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Share prices steady in 2015

Steve Menary looks at the share price performance of the listed housebuilders and the City's view of the sector in 2015

There are few better illustrations of the increased importance of housebuilders in the City over the past couple of years than the list of the top ten risers for 2014. Dixons Carphone, pharma group Shire and plant firm Ashtead were the three best performers with shares in all three rising by between 50% and 70%, but two housebuilders sat comfortably inside the top ten. According to Thomson Data Stream, Barratt was the best performing housebuilding stock in 2014, just ahead of Persimmon.

There are 16 quoted housebuilders – or companies with housebuilding operations – and the last calendar year saw share prices rise in 12 of these companies. Eight of the ten main listed housebuilders outperformed the FTSE 250. The exceptions were Berkeley and Redrow. The only other two housebuilding-related stocks to suffer a fall last year were the minnow Trafalgar New Homes and Kier, whose shares are arguably more influenced by the wider construction industry.

Given that many market professionals are suggesting that investments that rise by more than 5% over the year are outperforming the market, then the sector was a top pick in 2014. Five years ago, stocks were at their nadir. Since then, all of the main pure housebuilders have outperformed the market. This performance is reflected in our *Housebuilder* index, which in 2014 rose 16.5%. The current index only began in February 2013, but between then and the end of that year, the rise was 47.8%. So does that mean the market is slowing? Or appetite for housebuilding shares weakening?

In January this year housebuilders issued a raft of trading statements. Citigroup had already downgraded recommendations before Christmas and broker Jeffries further dampened traders' ardour in the new year by warning of deteriorating conditions in 2015. That knocked some shares yet the statements show the fundamentals remain sound. In 2014, completions at Taylor Wimpey rose 6%. The average selling price for private homes was up 11%. With the cost of living falling, housebuilding executives such as Taylor Wimpey chief executive Pete Redfern expect this to boost optimism amongst buyers.

balanced market

Redfern welcomed the changes to stamp duty, which previously meant left housebuilders actively trying to build houses valued at around £260,000 because the 3% higher rate kicked in. With a new taper system, this will liberalise housebuilders approach to house type. Overall, Redfern anticipates a "more balanced" market. Despite influential analysts such as Deutsche Bank re-iterating a "buy" rating after the update, shares in Taylor Wimpey were initially marked down.

Fickle though its denizens are, the City has not lost faith in the leading housebuilders but the concern – one voiced by Citi, and reflected elsewhere – remains that after a long run of growth, share price valuations now look stretched. The initial surge of Help to Buy has gone.

The result of the general election is unlikely to have a major impact and long term investors now expect steady improvement. Put simply, growth is now a given.

There was certainly little negative to be found in Barratt's update. In the second half of 2014, the asp on private sales was up 12.3%. Even the total asp, dragged down by sales of social housing, was ahead 8.4%. Investment managers guaranteeing that size of return in 2015 would have to be seriously questioned by any intelligent investor.

Yet after Barratt's results, brokers such as Credit Suisse and Panmure Gordon were unmoved and stuck with a neutral rating. Although a "neutral" rating by a housebroker can be widely interpreted as negative guidance, the plethora of neutral ratings re-iterated after the updates reflected the "balanced market" that Pete Redfern suggested lays ahead.

That sort of market is good for companies planning long term and executives wanting to keep their jobs, but less so for market professionals. The start of the new year brings not only updates on trading, but on bonus payments on the sales floor and the analysts' suites. There, no-one wants steady. Instead, the eagle-eyed occupants of counting stools and sales floor alike want to outperform the market. That will bolster the 2016 bonus, not steady as she goes.

