10% – and EBIT margins at 8.6% (2017: 10.2%).

In turn, profit before tax rose 16% to £10.1m with earnings slightly better at +17%, and the dividend was raised 6% to 8.5p. The latter underlines Telford's confidence in its long-term plan of "delivering an increased number of much needed homes in non-prime locations of the chronically undersupplied London market". Cleverly, too, the Group is continuing its strategic shift towards build to rent, which it expects to form a significant part of the London market going forward. Note, too, that Telford has reported a development pipeline of £1.65bn of future revenue comprising just over 5,000 homes.

Back in early October, Telford reiterated its original target of exceeding £50m pre-tax profit for fiscal 2019 (2018: £46.3m). It also identified that the greatest risk to achieving this target was approximately 90 homes that were still to be sold, of which 25 were priced above £600,000. Since then, 30 have been sold, which leaves 60 remaining, of which 20 are priced above £600,000. "However, the uncertainty arising from Brexit and indeed the wider political situation remains a concern across the sector making it difficult to accurately predict sales rates over the coming months". This means that Telford is plumping for a pre-tax profit "in excess of £40m" – not at all bad to be getting on with in the dog days of 2018 and the diurnal ones to come.

The Berkeley Group (Interims – 7 December)

Still pretty clever…

In a difficult Week 49 for the Sector, it takes some panache to deliver a 26% decline in half-year pre-tax profit to just over £400m and see your shares rise 1.5% (to £33.21). Okay, it is not untypical of "the country's leading place-maker" but it is still pretty clever.

And the carrot, if you will, was raising pre-tax profit guidance for the current year (to 30 April 2019) by 5% i.e. from minus 30% to minus 25%; it also said that it expected to have generated ca.55% of its annual pre-tax profit for this fiscal year in 1H. This means we are looking at ca.£730m for fiscal 2019 (2018: £977m).

Earlier, too, the Group had committed to £3.375bn of expected pre-tax in fiscal 2017 through 2021. Assuming the arithmetic above is correct, Berkeley has ca. £900m to cover fiscals 2020 and 2021. Remember that the Group made more than this in a single year in fiscal 2018. But is Berkeley the only one telling the truth?

Carrot number 2 is an extension of its Annual Shareholder Return, which will be extended at the current amount of £280m p.a. to 2025. The current formal Shareholder Returns Programme was initially put in place in 2011 and is forecast to return at least £16.34 per share (£2.2bn) to shareholders by 30 September 2021, through either dividend or share buybacks (10.9 million shares at £34.99 each).

All of the above commitments are made too "assuming there is no material deterioration in the operating environment".

Back to the numbers, net revenue was pretty much flat (ex-ground rents in 2017) at £1.65bn. EBIT margins declined from 29.7% to 24.3% and, in Pounds, EBIT was down 17% to £401.2m. RoCE and RoNA, although lower, were also extraordinary at 26.3% (2017: 35.4%) and 30.0% (2017: 43.5%), respectively, as was £860m of net cash – up from £633m last time. Note, too, that work in progress dropped almost £350m to £2.49bn. Berkeley has clearly read the market and pumped up liquidity.

That said, Berkeley also spoke about a "new investment phase" as it invests for the long term, bringing forward the next wave of regeneration sites, coupled with new opportunities and adding 11 new sites in the period.

"Holistic, sophisticated, longevity"

"Berkeley has had a good start to the year and this is reflected in our guidance which is increased for the full year, and reaffirmed for the next two years, based upon current market conditions. This is in the context of a short-term outlook that is clearly uncertain due to the ongoing Brexit process and a number of headwinds in the operating environment in London and the South East. This uncertainty affects sentiment and confidence which has a consequential adverse impact on investment levels and transaction volumes with a number of developers withdrawing from these markets. However, we are confident that London will remain a vibrant, tolerant and diverse global city, attractive both domestically and internationally where the cumulative demand for new homes is only increasing".

Finally, how often, in a profit statement, do you see the words "beautiful", "fantastic", "holistic", "sophisticated", "exodus", "moderation", "longevity", "culture of enabling", "people-centred" and "social purpose"? And these 10 words/phrases tell the Berkeley story.

Abbey (Interims – 7 December)

A 100 cent special dividend

These results covered the six months to 31 October and what a pleasant surprise they contained in the form of a Euro 100 cents special dividend; even better, too, that it was totally unexpected. The company also paid a normal dividend of 9.0 cents, which was up 12.5%; and with EPS only nudging ahead 1.5%, cover dipped from 11.1x to 10.1x – albeit this is still verdant.

