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Full Year Results 2014

Pete Redfern - Group Chief Executive

Good morning, thank you for joining us. I recognise for many it's a very busy morning in the markets, so we're very glad you're here with us instead of choosing some of your other options.

I will get straight into it. I'm going to leave dealing with the market until the final section, and I'll touch on it very briefly in setting the scene for 2014, but focus mostly on performance looking back, but particularly where we are heading into 2015. And Ryan, as well as focusing on the financial delivery, will also pick up costs and some of the underlying quality measures.

So, getting straight into the 2014 highlights, I think I'm entitled to spend a few seconds on the operating profit, which actually is a record for the business, at 18% in the UK, 17.9% for the Group, and the equivalent number in the previous cycle, the peak in the UK was about 17.2%, so we're particularly pleased with that and the significant growth in 2014 over 2013. But I think the area where we probably want to spend slightly more time today on is the return on net operating assets and the conversion of that capital efficiency into cash as we go forward.

This was the first year in which we paid out the beginnings of material dividends to shareholders with £73m paid to shareholders in 2014. But probably the 'new' news of the day is the doubling of the maintenance dividend. We recognise it's not enormous sums of cash, but I think we see it as a clear signal of the confidence we have in the sustainability of this performance, and that word 'sustainability' will probably come up quite a number of times over the course of the next 45 minutes or so.

Looking at some of the operational highlights in the UK every number on this slide is a record, except for one, and it's quite conscious the one that we've put up there, which is the sales rate, which wasn't a record. Through the previous cycle we would have tended to see at this sort of stage a sales rate of 0.8 to 0.9 for our business as what we were targeting. We consciously haven't been targeting that and we'll talk quite a lot about sales rates during the course of the presentation. But all of the other numbers, which particularly are focused on the amount of value we derive from each completion, the contribution per completion and that operating margin number, are ahead of where they've ever been before.

We'll also talk about the strategic pipeline and you've seen the number of converted plots that we've had during the year build up, so I don't think the 10,800 will be a huge surprise, although it's about 1,000 ahead of the numbers we guided you to; but that underlying sense

of the number of plots that we're bringing forward from that landbank underpinning future performance is very strong.

I said I'd touch very briefly in this section on the market, but this is backward-looking. It was obviously a very strong set of market conditions, particularly in the first half. We were not concerned in the second half as we saw more stability in the level of price growth as it flattened off, solid sales rates into the end of the year, and probably, given the headwinds of political speculation about mansion tax and before the stamp duty changes, what might happen to stamp duty, and some of the perceived risk of interest rate rises at that point, a pretty solid second half, but I'll give you more information looking forward later on.

Touching on the geographic split of our business, and I don't want to focus on every single number, but probably the stat we're most pleased with across North and South is the fact that the average plot cost as a percentage of average selling price has actually reduced in both divisions at a point when our underlying quality of land is improving, the average selling price is improving, which would tend to drive up that plot cost as a percentage of average selling price. So you see that sort of coming forward quite strongly in terms of the strength of the business for the next four or five years of land delivery. But also, our strategic land isn't focused where it historically might have been across Scotland, North East and down into the South West, it's focused strongly across the whole of the business with a particular weighting into the South East, and you'll see exactly where those sites have come forward in a couple of minutes.

In the North, you've seen slightly slower sales rates and I don't think that will surprise you, but actually in '14 more growth relative to '13 than you saw in the South, so definitely an improving set of market conditions in 2014. And again, that same trend of plot cost as a percentage of average selling prices in the landbank falling despite the improvement in the market and the improvement in quality. Whilst we've brought through less strategic land in the North, the focus has been on making sure those are the highest quality locations. You have to be extremely selective to find the right sites, but sites like Edinburgh, Yarm, high average selling prices by historical context for those strategic land sites in the North of our business.

Then standing back and looking at our overall land position, we've said this before, but it's so important to the strategy of the business that it's worth reinforcing. We see where we are today as being the right target range for us, 72,000 to 75,000 plots; we're actually at the top end of that range. The 14,000 units, that we still see as about the right level for our business, is about 5.4 years and we set out three or four years ago and we saw that sort of landbank years settling down somewhere between 5 and 5.5, and that's where we are at the moment. So at the moment we're not trying to drive that forward, we are focused on maximising the strategic conversions, but our activity in the short term market is a bit less than it has been over recent years.

Our key focus and the big benefit of having that view that the landbank scale is right is it lets us focus very hard on quality, so it means that not just the quality of locations but the quality of the financial performance of every site we can really fine-tune and hone and pick the best deals that are out there rather than driving for scale. It's also, and I said sustainability would come up as a watchword during the course of the presentation, it also lets us focus on the sustainability and the risk, so we're able to choose higher quality locations, which actually tend to be far more resilient through all sorts of market conditions.

To summarise in that short term land bank, as I say 75,000 plots, a large part of that growth was in the first half of the year, so I don't think those numbers will surprise you. This is the first time that we've brought forward more strategic land plots than we've acquired in the short term market, but very much got us into the steady state.

I think the key bit - and it's hard to give you statistics that give a sense of this, but the bullet points at the bottom try to express it. We have a high degree of confidence in the sustainability and quality of the outlets that we've got. We're not double-heading on lots of sites, which if you go back six or seven years, reduces the quality, reduces sales rates, particularly in slower markets. We have planning permission on 97% of our plots for this year. In reality, we have planning permission on 100% of the plots because the balance is affordable housing where the planning permission actually doesn't drive the timing, so our level of security for our outlets for the balance of this year is strong. We still expect outlets to grow this year, but it's the sense that at the moment we have choices. If sales rates soften a bit we can pick up a few more outlets, and if sales rates pick up we have some choices on price.