While above average growth can be found in some smaller players – at Gleeson, sales are up a quarter – amongst the housebuilders in the FTSE 250 that institutional investors target, there is less short-term value. So bad news for the casino capitalists of the City, but not for sensible investors or the housebuilding industry. hb

Put simply, growth is now a given

Housebuilders share price performance in 2014

Company	Price (£) 1.1.2014	Price (£) 31.12.2014	% rise/fall
Barratt	349.00	471.00	35.0
Persimmon	1173.89	1578.00	34.4
Inland	47.00	59.50	26.6
Taylor Wimpey	111.50	137.80	23.6
Bellway	1570.00	1939.00	23.5
Mar City	97.50	115.50	18.5
Bovis	793.00	884.50	11.5
MJ Gleeson	322.00	357.00	10.9
Galliford Try	1169.00	1288.00	10.2
Crest Nicholson	365.10	388.40	6.4
Telford	343.25	353.25	2.9
Abbey	849.50	865.00	1.8
Redrow	312.00	295.50	-5.3
Berkeley	2656.00	2480.00	-6.6
Kier	1835.00	1491.00	-18.7
Trafalgar New Homes	3.75	1.20	-68.0

Source: Thomson Reuters Datastream.

Finance Diary February 2015

Date	Company	Announcement
Feb 10	Bellway	Trading update
Feb 11	Redrow	Interim results
Feb 18	Galliford Try	Interim results
Feb 23	Bovis	Final results
Feb 24	Persimmon	Final results
Feb 26	Kier	Interim results
Feb 27	Barratt	Interim results
	Gleeson	Interim results

Steve Menary city focus

Going to market

Steve Menary looks at the prospects for housebuilders looking to float on the stock market post the general election and wonders who may step up to the plate

"We live in a virtual world". How often are we told that? But for all of the tech world's dominance we cannot, thankfully, buy a flat amidst the battlefields of *Call of Duty* or park our cars in the murky shadows of *Grand Theft Auto*.

Minecraft might be better but for now bricks and mortar is our reality. The Square Mile is totally in thrall to technology, but enthusiasm for funding bricks and mortar is returning.

caveats

At the start of this year, accountant PricewaterhouseCoopers predicted there would be between 30 and 40 initial public offerings (IPOs) in the UK before the general election that would raise £8 billion. PwC's prediction was, however, doused in caveats about market volatility – and these have since played out. In Q1 2015, although there were 32 IPOs in Europe that raised £12.5 billion, getting a float away proved harder in the UK. There were 16 IPOs, which raised just £2.2 billion. Despite this, conditions for housebuilding floats remain strong and may stay so through the year and post the general election.

While the 500,000 new social housing units suggested by the Green Party is about as likely to materialise as its leader Natalie Bennett forming the next government, all the main political parties agree that there is a massive shortage of new homes.

The new government will be able to do no more than tweak the planning system, but still the prospects for housebuilders this year are sound. Share prices reflect this. Two out of the ten best performing stocks in 2014 were housebuilders – but who can join them?

Two out of the ten best performing stocks in 2014 were housebuilders – but who can join them?

Essex social housing contractor Lakehouse hopes to float before the polls, but PwC does not expect a major housebuilder to get away prior to the election. Post the polls, there is a small window prior to the summer break but PwC suspects that September or October is more likely.

The last mooted float was Miller, which, shorn of a contracting business that would not appeal to investors, proposed to raise circa £140 million by selling off at least 40% of the company in order to raise cash to reduce debt and increase flexibility.

Major shareholders including GSO Partners, the credit arm of private equity giant Blackstone Group, Royal Bank of Scotland and a subsidiary of Lloyds Banking Group, wanted out. But the markets were hit by turmoil. The FTSE 100 fell to its lowest level for ten months and the IPO was ditched on volatility concerns.

But as the market settles again Miller is expected to return, while rumours of a float at CALA and McCarthy & Stone have done the rounds in the City for years now. Stewart Milne was also talked up, though the decline in the oil price has hit the group's core Aberdeen market and City gossip waned. More recently, Galliard's decision to hire former Asda Property finance director Paul Huberman as a non-executive director prompted speculation that a float may be on the cards.

