Group financial review

Focused on protecting value and margin

Chris Carney
Group Finance Director

"Our primary performance focus is on returning the business to 21-22% operating profit margin in the medium term and we continue to target a number of areas to achieve this; focus on cost, process simplification and the incremental growth as a result of the equity raise."

Q&A with Chris Carney, Group Finance Director

Q What are the key financial priorities for the group?

A Our primary performance focus is on returning the business to 21-22% operating profit margin in the medium term and we continue to target a number of areas to achieve this; focus on cost, process simplification and the incremental growth as a result of the equity raise.

Q What will help drive margin performance?

A We have strong embedded margins in the landbank which, together with the recovery in our completion levels, gives us confidence in achieving our medium term margin targets, assuming stable market conditions.

Q What costs savings have you made this year?

A In 2020, we undertook a detailed review of our organisational and cost structure to ensure that we continue to operate efficiently in a changing market. This resulted in a series of actions, including the removal of one layer of management, a rationalisation of our London operating structure to focus on affordable price points that meet the affordability needs of Londoners, and a series of other reductions in central and business unit overhead levels. These changes will generate savings in the region of £16 million annually from 2021, with the £12 million costs to achieve these savings already incurred in 2020.

Q What is new for 2021?

A In 2020 we designed and piloted a new customer relationship management system using Microsoft Dynamics software. This will be rolled out across our business in 2021 and will build on the progress we have made in digital communications with our customers over the past few years. As well as the customer service and efficiency benefits of better, more targeted communication, we expect the system to provide better insight led decision making, enhancing revenue and margin. The system will bring customer service benefits such as real time online issue resolution, delivering greater visibility and faster responses. Operationally, there are a number of benefits, for example, the system will enable end to end workflows for legal processes, with online notifications and approvals ensuring customers, solicitors and our legal teams are aligned, helping to reduce time to completion.

Group financial review of operations
Income statement

Group revenue decreased by 35.7% to £2,790.2 million in 2020 (2019: £4,341.3 million) due to a reduction in completions as a result of the controlled closure of our sites and sales centres during the second quarter of 2020, as we responded to the COVID-19 pandemic and developed safe working practices for our employees, subcontractors and customers. Completions in the UK (excluding joint ventures) decreased by 39.4% to 9,412 (2019: 15,520). Despite the uncertainties associated with the pandemic, prices have remained resilient and UK average selling prices increased 7.3% to £288.3k (2019: £268.6k) with private completions up by 5.8% to £323.2k (2019: £305.4k), the majority of the increase driven by geographical and product mix.

During the year we have identified and expensed £62.7 million of costs relating to the COVID-19 pandemic, with £60.3 million charged to gross profit and £2.4 million to administrative costs. These costs include unproductive site overhead costs incurred during the controlled closure and lockdown period which would ordinarily be capitalised to WIP and expensed as plots legally complete of £29.9 million; additional costs incurred by the business due to extended site durations resulting from the reduced productivity levels as we implemented our operational processes under the COVID-secure guidelines totalling £17.4 million; and incremental costs incurred by the business in responding to COVID-19, including to meet our health and safety requirements and complying with Government guidelines, of £15.4 million.

Group gross profit reduced to £496.7 million (2019: £1,044.1 million) representing a gross margin of 17.8% (2019: 24.1%). The decline was mainly driven by expensing costs relating to the COVID-19 pandemic (as discussed above) as well as fixed build and direct selling costs which are absorbed across fewer completions.

Administrative costs reduced to £206.8 million (2019: £211.7 million) reflecting the reduction in payments under the Group's bonus plans and impact of the current financial performance on the long term incentive schemes, in part offset by the £12.1 million of restructuring costs incurred following the detailed review of our organisational and cost structure to ensure that we continue to operate efficiently in a changing market.

We have implemented a series of proposed changes that will generate annualised savings of £16 million from 2021. These changes include the removal of one tier of operational management, a rationalisation of our London operating structure to focus on affordable price points that meet the affordability needs of Londoners, and a series of reductions in central and business unit overhead levels. These changes will not affect the ability of the business to generate future growth or to deliver a high quality product and service to our customers. Operating through the challenges of the last six months has also highlighted opportunities for ongoing efficiency and performance improvement, as our recent investments in systems and processes have performed well.