The strategic pipeline has been incredibly important to us during the course of 2014. I think the number we've tended to focus on, and which we've tended to focus you on, is that 10,800 strategic land conversion. A number we've been reasonably silent about is the number of new plots acquired, and 18,000 plots of new strategic land is a record. At the beginning of the year I did not expect it to be that high. What we've found is that success we've had over the last two or three years brings more success, because people come to you, landowners come to you, agents come to you, with new strategic land opportunities because they see that you're in the marketplace, they see you're being successful in planning permissions, they see you have the quality of team.

The review and scope change line you'll remember from the half-year was mostly driven by the first quarter where we've gone through a complete review of that strategic landbank. We expect that change to drop off in the course of 2015, and at the moment it's a marginal positive for the first two months.

The other key piece about the strategic sites that we've brought forward is that they are quite different to the historic strategic sites. Historically, strategic sites have tended to average somewhere around 400 units per site compared to short term sites of somewhere between 100 and 120. The 71 sites that we converted during the course of 2014 had an average size of 152 units, significantly closer to the short term mix. Part of that is about the quality of sites, they're generally higher average selling price sites, often in high quality locations, either village or suburban locations. But what that means is the traditional impact negatively on return on capital of being very strategic site-weighted is significantly reduced. So as well as higher margins, we can also bring forward decent capital returns on those sites, which is quite a big shift.

Just over to the left, and I don't want you to focus too much on the site size, but just the broad spread of those 71 strategic sites, it gives you a sense of that southerly weighting, but also the fact that we're active in strategic land across the country. Pretty much all of our businesses benefit from some strategic sites that we've brought though, which means none of our businesses are having to act hand-to-mouth in the short term market.

I'm just going to refresh that graph now and then this gives you a sense of all of our active sites. So this is all of our sales outlets, plus those sites that we're bringing forward into sales outlets over the course of the next six months. Again it gives you a sense of geographic spread, but gives you that real sense that everywhere in the country we've got a good balance of short term sites and strategic sites. And keeping our local teams focused on those measures of high quality returns and sustainability of great performance means that we can see that consistently across the country rather than having pockets of strength and then pockets where we're weaker.

Now I'm going to stand back and touch on London. The level of data we're giving you here we don't expect to repeat. We don't run our London business as a totally separate entity, but

we did think it was a good time to stand back and give you a sense of what impact London has on the business.

So you can see in the 2014 column some detail on what our total London business delivers. This actually takes the London data from sites from about five of our business units. We're running about 18 outlets [in London], just over 1,000 completions, which is up about 12% on the year before, so slightly higher levels of growth in the Group as a whole. The capital employed at the end of 2014, sorry, average during the year, was £380m. And it's earning a decent return on capital, at a point when we're still in growth mode for that business, we're still adding new capital and some of the sites that we're developing still are not delivering yet. So it's still at the lower end of return on capital, but a return on capital at this point in the cycle of that development of that business of 19% we're very happy with, and it's accretive to an operating margin of 22%.

We're, unusually, just trying to give you a sense of where that goes in 2015, so the number of sites based on land that we already own and are developing on will pick up to 20/21. We expect the sales rates to be fairly stable, based on what we've seen in the first two months. Completions will again grow by slightly more than the underlying business. We'll continue to invest in existing sites, which means the capital base will go up, but at the same time as investing in that capital growth, the return on capital will head north of 20%, and the operating profit margin should be significantly ahead of the rest of the business. So at a point when we're still in a growth phase for that business, it's delivering to us, but it does take some additional cash investment.

Now just standing back from the numbers and thinking about some of the other drivers, and just getting on to the underlying strength of the business, customer service for us has always been a very strong focus. 2014 was quite a difficult year across the market with significant growth in build and constraints on availability of labour and materials. We saw some compression of customer service results in the first half, which improved in the second half.

We're totally committed to getting this right and you'll see over the next 12 to 18 months us launch new customer service initiatives about how we communicate with customers over timing and how we deliver a quality product. We gradually increased our specification during the year; you'll see those in the cost numbers that we previously talked about. We think we're getting that back in the sales price because you see stronger sales price growth on those high quality locations, but getting that balance right of getting the right quality of product and service is key.

And whilst we haven't launched a new national house type range and have changed our product radically, we've now completed the rollout that we started three years ago and we have it on over 70% of sites, and probably about 80% of our plots. We'll gradually evolve that to meet the changing demands of the consumer. We see value out of that in terms of selling price and sales rate, and in terms of cost efficiency if we manage the balance of those correctly.

And then people, again it's been quite a difficult period for the industry in terms of people. Any industry which is growing by double digits and above is going to have some challenges. Our level of staff turnover has actually remained very low, in single digits. If you go back to the previous cycle, at the worst points we saw that running up to 20%, but we have increased our investment on new programmes, we've doubled our graduate programme, we've increased our trade employees over the last two years by nearly 300, and I suspect that increase will continue. We've also participated in the sponsorship of a new school that's focused on construction skills and IT skills.

And last of all, and again a programme we're coming towards the end of and really seeing the benefits of, our new IT system is fully embedded, and we really see that in the data. We

saw it during the course of 2014 in our ability to really finely manage selling prices and make sure we maximise the upside from the market. We'll see it in '15 in cost management and in really optimising that product range and making sure that we know which products are really working properly for us.

Ryan Mangold - Group Finance Director

Thanks Pete and good morning ladies and gentlemen. I'm going to be covering in this presentation clearly financial matters, but the main thing I want to focus on through the presentation is delivery. That's the delivery of the operating results, so the trading performance relative to our strategy; quality measure, which is quality of the balance sheet, but most importantly, quality of the land buying; as well as confidence, confidence in delivery of our medium term priorities that we set out earlier in 2014.