Outside these names, there are few other likely major candidates. That was evident from Balfour Beatty's recent entrance into housebuilding. The UK's biggest contactor is also – given the swathe of recent profit warnings – one of the most bombed out but will deliver 1,500 new homes in Stratford, east London, in partnership with registered social landlord (RSL) Places for People.

Given the need for lower cost housing, the conditions for a float are surely even better for companies focused on this area. Bigger RSLs have been acting as *de facto* housebuilders for years. At the end of its last financial year, London & Quadrant – one of the biggest RSLs with a private development arm, Zest – had 13,000 new homes under construction and sold 965 units. The operating margin was an impressive 36%.

housing associations

Housing associations raise money via bonds and this rather than a float could be the route for smaller private housebuilders. London-focused Pocket Living wants to build 4,000 units over the next few years but eschewed the stock market. Instead, Pocket wants to raise £1.5 million in a mini-bond via crowdfunding platform Crowdcube. In return for an initial £500 investment, investors get an annual interest payment of 7.5% for four years, when their money is due for repayment.

Pocket is focused on smaller homes for people earning less than £40,000 a year and has projects ranging from 18 units up to 44 homes across the capital from Ealing to Camden and Lambeth. Most will be built out by main contractors such as Primus or HG.

Using main contractors makes Pocket a developer rather than a housebuilder. A pedantic distinction perhaps, but with fewer supply chain issues and risk passed onto a contractor, that model may attract more interest on the markets going forward than the traditional style of housebuilding. **hb**

Finance Diary April 2015

Date	Company	Announcement
Apr 21	Redrow	Trading update
Apr 23	Taylor Wimpey	AGM & trading update

An industry in expansion mode

Steve Menary assesses the latest results for the listed housebuilders and sees an industry pushing up margins

Unless you are Berkeley's Tony Pidgley, an ill-informed politician (and we are all sick of them by now) or an analyst looking for some media coverage, calling any point in the housebuilding cycle is a dangerous business.

However, most housebuilders have succeeded in rebuilding their balance sheets since the worst downturn in generations. Margins continue to grow across the quoted sector and, in some cases, back to a level that not so long ago seemed untouchable, but can they grow any further?

Back in 2001, McCarthy & Stone – then a quoted business – had the best operating margin amongst the 20-odd quoted housebuilders with a figure of 31%. Since then, the industry has convulsed: first through a rash of takeovers that saw the number of plc housebuilders dwindle followed by a crash that nearly sank some of the remainder.

Returning to those sorts of profit levels seemed unlikely but with virtually all the results now in from a results season, Berkeley has succeeded in emulating that 2001 margin achieved by McCarthy & Stone.

With Berkeley due to unveil preliminary results next month (June), even further progress could be made but some clarification is, however, needed. That interim profit margin of 31.3% is an underlying gross margin and excludes £99.8 million booked from the sale of rental assets. At an underlying operating level, margins are still "only" 23.3% (2013: 20.7%).

Those are still the industry's best operating margins, although Berkeley must now share that title with the UK arm of Anglo-Irish outfit Abbey, whose results are a bit more opaque. There are no figures for sale of rental assets or land here, and this raises an interesting issue. Just what is the true margin from the volume business of optioning/buying land, getting planning permission (where necessary) and then building and selling homes?

Operating margins are worked out by dividing profits by turnover, but most plc balance sheets include a rash of exceptional items. Berkeley's last turnover was £1,022.2 million but exclude those sold rental assets, along with £11.3 million of revenue from land sales (2013: £nil) and £10.1 million commercial turnover (2013: £5.7 million), and the group's residential turnover is £901.0 million (2013: £815.3 million).

Turnover, as the old adage goes, is only vanity and sanity can only be found in profit. After taking into account expenses of £74.4 million and the sale of those rental assets, a gross profit from operations of £288.6 million turns into a figure of £299.6 million. Divide that figure by the one solely for residential turnover and the margin is even higher again at 32%.