During the year, completions from joint ventures were 197 (2019: 199). The total order book value of joint ventures as at 31 December 2020 decreased to £51 million (31 December 2019: £62 million), representing 118 homes for completions in 2021 and 2022. Our share of results of joint ventures in the period was a profit of £7.9 million (2019: £8.0 million).

Operating profit was £300.3 million (2019: £850.5 million), delivering an operating profit margin of 10.8% (2019: 19.6%).

During the year we continued our works to replace Aluminium Composite Material (ACM) cladding on a small number of legacy developments. Following a review of these works and expected costs to complete during the first half a further £10.0 million was provided and in line with our policy charged to exceptional items. The prior year exceptional credit of £14.3 million arose on the implementation of a Pension Increase Exchange for members of the Taylor Wimpey Pension Scheme which enabled some pension scheme members to elect to exchange future pension increases on part of their pensions for a one-off increase in pension.

The net finance expense of £25.9 million (2019: £28.9 million) principally includes imputed interest on land acquired on deferred terms, bank interest and interest on the pension scheme. The net interest charge on the defined benefit pension scheme reduced as the liability at 1 January 2020 was lower at £84.5 million compared with £133.0 million at 1 January 2019. In addition, changes in foreign exchange rates in the year resulted in a small foreign exchange gain compared with a loss in the prior year. This was partially offset by an increase in net bank interest payable reflecting the prudent step of fully drawing down the previously unutilised £550 million revolving credit facility following the temporary closure of sites. Once construction had restarted under new operating protocols the facility was fully repaid before the end of June 2020.

Profit on ordinary activities before tax decreased to £264.4 million (2019: £835.9 million) after the exceptional charge of £10.0 million (2019: exceptional credit of £14.3 million). The pre-exceptional tax charge was £49.1 million (2019: £159.3 million) with an underlying tax rate of 17.9% (2019: 19.4%) which includes a £1.4 million credit (2019: nil) arising from the remeasurement of the Group's UK deferred tax assets at 19.0% following the changes to the corporation tax rates enacted by the UK Government. A tax credit of £1.7 million was recognised in respect of the exceptional charge (2019: exceptional tax charge of £2.7 million). This resulted in a total tax charge of £47.4 million (2019: £162.0 million), a rate of 17.9% (2019: 19.4%). Profit for the year was £217.0 million (2019: £673.9 million).

	UK	Spain	Group
Completions including joint ventures	9,609	190	9,799
Revenue (£m)	2,726.9	63.3	2,790.2
Operating profit (£m)	284.5	15.8	300.3
Operating profit margin (%)	10.4	25.0	10.8
Profit before tax and exceptional items (£m)			274.4
Profit for the year (£m)			217.0
Basic earnings per share (p)			6.3
Adjusted basic earnings per share† (p)			6.5

Group financial review continued

> "We have a strong financial position with a robust and flexible balance sheet with net cash of £719.4 million, positioning us well for growth in 2021 and beyond."

Basic earnings per share was 6.3 pence (2019: 20.6 pence). The adjusted basic earnings per share was 6.5 pence (2019: 20.3 pence).

Spain

The Spanish second-homes market has been impacted by travel restrictions as a result of COVID-19. We completed 190 homes in 2020 (2019: 323) at an average selling price of €375k (2019: €429k). The total order book as at 31 December 2020 stood at 126 homes (31 December 2019: 217 homes).

The Spanish business delivered an operating profit of £15.8 million for 2020 (2019: £32.1 million) and an operating profit margin of 25.0% (2019: 26.7%). We expect the business to begin to normalise when foreign travel returns to more normal levels.

Balance sheet and financial position

We have a strong financial position with a robust and flexible balance sheet positioning us well for growth in 2021 and beyond.