From a P&L perspective, these are the Group results. Just as a small reminder, we have a small operation in Spain and what is very pleasing about our Spanish business is that it contributes positively to the operating result for the year. They've added £4.2m worth of operating profit, particularly on the new sites that they've acquired over the last two years and we expect the Spanish business to continue to make some strong progress. There is in the appendices some more breakout on the Spanish business, on the operational metrics, which you can refer to after the presentation.

We have delivered £621m worth of gross profit in the period. Just as a reminder, we had some substantial net realisable value write backs during the course of 2013 and 2014 which has taken some of the gloss away from that, but it's a very good positive result overall, with gross margins increasing 3.5 percentage points year on year.

From an overhead efficiency perspective, overheads are running at 5.9% of revenues in 2014, and as you heard from Pete, as we're approaching optimal scale from a business performance perspective, we'd expect to continue to make some progress with regards to the recoverability, that compared to 6.6 percentage points in 2013. And that's driven the operating margin growth of 4.3 percentage points year on year to being just under 18% for the Group.

Profit before tax at £450m is also a good performance that's benefited from a low interest charge during the period. You might recall that we bought back the senior notes that were outstanding at the end of 2013, so this is a function of a far better structured debt capacity for the business, as well as overall lower average borrowing during the course of the year.

Profit before tax then up 67.7%, and with an effective tax rate of 20.1% in the period, we also expect the future tax rate to largely reflect the statutory rate, which has driven earnings per share up 67% on an underlying basis, to 11.2p.

From a UK performance perspective, we've made steady progress on volumes and we expect to continue to make steady progress on volumes, largely driven more by outlet growth as opposed to sales rate growth, given that we're operating the most efficient structure from a mid-sales rate per outlet at the moment. We have got a value-focused pricing growth, so we try and benefit as much as we can from the market, but clearly the quality of locations that are now forming a bigger attribute of our land bank is delivering pricing growth as well, with average selling prices up by 11.5% in the year.

All of these things have driven operating profit in the UK up to £476m, and an 18% margin, so that's 52.3% up year on year. And what is also very pleasing is that the second half margins delivered by the UK business, at 19.3%, is one of the market leading margins.

On this chart this is an indicative reconciliation of margins, it's not an absolute precise science, but it's an indicative reconciliation of margins year on year – where we're trying to benchmark our performance, both from an underlying quality of the business coming through from a land mix perspective, which is driving profitability, but also how we've performed relative to the marketplace that we operate in.

Market inflation – using Nationwide and Halifax indices for the locations that we operate in, we think the market moved by ten percentage points year on year; that's December through to December. Of that growth, we think that we've captured about 6.6 percentage points. The more buoyant marketplace has kind of impacted build costs and this would suggest that, and this is only to the second quarter 2014 because we're still waiting for the final two quarters to come out, but build costs from a market perspective, approximately 6% as the best indicator and overall we think that that took about 3.2% out of our margin year on year. A reasonable proportion of that is actually driven by mix, so it's better quality locations, better specification that we're selling for in our homes going to that measure too.

The NRV provision release, the more buoyant marketplace, has resulted in that exceptional write back that I mentioned earlier in the presentation. That's impacted margins by about 1.2 percentage points. So the overall impact for 2014 from a margin perspective is 2.2 percentage points.

The impact of mix – so it's better quality locations being sold from, and a lower proportion of our legacy sights and particularly the impaired sites, has improved the margins by 1.5 percentage points, and, coupled with some slightly better affordable housing pricing offset by the growth in overheads has made the margin growth of 4.3 percentage points year on year.

If we go back to the first half of 2011 in terms of what are the key drivers for the gross profit, as you can tell from the chart, we've got a very, very steady trend of land costs to average selling price, running at 20.7% in the second half of 2014. This has been significantly underpinned by some excellent buying in the short term market, but also from the conversions from our strategic pipeline where the value is created from a significantly lower average plot cost.

The NRV has now pretty much largely washed through the P&L so that will be a significantly lower change in plot costs on a go forward basis. Build costs have increased, but as a percentage of revenues have declined over the period as the better quality locations we're selling from continue to show positive impact in that regard, which give rise to overall a gross margin per unit up at 24.3%, up 28% year on year.

From a build cost perspective, total build cost per square foot increased to £114. The underlying increase, from a market point of view and inflationary pressures we think was five percentage points year on year. A fairly significant proportion of the growth in build costs per square foot is the quality of locations we're selling from as well as the London dynamic, we're having a much greater exposure. As you can see from the chart, £179 a square foot in London compared to £160 the year before that.

Our central procurement function runs through Taylor Wimpey Logistics, which procures a large portion of our commodities that go into homes on the national deal perspective, increased approximately 2.8 percentage points year on year. And what is pleasing is that some labour is returning back to the marketplace from a capacity point of view, more capacity is coming back from the commodity supply side as well, but overall we expect the underlying inflation for build costs for 2015 to be broadly in line with 2014, of five percentage points.

From growth in our net assets we've made very good progress on our medium term objective, just as a reminder, our medium term objective is to grow net assets by 15% per

year before we make any distributions to shareholders, and for 2014 we've grown the net assets by 15.8%. Almost all of that's been driven by operating profits converted through to profit after tax in the period, adding 16% to the net assets.

We have got a small amount of volatility due to pensions and other assumptions that impact the balance sheet, but those are very, very small and we continue to make good progress in that regard, and for 2014 we have distributed 3.2% of the net assets of the prior year from the profit added. And if you think of the £300m that we will be returning in 2015, it's approximately 11.5% to 11.8% of the prior year net assets that we're going to be distributing to shareholders, which has been underpinned by a profitability expectation.