This might seem like pedantry but there is an important issue here of the financial measures that are used to gauge and measure financial performance at housebuilders, both listed and privately-owned.

Across the board, there are now hardly any red marks on balance sheets

Companies quoted on the main market must provide far more detail, and more often, than those firms whose sole fiscal responsibility lies in preparing an annual return for Companies House.

In the City, finance directors – and their City public relations companies – inevitably choose the figures that look best. That is human nature. But of the myriad quoted sectors, there is perhaps a little more sensitivity amongst housebuilders in the City than elsewhere.

highlights

Hence, Berkeley's margins were not amongst the highlights picked out at the top of the results presentation sent out to the City and the media.

Other housebuilders are less concerned, in part because their margins are lower, but the likes of Bellway felt able to highlight a margin that had surged 430 basis points to 19.9% (2013: 15.6%).

Bellway traditionally brings up the rear of the results seasons, which, as the number of housebuilders listed on the markets has gradually risen, is now more sporadic than ever. Major housebuilders produce results relatively quickly, but some have financial years that end in December, others that close in June. There is also a distinct lack of urgency amongst some of the 16 quoted housebuilders. Mar City, the social housing contractor turned housebuilder that is listed on the junior Alternative Investment Market, was due to post results in March but by mid-April had still not done so.

Excluding Mar City, the average margin amongst the housebuilders is a healthy 15.8%. After then also excluding minnow Trafalgar New Homes for reasons of size, the average plc housebuilding margin rises to 16.8%. A year ago, the comparable plc industry average margin was 13.4%. So, on average, industry margins have improved by a quarter over the past 12 months.

To put those figures in some greater historical context, in 2001 a standalone Wimpey prior to the asset swap with Taylor Woodrow that would create Taylor Wimpey, had an operating margin of 11.4%. That figure had risen from 8.8% in Wimpey's last results, but was still in the lower echelon of the quoted housebuilders. In the 2014 calendar year, Taylor Wimpey's margin was a well above industry average of 18%.

Across the board, there are now hardly any red marks on balance sheets. Only Telford, where completions are weighted towards the back-end of the group's financial year, experienced a fall in turnover; even then this was compensated for by a 21% surge in operating profits.

On the measure of profitability, all the major plc housebuilders (excluding Trafalgar) pushed profits up.

Completions rose everywhere bar Telford, Galliford Try and Berkeley, whose comparable figure a year ago was massively boosted by a block sale of private rental developments and student housing.

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Finance Diary May 2015

Date	Company	Announcement
May 8	Barratt	IMS
May 13	Galliford Try	IMS
May 15	Bovis	AGM & IMS

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The largest rise in both turnover and completions came at Inland, which was originally set up by former Country & Metropolitan founder Stephen Wicks as a landbanking business. Since the downturn ended, Inland has been building out some plots. This has accelerated to such a degree that the group's private housebuilding revenue in the most recent six months outstripped that of Abbey's UK arm.

This illustrates that, on the whole, this is an industry very much in expansion mode. Redrow expects to have 115 active outlets by next month (June) – up from 103 a year ago. Bellway opened its sixteenth and newest operating division in Bristol and secured a quarter of its latest turnover from London, which was a no-go area for many volume housebuilders until recently.

As companies, even ones long in the tooth, expand again after such a massive contraction, there can be growing pains. That is why being able to find effective gauges to measure performance that can be applied across companies such as margins is important.

While quoted companies are obliged to be freer with information than their privately-owned brethren, there is not always consistency. In some cases, there is what can only be described as low-level obfuscation.

As the market rises, housebuilders are highlighting increases in average selling prices for private homes. Combined figures are, in some cases, not always even included in releases, as the impact of the sale of social housing drags down the overall ASP. Social housing remains an obligation, though for some housebuilders this – like the demands from the City for more detail in results – can be seen as excessive red tape.

turnover

At some housebuilders such as Berkeley, the value of land sales and commercial work is broken out in terms of turnover. Bovis too disclosed that 2014 housing revenue of £783.6 million excluded land sales of £21.6 million (2013: £3.0 million). So too Crest Nicholson, where turnover in the year to October 2014 of £603.9 million excluded £32.4 million from land sales and commercial mixed use.