Further up the P&L, revenue soared 22% to Euro 111m, largely on the back of the UK, which was up 30% in local currency terms to £78.5m with 38% more completions to 277, at an average selling price off 5.7% at £283,500. In Ireland, revenue fell 42% with only 19 completions, against 32 last time, and average selling prices also 1.7% lower at Euro 322,500.

Overall, Abbey's gross margin was sharply reduced at 26.7% (2017: 30.5%) with EBIT returns going the same way to 21.6% (2017: 25.9%). These metrics were dragged down by Ireland where EBIT margins dropped from 22.7% to 10.0%; although, for the record, the UK operating margin slid from 27.9% to 22.8%.

For historical reasons, Abbey has a development business in Czechia, and it had a storming year. Revenue and unit output increased five-fold to Euro 4.4m and 19, respectively, and a profit of Euro 673,000 was achieved, from a loss of Euro 58,000. The company also operates a plant hire business (M&J Engineers), which contributed Euro 1.9m (+13%) of EBIT and a 17.2% margin; plus Abbey collects half-a-bar-or-so in rents, which were also up by around one fifth.

For the Group as a whole in the half year, EBIT and pre-tax profit were the same at Euro 23.9m, up 2%. Net cash was a touch under Euro 95m and, while the company's RoCE is just 13.4% (2017: 14.8%), its Quick Ratio is at 1.48 (2017: 1.18). This is extraordinary for a housebuilder.

"Trading in the UK has held up well over the six months. Margins, as previously guided, have reduced in line with our expectations. Forward sales continue to be encouraging. In particular our projects aimed directly at first time buyers are selling well. Production continues to be impacted by tight labour and materials markets and some delays have been experienced. Costs are rising. As always trading in the last quarter will determine our final result. In Ireland production will soon be in progress on five projects and we are hoping for a useful contribution to our year-end figures. A further four projects are making their way through the approvals process as efforts continue to grow our Irish business".

"Whilst our UK forward sales position gives confidence that a reasonable result for the year will be achieved the continuing uncertain external conditions are cause for concern. The Group will continue to progress all its activities but intends to be cautious about new investments in the months ahead".

Admirable erudition

Yes, there was a sniff of Fabian policy and no order book data, but there was a special dividend. Similarly, we offer our perennial plaudits to Abbey for its erudition i.e. its Interim Statement ran to just 629 words or 482 net. This is also extraordinary for a housebuilder. "The low-cost housebuilder and strategic land specialist" said it sold 691 in 1H (to end-December), which is an increase of 16.5%.

Gleeson (Trading Update – 7 January 2019)

"The low-cost housebuilder and strategic land specialist" said it sold 691 units in 1H (to end-December), an increase of 16.5%.

"We continue to see strong demand for our low-cost homes, supporting both increased build activity on existing sites and the opening of new sites".

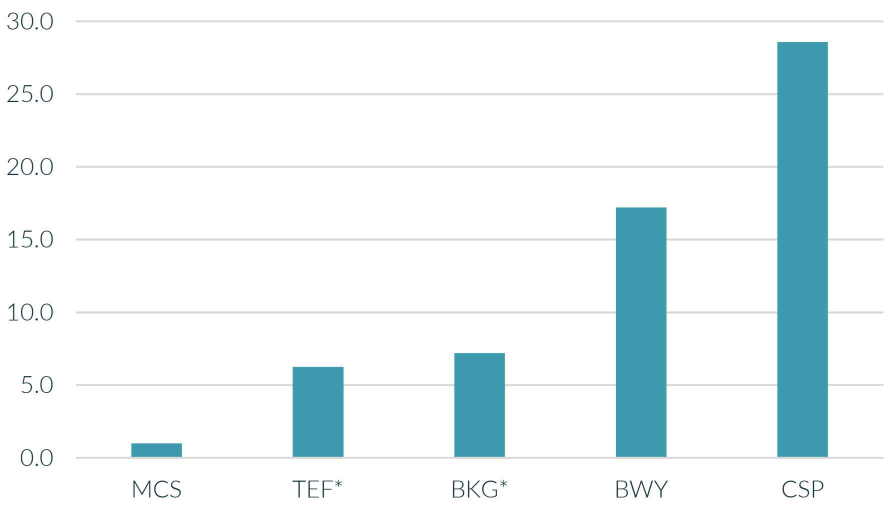
"Our target market remains strong and our customers have maintained their confidence. We do not see any signs of customer caution".

"We do not see any signs of customer caution"

The Board expects the Group's 1H results to be significantly ahead of those of the previous first half year and those for the full year to 30 June 2019 to be "at least in line with expectations".