For investment in the land bank, the total short term land bank is at 75,000 plus, which we believe is an optimal scale. We've got £2.3bn invested in our short term landbank, showing reasonable growth year on year, which is a function of those better quality locations acquired, a function of greater exposure to the London market, but at that scale we think that that is optimal from us from a balance sheet and capital perspective. Most of the growth in the landbank has actually been funded by profitability from the business.

The strategic pipeline at 110,000 plus is on the balance sheet at only £162m, so it's a fairly incidental capital allocation for what's going to be a significant underpin of profitability for the Group going forward.

Land creditors year on year have grown to £475m, but those are only 19% of the landbank value. Land creditors, we'll continue to use them on a go forward basis, but they are really specifically deal-by-deal negotiation with land vendors, we do not have a mandated policy in terms of funding our short term land bank.

The evolution of the heritage of our landbank is a significant underpin of margin, and a driver of margin going forward. The closing landbank quality is excellent, with more than 75% of that being bought post-downturn. Our strategic pipeline remains very strong and our success from the strategic pipeline will continue to ensure that the short term landbank has very, very good quality coming through to underpin future profitability.

Overall, the total landbank revenues inherent are £39bn, of which £17bn are in the short term land bank, with planning permission. The average selling price on our short term owned landbank is £222,000. Now there clearly is a little bit of a lag or a tail of some of the larger sites which have got a slightly lower average selling price and so we'd expect to outperform that price point in the short term.

Total average selling price to plot cost ratio is down to 17.3% and if you compare that to the P&L number that I showed before, just over 20%, is an underpin for future value.

What we've done in this chart is we've looked at our land approvals since 2012 and plotted those for you, so this analysis, which is contribution margin and return on capital employed, is as at the point of approval. So it's an investment thesis that we've applied at the point of acquiring the plots. Clearly you can see there's a fairly decent range of acquisitions, but if you look at the chart on the right hand side, we've given you an indication of how that's tracked since 2012 and you can see we've made steady progress on both margins as well as return on capital employed expectations.

What we also have is that 57% of our completions in 2014 were from plots that have been acquired post-downturn and we've outperformed the investment margins, which were 23.7%, by 2.7 percentage points, which gives us great confidence in terms of the quality of delivery of our short term landbank.

In looking at the cash flow measures in terms of our medium term priority of converting operating profit into cash, we've invested £161m in work in progress in the period. Part of that is funded by growth in trade payables, but the exposure that you would have seen from Pete's earlier chart on the London market, that has been consuming a reasonable amount of capital and we'd expect that to continue into 2015.

We've invested a net £248m in the landbank in the period as we approach optimal scale. We had £16.8m of our shared equity redeem in the period as a positive inflow, and we paid £36m of cash to the pension scheme, resulting in the cash generated operations – which is the measure that we set our medium target against – of £207m, which is up 56% on the previous year.

We paid £73m in dividends in the period, and bought £10m worth of our own shares to satisfy share scheme awards. We paid £14.6m in interest, and it's just worth noting that we have not paid any cash tax in 2014, but on a go forward basis we expect to be marginal cash tax paying towards the end of 2015 and as the deferred tax assets fully exploited in the UK and then obviously more substantially into 2016. This has resulted in a net movement in cash of £107m in the period.

For the pensions, it's been a fairly busy year for us. We've completed the actuarial valuation during the course of 2014 of the newly merged scheme done in 2013. We've reduced the contributions by £30m to the pension's scheme, resulting in an overall contribution on a go forward basis of £23m.

We've also completed towards the end of the year a medically underwritten buy-in covering the top slice of the pensioners, which completed at £9m below the technical provisions level, so a very, very good result for ourselves. That did result in a £19m accounting strain that you see on the balance sheet, but it is a significant de-risk of the scheme.

We are in the process of finalising a flexible retirement offer for deferred members, and we expect about £25m or £26m to elect to transfer out from that scheme and we will continue to work very closely with the trustees for both managing an investment strategy as well as the liabilities overall.

From the balance sheet and the financing structure, it's very pleasing to be recognised as investment grade by Fitch at the back-end of 2014, where the quality of our trading performance, as well as our balance sheet strength and our funding strategy, has been recognised. In February of this year we've completed an amendment and extension to our revolving credit facility with the banks, which means that we have got £650m worth of committed facilities covering the next five-year term, and that amendment and extension at better fees and margin has resulted in a saving of about £2.5m per year.

We ended the year net cash of £113m and an adjusted gearing which includes land creditors of only 14.8% which is a significant underpin for our flexibility going forwards.

So, in summary, we've made very good progress on our financial metrics in the year. We've outperformed two of them already in terms of return on net operating assets, at 22.5% versus our medium term target of 20% over the three-year period, as well as the growth in net assets, at 15.8%.

On the operating margin trend, from the charts and the quality of the landbank that we've shown you today, I think you'll join me in agreeing that we've got great confidence in delivering that 20% average of 2015 through to 2017, and we are now entering a phase of more substantial returns to shareholders, with over £300m committed to payback in 2015.

I'm going to hand over to Pete to cover the market more widely and the outlook.

Pete Redfern

Thanks Ryan. I'll spend a little bit longer than usual on the market, but then the balance of the outlook which shouldn't take too long. You've seen this chart before, it's our way of giving a quick overview of the input data we have from a short term market point of view, and this brings it literally up to the back-end of last week. And you can see I think it's particularly worth focusing on the blue line, which if you'll remember is a total of three different indications of consumer interest, so brochure requests, website hits and visitors to site. The driver of that big increase in 2015 is from the website. There's a bit of this that is company-specific, so if you took is as pure market you'd be exaggerating that impact, but if you looked at the underlying data you'd see strength.