Net cash and financing position

Net cash increased to £719.4 million at 31 December 2020 from £545.7 million at 31 December 2019. The increase was due in part to net proceeds from the issuance of shares in June 2020 of £510.1 million being partially offset by a net cash outflow from operating activities of £301.2 million and an increase in investment in joint ventures of £19.8 million. Average net cash for 2020 was £399.3 million (2019: £157.0 million).

The main driver of the net cash outflow from operating activities in 2020 was an increase in land and work in progress working capital of £362.2 million as we settled land creditor obligations, continued investment in land and the number of completions decreased.

In the 12 months to 31 December 2020, the outflow of cash from operations as a result of increased working capital led to cash conversion of (54.9)% of operating profit (2019: 82.6%).

Net cash, combined with land creditors, resulted in an adjusted gearing‡‡‡ of (1.1)% (31 December 2019: 5.5%).

At 31 December 2020 our committed borrowing facilities were £653.6 million of which £550 million was undrawn. The average maturity of the committed borrowing facilities at 31 December 2020 was 3.8 years.

Balance sheet

Net assets at 31 December 2020 increased by 21.4% to £4,016.8 million (2019: £3,307.8 million), with net operating assets increasing by £464.6 million to £3,264.8 million (31 December 2019: £2,800.2 million). The increased investment in operating assets together with the decrease in operating profit results in return on net operating assets reducing to 9.9% (2019: 31.4%) and Group net operating asset turn†* was 0.92 times (2019: 1.60 times).

The balance sheet principally comprises work in progress and land investment, with total investment in the year increasing by £338.7 million.

Work in progress ('WIP')

Average WIP per UK outlet at 31 December 2020 increased by 13.8% to £6.6 million (2019: £5.8 million), reflecting the increase in overall WIP held whilst outlet numbers remained broadly flat. The increase in WIP reflected the delay of some 2020 forecast completions into 2021 due to site closures in the second quarter and the continued investment in build since our sites reopened in May.

Land

Land at 31 December 2020 increased by £139.8 million as the Group invested in land opportunities following the equity raise completed in June 2020. Land creditors decreased to £675.9 million (31 December 2019: £729.2 million) following repayments made in the year being in excess of the level of new creditors. Included within the gross land creditor balance is £64.9 million of UK land overage commitments (31 December 2019: £56.4 million). £347.9 million of the land creditors is expected to be paid within 12 months and £328.0 million thereafter.

As at the balance sheet date, the Group held certain land and work in progress that had been written down by £64.4 million (31 December 2019: £68.6 million) to a net realisable value of £53.8 million (31 December 2019: £59.3 million). The balance of previously written down land and work in progress in the UK was £34.5 million (31 December 2019: £39.0 million), following the associated write-downs of £25.5 million (31 December 2019: £30.5 million).

At 31 December 2020 the UK short term landbank comprised 77,435 plots (31 December 2019: 75,612), with a net book value of £2.5 billion (31 December 2019: £2.4 billion). Short term owned land comprised £2.4 billion (31 December 2019: £2.3 billion), representing 53,731 plots (31 December 2019: 54,641). The controlled short term landbank represented 23,704 plots (31 December 2019: 20,971).

The value of long term owned land increased to £217 million (31 December 2019: £97 million), representing 36,968 plots (31 December 2019: 33,329), with a further total controlled strategic pipeline of 101,676 plots (31 December 2019: 106,895). Total potential revenue in the owned and controlled landbank increased to £54 billion in the period (31 December 2019: £53 billion), reflecting the overall mix of opportunities in the short term landbank and strategic pipeline.

As at 31 December 2020, in the UK, 90% of the short term owned and controlled landbank was purchased after 2009, 56% of which was sourced through our strategic pipeline. This results in a land cost to average selling price in the short term owned landbank of 15.2% (31 December 2019: 14.9%).

Provisions increased to £130.5 million (31 December 2019: £128.4 million). The £10.0 million increase in the ACM cladding replacement provision and the provision for restructuring in the final quarter of the year being substantially offset by utilisation as claims were made and processed through the Ground Rent Review Assistance Scheme and costs were incurred on work performed to replace ACM cladding. Further details on the post balance sheet increase to provisions is included in Note 33.