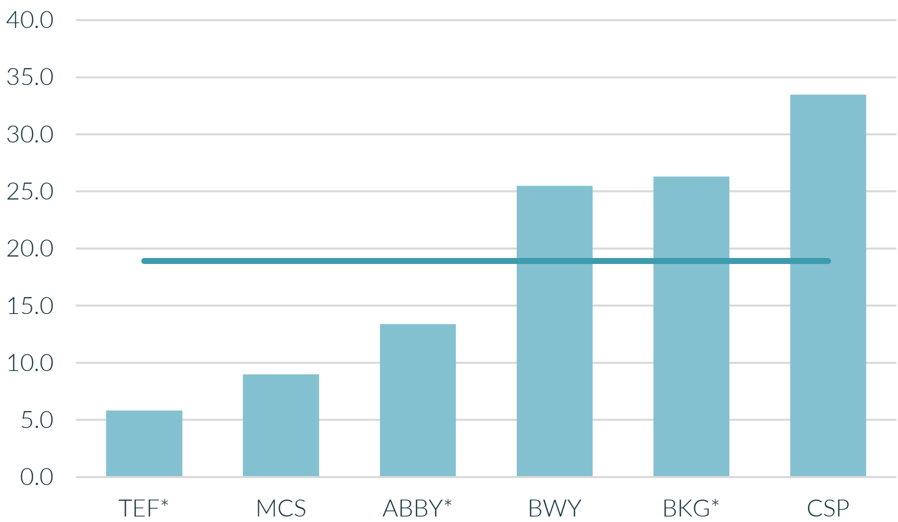
Mr Dury would say they were "lighting up the chalice".

Dividend increases (%) reported in 4Q'18



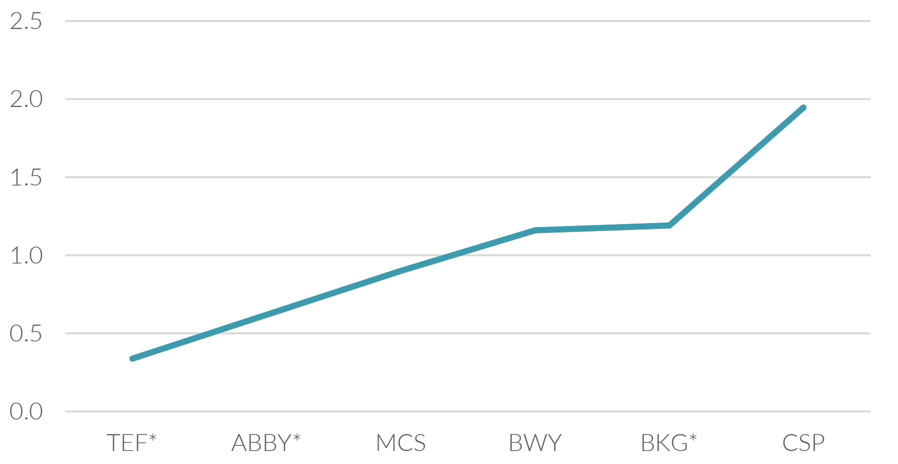
**denotes interim results*
Source: Hardman & Co Research

Latest reported and average RoCE (%) reported in 4Q'18



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

Capital turn (x) reported in 4Q'18



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

Macroeconomics

GDP in the UK grew by 0.4% in the three months to October 2018, driven mainly by the Services Sector, although the Production and Construction Sectors (+2.2%) were also positive contributors – housebuilding and infrastructure specifically. Looking forward, consensus forecasts are in a 1% to 2% band for 2019 and 2020.

Inflation, as measured by the CPI, was 2.3% in November 2018, down from 2.4% in October 2018 and 3.1% in November 2017.

Unemployment was an extraordinary 4.1% in the October quarter and down from 4.3% the previous year. Note, too, that regular pay in nominal terms rose 3.3% in the October quarter of 2018 on an annualised basis, and it has not been higher since the November quarter of 2008.

Finally, Retail Sales in November rose 1.4% against October and by 3.3% year-on-year by volume bolstered by non-food.

Mortgages

Mortgages in November showed the first year-on-year rise since September 2017

UK Finance said that the number of mortgages approved by British high street banks flattened in November, with the first year-on-year rise since September 2017 i.e. 39,403 mortgages for house purchase were approved in November on a seasonally adjusted basis, down 0.6% from October but up 0.2% from November 2017.

At the Bank of England, with a wider catchment, its November mortgage approval data showed a fall of 4.5% to 63,728 against October. On an annualised basis, though, November 2018's tally was just 1.7% shy of November 2017.

Volumes and prices

Experian (where I am an advisor) says that Private Housing Output is forecast to rise by 3% this year and by 4% in 2020; at the same time, the much smaller Public Sector is set for 3% and 6% rises this year and next, respectively.

Turning to house prices, the Nationwide said that they rose 0.5% in 2018 and that its conditional forecast for this year is "a low single-digit pace".