The company specific bit is particularly driven by improvements we've been making to the search engine optimisation on the ordinary website, but also a doubling of hits to our mobile website, which has been steadily improving over the last six or nine months. But the underlying market data with visitors to site is also up. So we see a significant level of consumer interest step up in early 2015, after a second half of 2014 which, as you say, was slightly slower than the trend we'd seen over the previous 12 months.

If you look at the sales rate, and probably easiest to look at this from a numerical rather than a graphical point of view, you can see, as we've said in the Statement, the sales rate in the first few weeks of this year at 0.70. We're now into what we would consider the Spring selling season, the last couple of weeks have run up 0.79. We don't expect it to stay there. If we're up 0.70 through the first quarter and then it drops off a little bit that's about what we'd expect, and be very comfortable if the sales rate for the year is a couple of percent below last year. We're in that sort of territory, but very much in what we would see as a solid spot delivering the strategy that we've set out.

Underlying sales price movements in those first few weeks have been a small net positive, but it is small compared to this time last year where we were seeing over a 12-month period annualised 10% higher in London, we're more into 1% or 2% over the last three or four months, and an annualised maybe 3% or 4% sort of territory. We're pretty happy with that, we see that as a much lower risk environment to be in. If we were seeing the conditions in pricing that we saw this time last year, we would be concerned about some of the land investment decisions and the like. So we think it's a better environment. And still a very strong order book, and that strong sales performance in the first two months has helped to add to the strong order book position that we had at the end of 2014. To be over 50% sold at this point in the year is a pretty solid place to be, so it gives us choices, and certainly not - as I'll touch on in a second – not concerned about General Election impact, which we see no impact of at all in the marketplace at the moment.

I'm going to quickly run through the next three graphs, some of them you'll immediately recognise the shape of, and it's more to get onto where we think the market is at the moment. But clearly UK and supply and demand is still out of balance. There hasn't been a significant step-up in supply, there's been gradual growth and there'll continue to be gradual growth in supply. But what's driving that consumer demand is real underlying demand that hasn't been satisfied, whether it's been because of mortgage availability or because of the true supply side over the last three or four years.

You also house prices, despite last year's strong performance, still remaining well below the peak, and, if you strip London out of this, quite significantly below the peak on any sort of real basis. And probably mostly importantly for our customers today, if you focus particularly on the red line, you see the interest rates which are still remaining low and are particularly

low and falling for actual mortgage costs, not just underlying base rates, the mortgage payments that people are making are making housing more affordable today than it's been in a long time, and actually that affordability is improving.

So the environment that you see from a mortgage interest rate point of view hasn't on the surface changed dramatically from the first quarter of last year. For Help to Buy equity loan customers, interest rates are still low and most people can get an interest rate if they're a Help to Buy customer at about 2.5%. What has changed more significantly is the move up customers, where effective interest rates have dropped from about 3.25%/3.5% a year ago to more like 2.75%, which makes quite a significant difference to the liquidity in the move up market. But particularly as you look forward, compared to where we were six or nine months ago, an expectation the Bank rate will stay low and probably be lower for longer than we would have expected. Lending is more competitive, you're seeing more drive for volume from the mortgage providers you're seeing some early signs of wage inflation. So actually the affordability at the point people purchase, which is what drives the buying decision, is improving, but positively you're seeing lending practices, stress tests, the MMR process as a whole, keeping price growth from getting out of hand, so you're seeing improving affordability, good sales rates. That's a good environment for us to operate in, and it's probably that more than anything else that gives us the confidence on the maintenance dividend, which I'll come back to. It's a good environment, but it's also a lower risk environment right now.

If we stand back and look at the non-market drivers for 2015, we've not been deeply concerned about the General Election through the course of the last six or nine months. I think the political risk around the sector reduced with Labour's main report on the sector in the Autumn. It's not non-existent, there are some things that will change under a different Government that we might not like, and there'll be some things that we do, but we don't see a big catastrophic risk out there.

We're not currently seeing - as I touched on earlier - an impact of the General Election on customer behaviour at the moment. We still expect to see that a little bit in April and May, but with the order book that we have, and the normal sort of trend in an Election year that picks up again afterwards, we're not concerned. We do expect potentially the impact of price rises and rates to come more in the second half than in the first half. But over the course of the year, we expect it to be pretty limited.

If we look at build costs, as Ryan touched on, the pressure on build cost today is lower than it was this time last year and during the course of last year. We saw that start to alleviate in the back-end of last year. The pressure on availability is lower. But it's not non-existent, and so at the moment there's probably a small net positive on price, but compared to where we were 12 months ago it's small. Our focus remains on national builds, where we get very good values, our own logistics business, which helps us both control the material supply but also keep prices low, and making sure that we build on sub-contractor relationships. And, as I touched on earlier, higher levels of recruitment of the directly-employed trade base and those national house types which do help the efficiency.

But our focus is very much on turning that strong level of performance with the optimum level of short term land to deliver the strategy into cash. With higher margins getting towards 20%, and as we've said before we don't commit to 20% this year, we might get there if the market is slightly with us, we might be 19 point something, but we're in that sort of territory.

Particularly important, ongoing improvement in that return on net assets. As I'll touch on right at the end, we see that as being the target that we can probably exceed by more than any of the others. Investments in London are now self-sustaining on a return on net assets basis, we're earning into the 20s, and that will grow substantially over the course of the next year or two.