Our net deferred tax asset of £33.7 million (31 December 2019: £29.8 million) relates to our pension deficit, employee share schemes and the temporary differences of our Spanish business, including brought forward trading losses. The net deferred asset held was affected by the changes to the corporation tax rates enacted by the UK Government in 2020. The increase in the pension deficit in the year also further increased the deferred tax asset recognised.

Pensions

Following the 31 December 2016 triennial valuation, the Group agreed a recovery plan with the Trustee to pay deficit reduction contributions of £40.0 million per annum for the period from April 2018 to December 2020.

During 2020 and in response to the site shutdowns, a temporary suspension of the agreed deficit reduction contributions was agreed with the Trustee for the three months between April and June 2020 and as a result, the recovery plan period was extended to 31 March 2021. The agreed recovery plan included a contribution mechanism, tested quarterly, such that should the Taylor Wimpey Pension Scheme (TWPS) become fully funded on the Technical Provisions funding basis, further contributions would be suspended and only recommence if the funding level fell below 96%.

In April 2018, the Group paid a one-off contribution of £23.0 million into the TWPS to increase the funding level to 100% and thereby suspend any future contributions from 31 March 2018. However, the quarterly funding test for 31 December 2018 showed that the TWPS funding level had subsequently fallen to 94%. The Group therefore recommenced regular contributions from January 2019.

The most recent funding test at 31 December 2020 showed a funding level of 95% on the Technical Provisions funding basis. As a result, regular contributions will continue for the remaining three months of the recovery plan. The Group continues to provide a contribution for Scheme expenses and also makes contributions via the Pension Funding Partnership. Total Scheme contributions and expenses were £37.1 million in 2020 (2019: £47.1 million). Confirmed payments in 2021 are expected to be £17.4 million although this is dependent on the outcome of negotiations for the triennial valuation at 31 December 2019.

During 2020, the Group has engaged with the TWPS Trustee on the triennial valuation of the pension scheme with a reference date of 31 December 2019. At the current time discussions are ongoing with the Trustee to agree the valuation as well as any future contributions. Legislation requires that agreement is to be reached by 31 March 2021.

At 31 December 2020, the IAS 19 valuation of the Scheme revealed an underlying deficit of £89.1 million (2019: surplus of £100.5 million). Due to the rules of the TWPS, any surplus cannot be recovered by the Group and therefore in 2019 a deficit was recognised on the balance sheet under IFRIC14. This deficit was equal to the present value of the remaining committed payments under the 2016 triennial valuation at that time. No such adjustment has been recognised at 31 December 2020 since the Scheme was in a deficit on an IAS 19 accounting basis.

Total retirement benefit obligations of £89.5 million at 31 December 2020 (31 December 2019: £85.0 million) comprise a defined benefit pension liability of £89.1 million (31 December 2019: £84.5 million) and a post-retirement healthcare liability of £0.4 million (31 December 2019: £0.5 million).

The Group continues to work closely with the Trustee in managing pension risks, including management of interest rate, inflation and longevity risks.

Dividends

Subject to shareholder approval at the AGM scheduled for 22 April 2021, the 2020 final ordinary dividend of 4.14 pence per share will be paid on 14 May 2021 to shareholders on the register at the close of business on 6 April 2021. This dividend will be paid as a cash dividend, and shareholders are once again being offered the opportunity to reinvest all of their ordinary dividend under the Dividend Re-Investment Plan (DRIP), details of which are available from our Registrar and on our website. Elections to join the Plan must reach the Registrar by 22 April 2021 in order to be effective for this dividend. Further details can be found on our website www.taylorwimpey.co.uk/corporate

Alternative Performance Measures

The Group uses Alternative Performance Measures (APMs) as key financial performance indicators to assess underlying performance of the Group. The APMs used are widely used industry measures and form the measurement basis of the key strategic KPIs (return on net operating assets, operating profit margin and cash conversion).