Commercial activity was primarily the sale of a superstore for Morrisons in Southampton, but what was the impact of this on the bottom line? How is the original cost of the site accounted for? Is all this income a straight profit? Or, are land sales and commercial work not just part of the overall business of housebuilding?

Of course, in the City the source of a profit does not matter. Whether the bottom line and earnings per share are boosted by improved productivity, land sales or job cuts, matters little, but what is illustrative here is how much housebuilders are actually making solely from the business of planning, building and selling of homes.

While some companies keep this information to themselves, a few are happy to let on.

Galliford Try has come to the end of a major expansion and, as a result, suffered a minor fall in completions. Worthily, the group breaks out the impact of land sales on the bottom line and the result is interesting.

The headline operating margin at the Linden Homes business, which is focused on private housebuilding, was slightly below industry average at 15.1% in the last half of 2014. The management expects margins to reach 18% by 2018, but strip out the impact of land sales from the current margins and that latest figure drops to 12.9%. And that figure is a lot closer to the bottom end of the scale back in 2001 than the top. hb

PLC ANNUAL RESULTS 2014

Company (£m)	Turnover %	Change %	Op. profit (£m)	Change %	Op. margin	Completions	Change	ASP	Change %	Landbank (£)
Taylor Wimpey UK	2,652.4	16.8	476.5	52.3	18.0	12,454	6.5	213,000	11.5	75,000
Persimmon	2,573.9	23.0	465.3	42.5	18.1	13,509	17.0	190,533	5.3	87,700
Bovis*	783.6	43.0	137.6	66.2	17.6	3,635	29.0	216,600	11.0	18,062
Crest Nicholson*	603.9	22.9	128.1	490.5	20.1	2,530	16.0	238,700	5.5	17,247
INTERIM RESULTS 2014										
Barratt	1,576.3	24.6	224.1	60.6	14.2	6,971	12.5	229,000	8.5	68,947
Berkeley[1]*	901.0	10.5	288.6	20.1	23.3	1,372	-40.2	649,000	85.4	24,381
Bellway*	823.4	19.6	165.7	52.0	19.9	3,754	15.7	219,343	3.4	35,837
Redrow[2]	560.6	54.0	95.4	94.7	17.0	1,850	18.0	300,00	14.5	16,950
Galliford Try[3]	346.1	5.0	52.1	18.1	15.1	1,364	-1.7	259,000	2.0	14,300
Gleeson	90.0	25.0	5.2	51.0	13.0	321	24.0	124,600	3.8	5,200
Telford[4]	65.1	-11.7	10.5	20.7	18.0	140	-37.0	462,000	64.4	N/d
Kier[5]	52.0	6.0	0.8	60.0	0.9	254	16.0	197,000	1.0	3,643
Inland*	48.1	598.8	9.3	132.0	19.3	199	503.0	242,000	0.8	4,512
Abbey[6]	39.9	45.9	9.3	129.8	23.3	205	31.4	195,000	11.0	N/d
Trafalgar New Homes	2.3	158.3	0.04	-65.3	1.6	4	N/a	558,000	N/a	N/d

* Turnover excludes commercial revenue & land sales

1 2013 figures include sale of 2 student schemes plus 534 units to M&G at an ASP of £197,000.

2 Profits before finance costs

3 Results for Linden Homes only, but landbank for LH & GT Partnerships. Margin excludes land sales.

4 Completions open market homes only.

5 Private housebuilding only. Underlying operating profits & margins before exceptional items

6 Converted from Euros at €0.7146 = UK£1.

N/d = Not disclosed. N/a = Not applicable.