We will generate significant and sustainable levels of cash. You ally that with confidence in where the market is, it's a better set of conditions from a risk management point of view, great visibility on operational delivery, and that leads to the maintenance dividend increase. And if you put together the maintenance dividend and what we're already committed to, to this year's cash return dividend, we expect to pay out about £300m of dividends in 2015. I think you can pick up from the Statement our comments we don't expect that to go down in 2016.

So finally, just going back to those three-year targets. Great progress this year, hugely pleased with where the operating margin growth and absolute performance is. We won't necessarily get to 20% in 2015, but we're very confident in getting to that average over the 2015 to 2017 period. We've already beaten the return on net assets target and it's the area where we see the most potential outperformance. We've beaten the net asset growth target and we expect to continue to do so.

The cash conversion, we expect to get to, potentially exceed the 65% over the three years. It's the one which we don't particularly expect to get to in 2015, but we'll certainly make significant progress against the 43%. London's probably the biggest impact there. But we expect to be running ahead of 65% in the latter years of that three-year period, and that's probably a better signal for where we see cash conversion in the period after 2017. So a high degree of confidence in hitting those three-year targets. There's potential for more bottom line growth, and with that land strategy converting that into cash for investors.

Thank you. We can now go for questions please.

Q&A

Question 1

Jeff Davis, HSBC

Just the first one, Slide 26, the new slide that you've put in, specifically the chart on the right-hand side. Just looking at the 2014 diamond, it looks like it's about 27.7% for the contribution margin. Is a fair calculation to deduct the 2.7 percentage points of variance that you've talked about to get to a 25% land intake margin, or is there something wrong with doing that calculation?

Pete Redfern

No, I think there is something wrong with that. This is a land intake margin, so the 2.7% is a positive variance to that on actual performance on sites historically.

Jeff Davis

So the actual gross margin we'd see would be closer to 30%.

Ryan Mangold

The sites that we delivered, or the homes that we completed in 2014, were on sites where the presumption was 23% contribution margin from the investment perspective, and we've outperformed that investment margin by 2.7 percentage points. So over time we'd expect it to drift upwards as we continue to acquire better quality sites, and these become more of a

feature for home completions given the lag from conversion and from investment to actually selling the house.

Jeff Davis

And the second one just following on from that, if you could just give some broad commentary on how you see the land market today. Has there been any change, any new entrants coming in, and what's going on, on land supply as well going into the Election please?

Pete Redfern

I'd say overall there's been no dramatic change in the land market over the course of the last six to nine months, but if it's gone in any direction it's got slightly easier. The only meaningful dynamic that's shifted is, you'll remember the beginning of last year/back-end of the year before we were seeing increasing competition from some of the smaller public companies and larger private companies opening new regional offices, and that leads to short term competition in those regions.

As you'll know from where those businesses are, that phase is starting to reduce. I'm not aware of any new office openings from any of those businesses in the course of the last four or five months, and so that means that we're in a slightly more stable period. Because that can distort a local market in the short term and we haven't seen that. You see it actually the same on people, that it can also distort the need for people, because obviously they're trying to instantly recruit a new team. Aside from that, I think I'd say that the land market is not hugely different.

Sorry, I didn't quite answer the second half of the question, Jeff, on the political side. We are seeing almost inevitably the odd planning decision that takes a bizarre turn because you get nearer to a General Election. But as we've said before, if we hadn't planned for that then we're not doing our job. With the kind of land positions that we've got that's not something that we see as a huge stress. We could sit here and bitch and moan about it, but actually it's just life.

Question 2

Harry Goad - Credit Suisse

Two please, for Ryan, from two of the slides you talked about. Firstly, on your slide on build cost per square foot, it looks like the private build cost is the same as the group build cost and that's different from prior years. Is there something there in terms of cost of build on the affordable side to think about, that's changed?

And the second point was your slide on building up the margin where you talked about the national HPI running at 10% in the year and you running at 6.6%. Can you talk about that and how you think that plays out, or how the gap between the two plays out in 2015?

Ryan Mangold

On the build costs for affordable, there's nothing specific related to the construction of affordable housing that's shifted year on year, it's more of a function. The way that we have to do the accounting for construction of a scheme is to allocate it across the entire scheme. So there's nothing specific indicated or any change in terms of how we construct or what we

construct from an affordable point of view to make that change, it's just purely accounting allocation, and it will have a bit of mixed impact in the period in terms of trading.

Then on the HPI, we start the year as you know with a very, very strong forward order book. We are not going to be able to capture the growth that happens during the course of year. So that 10% is just December to December, it's not averaged necessarily over the course of the year, which has an impact on the margin delivery.

<u>Question 3</u>

Gavin Jago - Peel Hunt

Just a couple of brief ones please. Firstly, following on from Harry, what you've seen on pricing in the first couple of months of 2015? Then, onto your outlook, you've indicated in the Statement that you want to be pushing them up this year. I wondered if you could indicate where you might see numbers averaging this year and where that stands in relation to capacity within your operating structure?

Pete Redfern

I think on pricing, as I say we've seen price growth, but muted compared to last year, so we're about 1.5% ahead of where we expected to be when we cut our numbers in the Autumn. If you take an annualised rate of 3%-4%, it's in that sort of range. What we're not seeing is a huge geographic variation in that, you're seeing that more or less across the board, you're not seeing the big differential between London and the South East and the rest of the country that you saw during the course of early part of last year but then unwound in the second half.