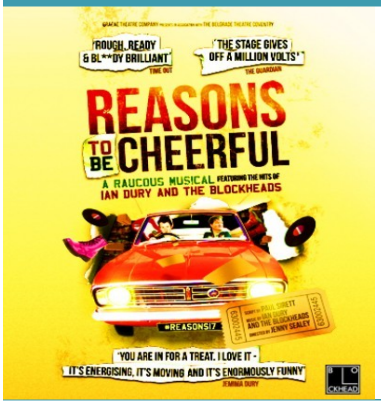
Rightmove, meantime, says that UK house prices in 2019 are likely to be flat with London and environs dipping and the North rising.

Up in Yorkshire, the Halifax is keeping its options open with a 2019 forecast range of plus 2% to 4%.

The Reuters Housing Market Poll (to which I contribute) expects median house price inflation of 1.8% this year and 2.0% in 2020.

And finally, the view of others on house prices in 2019: Hometrack (+3%); RICS (no change); Capital Economic (+1%); and mortgage broker Coreco (+1% to 2%).

Stick and Reasons



Source: Creatice Commons

"The juice of carrot, the smile of a parrot, a little drop of claret" are three more things to be cheerful about according to Mr Dury.

The eponymous single (remember those?) reached number three – oddly enough – in 1979, which was a busy year for the boy; and pretty much a professional peak. In 1982, he also dispensed with his band, the wonderfully monikered 'The Blockheads'; and a fitful career ensued.

Housebuilding's peak year was 2017 with a 43% annualised rise in stock market value and a peak of £44.3bn on 24 October that year. Remember, too, it had bottomed out on 7 July 2008 at £3.1bn amid the cacophony of the Global Financial Crisis (GFC); and, during its unmelodic denouement, the listed UK Housebuilders reinvented themselves.

Germane to this reinvention was £5.3bn of provisions taken during in 2008-10 i.e. 41% of pre-crisis NAV; and £1.7bn of new cash raised from shareholders.

Empiricism prevailed, and the industry is now wiser, ungeared and better managed (i.e. it eschews dodgy recording contracts). By example, check out the six companies which reported results in 4Q i.e. only one (Telford) has net debt at all – and Berkeley is sitting on £860n of net cash (up from £633m in 2017), which tells its own story.

At the same time, munificent dividends are being paid, with a number of double-digit yields available.

Using Berkeley, again, as an example, it has given guidance on a 25% fall in pre-tax profit in the year to 30 April 2019; and yet its share price fell only 17% last year in a Sector off 27%.

Yes, a lot of red ink was spilled in 2018. But, December (+1%) turned (the only 4Q month to rise), as did the nine-day Christmas holiday trading period (+2.2%) together with the opening four trading days of 2019 (3.2%); and (including Berkeley) the consensus view on Sector earnings is flat this year but, already, at +5% in 2020. In a yield-hungry world, too, check out 7% plus available on an average Sector dividend.

There is life after a little death; and we hope and pray that the plain old Brexit Big Bopper struts his stuff (if not, it will be a platinum record buying opportunity in the aftermath; just like July 2016). For sure, 2019's path will undulate.

Note, too, first-time buyers with mortgages soared in 2018 to 367,038 – which is double 2008's tally and just 6% off their 2006 peak.

Similarly, on Boxing Day, Rightmove said that 40 million homes were viewed online (two million more than in 2017).

And then, on 7 January, Gleeson said profits were soaring and "we do not see any signs of customer caution".

Ian Dury once said: "all I want for my birthday is another birthday"; and the industry will have one too.

Quote:

"What I wanted to do was paint sunlight on the side of a house"

Source: Edward Hopper

Glossary

Name (ticker): share price; market value

Abbey (ABBY): 1400 cents; Euro 300m

Barratt (BDEV): 462.8p; £4,694m

Bellway (BWY): 2515p; £3,095m

Berkeley Group (BKG): 3479p; £4,488m

Bovis Homes (BVS): 861.8p; £1,162m

Cairn (CRN); 107 cents; Euro 844m

Countryside (CSP): 304.4p; £1,370m

Crest Nicholson (CRST): 328.2; £843m

M J Gleeson (GLE): 644p; £352m

Glenveagh (GLV): 71 cents; Euro 619

Inland Homes (INL): 52.0p; £107m

McCarthy & Stone (MCS): 138.7p; £745m

Persimmon (PSN): 1930p; £6,129m

Redrow (RDW): 491.4p; £1,817m

Springfield (SPR): 104p; £100m

Taylor Wimpey (TW): 136.25p; £4,464m

Telford Homes (TEF): 285p; £216m

Watkin Jones (WJG): 205.5p; £525m

Note: Share prices at 31 December 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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