A portion of executive remuneration is also directly linked to some of the APMs. Definitions and reconciliations to the equivalent statutory measures are included in Note 32 of the financial statements.

Value distributed during 2020 (£m)

Contribution to local communities via planning obligations	Employment	Net investment in land & WIP	Interest paid	Pension contributions	Taxes
£286.6m	£264.9m	£362.2m	£10.8m	£52.3m	£136.4m
2019: £447.3m	2019: £275.9m	2019: £21.7m	2019: £6.4m	2019: £61.6m	2019: £178.8m

Group financial review continued

Going concern

The Directors remain of the view that the Group's financing arrangements and balance sheet strength provide both the necessary facilities and covenant headroom to enable the Group to conduct its business for at least the next 12 months. Accordingly, the consolidated financial statements are prepared on a going concern basis.

Chris Carney
Group Finance Director

Definitions

* Operating profit is defined as profit on ordinary activities before net finance costs, exceptional items and tax, after share of results of joint ventures.

** Return on net operating assets (RONOA) is defined as rolling 12-month operating profit divided by the average of the opening and closing net operating assets, which is defined as net assets less net cash, excluding net taxation balances and accrued dividends.

*** Operating cash flow is defined as cash generated by operations (which is before taxes paid, interest paid and payments related to exceptional charges).

‡‡* Return on capital employed (ROCE) is defined as 12-month rolling operating profit divided by average capital employed calculated on a monthly basis over the period.

† Adjusted basic earnings per share represents earnings attributed to the shareholders of the parent, excluding exceptional items and tax on exceptional items, divided by the weighted average number of shares in issue during the period.

†* Net operating asset turn is defined as 12-month rolling total revenue divided by the average of opening and closing net operating assets.

‡ Net cash / (debt) is defined as total cash less total borrowings.

‡‡ Cash conversion is defined as operating cash flow divided by operating profit on a rolling 12-month basis.

‡‡‡ Adjusted gearing is defined as adjusted net debt divided by net assets. Adjusted net debt is defined as net cash less land creditors.

Viability Statement

In accordance with the 2018 UK Corporate Governance Code, the Directors and the senior management team have assessed the prospects and financial viability of the Company for a period longer than the 12 months required by the 'going concern' provision.

Time period

The Directors have assessed the viability of the Group over a five-year period, taking account of the Group's current financial position, current market circumstances and the potential impact of the Principal and emerging risks facing the Group. The Directors have determined this as an appropriate period over which to assess the viability based on the following:

- It is aligned with the Group's bottom up five year budgeting and forecasting cycle
- Five years represents a reasonable estimate of the typical time between purchasing land (obtaining planning permission, putting in place infrastructure and commencing build) and selling homes to customers from a development

The time period is challenged annually to ensure that it remains appropriate and as part of the review the Directors also considered:

- The cyclical nature of the market in which the Group operates, which tends to follow the economic cycle
- The nature of the economic cycle and our expectations of how this will impact us
- Consideration of the impact of Government policy, planning regulations and the mortgage market
- Long term supply of land, which is supported by our strategic landbank
- Changes in technology and customer expectations

Assessment of prospects

We consider the long term prospects of the Group in light of our business model. Our strategy to deliver sustainable value is achieved through delivering high quality homes in the locations where people want to live, with excellent customer service, whilst carefully managing our cost base and the Group's balance sheet. Future prospects are primarily monitored through the risk management process detailed on pages 46 to 48.

In assessing the Group's prospects and long term viability due consideration is given to:

- The Group's **current performance**, which includes the current year performance (pages 6 to 9), the output from the annual business planning process and financing arrangements, the wider economic environment and mortgage market, as well as changes to Government policies and regulations that could impact the Company's business model including the recent announcement on the Future Homes Standard and developer taxes
- **Strategy and business model flexibility**, including build quality, customer dynamics and approach to land investment. Further detail is provided on pages 22 to 25
- **Principal Risks** associated with the Group's strategy and business model including those which have the most impact on our ability to remain in operation and meet our liabilities as they fall due

Principal Risks

The Principal Risks, to which the Group are subject, have undergone a comprehensive review by the Executive Committee and Board. Consideration is given to the risk likelihood based on the probability of occurrence and potential impact on our business, together with the effectiveness of mitigations. The review included assessing the impact of COVID-19 on each of the risks and is detailed on pages 49 to 53, particularly with the economic outlook remaining unclear in light of the pandemic.