And on outlets, as we've said many times, we won't give guidance to a number, we still expect it to be up. There's plenty of outlets there. We don't feel operationally limited by the capacity of our regional teams, they've got the space for some growth but you are, particularly in an election year, always slightly in the hands of the politicians on timing and we are absolutely committed to getting them open right. And we think that gives you both good value from our point of view, it also lets you manage the position for the customers properly because when you rush the outlet opening you're kind of selling too early and then it's very hard to deliver both consistent quality and to consistent timing. So all of those just keep us to that focus on getting them open right, rather than setting out the maximum possible growth.

<u>Question 4</u>

Chris Millington – Numis Securities

Three if I can please guys? I just noticed you had quite a big fall in the strategic land investment in your owned strategic land, I presume that that's because of the pull throughs this year, but the question really is, has there been a change in opportunities there more to option rather than owned?

The second one was just about overhead recovery. You mentioned there's further gains to be made there. I'm just wondering how low it can go at your normalised volume levels?

And the final one is just really about what your expense plot cost is at the moment? You mention about the landbank average plot cost falling, I'm just wondering how big a gap there is between those two measures?

Pete Redfern

Can you just repeat the second one Chris?

Chris Millington

The second one was just about overhead recovery at normal volumes.

Pete Redfern

We haven't seen a meaningful shift from option to owned, and in fact we would prefer to drive an increasing proportion towards owned, just there's more potential upside but as ever it's a little bit dependent on the right deal with the vendor's expectations and our own. The shift, as you say, is more to do with conversions and that owned landbank cost piece can be heavily geared towards one or two sites that are on the cusp of getting a planning permission; so you bought them out so they can then drop into the short term landbank and it looks like the numbers have shifted, but it's actually only one or two sites that have moved, so no real underlying trend except our focus is on maximising the upside. So, I would hope to see, but it is very deal dependent, to see the owned proportion trend upwards over the next three or four years rather than the other way. But I'd focus on plot numbers rather than costs on that.

Ryan Mangold

And then on overhead recovery the shape of the business is there to deliver the 14,000. there's a bit of incremental capacity that we would add in order to get there which is a reasonable amount of growth from the 12,500 that we've completed in 2014, but the recovery we'd expect to do slightly better and that should trend down close to 5% over time, coupled with better quality locations, of better quality sites we're selling from. So both volume growth as well as top line growth due to pricing point we're selling at.

And then on the cost versus the plot acquisition I think – is that the dynamic you're trying to tell from the balance sheet?

Chris Millington

It's more what you expect to see first as what's in the landbank at the moment and is there a gap between the two?

Ryan Mangold

You can see it to a certain extent on the chart that we've given on the half and half analysis, where the plot costs that's gone into the P&L for 2014 was just over 20% versus the landbank ratio of 17.3% to 17.4%, so there's obviously a little bit of difference between the two. I think that's got to do with more the timing of delivery where it's slightly more expensive, particularly in the London market, for example, owning land and a very, very short time for delivery, which hasn't got a very long tail attached to it. So it's a fraction higher in the P&L than it is to the balance sheet.

Pete Redfern

I think if you just stand back from that question Chris I mean the guidance that we gave quite consistently until last year, at this point in the year was that dynamic of more strategic land, less pre-downturn land, would add something like 100bps to 200bps to margin a year, and we tend to then outperform that even before we saw the selling price inflation. I'd give the

same guidance today at the beginning of this year that underlying land dynamic can drive that sort of difference.

The chances of us outperforming it because you do get to a point where the pace of change is slower, the chances of us outperforming it to the degree we have in the past is low, and that drives the view that an 18% margin last year is at 19.5%, it's in that sort of territory. And then beyond that it's about market growth and how much we can grind out cost, how much we can squeeze out an extra percent or two of selling price, and how much that strategic land then adds to that incremental margin over time.

So the plot cost number will vary, as Ryan says, with mix strictly with London but there's still benefit from phasing and timing of land investment to come through.

<u>Question 5</u>

Will Jones – Redburn

Three if I could please as well? Firstly just revisiting the odd 14,000 soft cap number, is that something you reviewed at the end of last year? And is your thinking changing at all? Obviously lots of press in the last couple of days around starter homes and the like, all of which point to higher volumes potentially? And maybe while you're there, could you comment on whether you think that can work for you from a margin perspective that scheme?

Secondly, just around net cash, and again less about the next 12 or 18 months but medium to longer term, Ryan, where do you think or want that net cash balance to be heading as we go further through the cycle and towards the next peak?

And then the last question was just around the intake margin. On the slide you gave just over 25% on approval for last year. What do you think the rough gap was between strategic and open market? One of your peers talked about that gap closing for them last year and I just wondered where you guys are on that? Thanks.

Pete Redfern

I might need you to repeat a couple of those, I think I got them but let us try and answer as many of them as possible but let me know if I've missed anything. We always stand back and question the 14,000, the soft cap, so at the end of the day you should never set anything out and say it's inviable under all circumstances, but we've questioned it and we still think at the moment it's the right place for us to be and we don't expect that to change.

We always said the one thing that would change it is a radical shift in the planning system which meant that the scale of market share we'd have, if you see what I mean, of land particularly, shifted and the land risk was different we'd then think differently. We've seen a positive shift on the planning system but we haven't seen a radical shift that completely changes that balance, and as you've heard us say during the course of the last hour, we're enjoying and getting a lot out of that focus on ever-increasing quality. So I wouldn't expect that to change unless something radically is different.

The soft bit we always struggle to put across to you as exactly what 'soft' meant and I think I quoted about two years ago what I mean is if it's 14,300 I won't throw myself off a bridge and that's kind of still a reasonable set of guidelines. If we've got slightly more sites, we're not going to arbitrarily hold back sites that we've got, that we've already bought, just to say it's 14,000, it's not a penny more! But it's not going to go to 15,000 or 16,000 unless something radically changes in the balance of risk.