The Directors identified the Principal Risks that have the most impact on the longer term prospects and viability of the Group as: 'Impact of the market environment on mortgage availability and housing demand', 'Government policy and planning regulations' and 'Quality and reputation'. A range of sensitivity analyses for these risks together with likely mitigating actions that would be adopted in response to these circumstances were modelled, including a severe but plausible scenario in which the impacts were aggregated together.

Assessment of viability

The Group adopts a disciplined annual business planning process involving the management teams of the 23 UK business units and Spain, and the Group's senior management, and is built on a bottom up basis. This planning process comprises a budget for the next financial year, together with a forecast for the following four financial years.

The financial planning process considers the Group's profitability and Income Statement, Balance Sheet including landbank, gearing and debt covenants, cash flows and other key financial metrics over the plan period. The Group has adapted its business plan in response to COVID-19, which includes the impact of the increased investment in land opportunities following the capital raise and impact of operating under COVID-19 secure protocols on build times. The plan also incorporates the likely market impact of the planned changes to Help to Buy and the impact of the Government announcements on transitional arrangements for the Future Homes Standard.

These financial forecasts are based on a number of key assumptions, the most important of which include:

- Timing and volume of legal completions of new homes sold, this includes annual production volumes and sales rates over the life of the individual developments
- Average selling prices achieved
- Build costs and cost of land acquisitions, including the impact of the Future Homes Standard
- Working capital requirements
- Capital repayment plan, where we have assumed the re-instatement of the ordinary dividend in line with the previous policy, which is a minimum of £250 million or 7.5% of the Group's net assets, throughout the period

Stress testing our risk resilience

The assessment considers sensitivity analysis on a series of realistically possible, but severe and prolonged, changes to principal assumptions. In determining these we have included macro-economic and industry-wide projections as well as matters specific to the Group.

The plausible downside scenario reflects the aggregated impact of the sensitivities, taking account of a sharp decline in customer confidence, disposable incomes, and mortgage availability. To arrive at our stress test we have drawn on experience gained managing the business through previous economic downturns and the COVID-19 pandemic.

We have applied the sensitivities encountered at those times, as well as the mitigations adopted, to our 2021 expectations in order to test the resilience of our business. As a result, we have stress tested our business against the following plausible downside scenarios:

Volume – a decline in total volumes of 30% from pre-COVID-19 levels, followed by a gradual recovery

Price – a reduction to current selling prices of 10%

Build cost – potential inflationary risks from shortfalls in material and labour as a result of Brexit, largely offset by deflationary pressure caused by the lower volumes. An increased build cost for 2023 onwards has been included to reflect the transitional arrangements of the Future Homes Standard

Costs – a one-off exceptional charge and cash cost of £150 million for an unanticipated event, change in Government regulations or financial penalty

The mitigating actions considered in the model include a reduction in land investment, a reduction in the level of production and work in progress held and optimising our overhead base to ensure it aligns with the scale of the operations through the cycle.

The Group's liquidity (defined as cash and undrawn committed facilities) was £1,373 million at 31 December 2020. This is sufficient to absorb the financial impact of each of the risks modelled in the stress and sensitivity analysis.

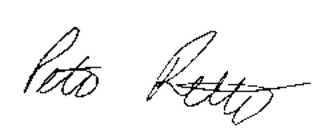
If these scenarios were to occur, we have a range of additional options to maintain our financial strength, including: a reduction in capital expenditure, the sale of assets, raising debt and reducing the dividend.

Confirmation of viability

Based on the results of this analysis, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the five-year period of their assessment.

Approval of the Strategic Report

This Strategic Report was approved by the Board of Directors and signed on its behalf by



Pete Redfern
Chief Executive