And in some ways it's more about land investment and what we see as the right exposure to the land market and the right focus to let us drive quality than it is about completion volume and I think that's something that our own understanding of that has improved over the course of the last three or four years.

On cash we broadly expect ourselves to stay cash and debt neutral. We're focused on getting the right dividend policy and we don't want that to be seen as so linked to a year-end cash balance because you know it can be volatile, but if we're looking forward over the course of three years and thinking we're going to be building up a significant pile of cash or increasing debt significantly then that will affect our dividend policy. So, to the extent that we see cash coming out of the business in a sustainable way, that isn't just a short term timing piece, we expect that to impact on dividends. So next year we might be marginal debt, we might be marginal cash, depending on the exact time of land purchase, but broadly directionally positive.

Intake margins haven't massively changed, the short term land you're still in the 19%-20% range, strategic land we still think the uplift is in the order of about 7%, give or take – we don't think that's massively changed. We can recognise what competitors are saying when they say the gap has closed, because the short term margins are high and you're at a period where negotiating pricing on strategic land is quite tough because during the first half of last year, the land market was definitely more competitive than it had been for a while, I think that leads again over the next period and it's short term I think to shift your strategy because you've got that short term piece. The gap may have been 8%, it's now 6%, but 7% is still not a bad guidance, and we tend to find that, because to a degree pricing strategy [on] land at the point of getting a planning permission is an internal piece, the pencil is never as sharp as when people are pricing in the external market.

So you can look at something on paper and it says it's compressed, you actually look back at performance, even over the last year or two of those strategic sites, and the gap widens again when you get to actual performance. Those are the sites we tend to outperform most significantly on selling price. Some of that's because we've got the right product, some of it's because we've just been a bit more cautious in our internal assumptions. So you've got to kind of build that into your view. So no radical change.

Does that pick up all the questions?

Will Jones

What's extra in there? Just around the starter home talk yesterday and 20% discounts and whether you think it can work for you in your land stats?

Pete Redfern

Did you think there are 100,000 plots worth of brown field land that can be commercially delivered with a 20% discount to average selling price? The concept's not wrong, it's scale. Is it scalable? And the devil's in the detail. So we'll wait and see the detail.

<u>Question 6</u>

Aynsley Lammin – Citigroup

Thanks, just two from me. I wondered if you could comment a bit more on your expectations for the cash conversion? Should we expect, given that you're at the optimal scale you saying that the land is around 75,000 plots, should that not jump up quite significantly this year, where are the other movements we should be thinking of?

And just secondly if you could comment on just cancellation rates that would be helpful, thanks?

Pete Redfern

Yes, you should expect to see the cash conversion move up from the 42%, 43% it's been at over the last couple of years. And we knew we said 2014 was very much a transitional year on that that you'd start to see it move, but it would be 2015, 2016, 2017 you'd see it move completely.

In the business outside London we're very much into that steady state, the cash conversion for our North and South business outside London is north of what we'd need it to be to be 65% for the group. But you will see us use some cash in London existing sites as they're building through and these are sites that are already substantially sold at very high margins, so it's a very good use of cash and very low risk. But it does use cash in that year.

Over the course of the next three years, you will see it build up and we'd be very surprised if 2016/'17 we weren't ahead of the 65%, but London still has a timing difference and it's why we set 65% for that three-year period. I think we'd see for the period beyond that that building up beyond it, but it's probably London that's the slight difference to what you had in your mind.

Sorry the second question was?

Aynsley Lammin

Just on cancellation rates?

Pete Redfern

Very much still at a pretty normal level. And when I say 'normal', lower than usual, but it's become sufficiently common though for the last two or three years that it's probably now normal in the low teens, somewhere between 11% and 13%.

Question 7

Glynis Johnson – Deutsche Bank

Two if I may. The first one just in terms of build cost, I wonder if you can just give us a bit more colour? You talked about it abating, but Ryan told us that 2015 would probably be about the same as 2014, so maybe just labour, materials?

And then second of all, coming back to page 26, with your land that you've bought, I notice there are a number which are 2013 which have a return cap employed below hurdle, so I just want to understand the logic behind some of the land buying, just in terms to give us a sense of the discipline and how you think about it?

Pete Redfern

On build costs we obviously saw a curve during the course of last year and there's always a lag as there is on selling price of things coming through, so there's a timing effect. So actually, what Ryan was talking about in terms of 2015 numbers includes some of 2014's inflation impacting on 2015's P&L. From where we look at where we are today, that pressure is less but in the same way as the increase takes 12 months really to get through the P&L, if

not a bit longer, so does the plateauing and the decrease, so yes, we don't expect to see a building material index from 1st January 2015 to 31st December to be as high as the equivalent for 2014. But because of that phasing effect there's just a timing lag. So that's all you're seeing there.

On the return on capital employed, and it's one reason for showing you this chart, you see a bigger range with the return on capital employed than you ever will on margin. And that's a little bit about the way the industry buys land, but it's also about some deals which have a very different deal structure and you get, as you can see, some very, very high returns on capital which are often about the land structure.

The three sites that you see below 20% have very specific characteristics. Two out of the three are actually sites where we had a contractual interest before the downturn, and so the impact that you see there is us effectively writing off, because this doesn't adjust for NRV, is us writing off the historical costs. So you factor that into this appraisal, but effectively from an economic point of view you don't.

The other one is a site where we felt, and it's rare that we would take this view, that the potential on that site was significantly greater, and as you can see it's a higher contribution margin site than we were buying at that period of time, so the margin upside and the level of risk was very low. So we had exceptional return on capital employed that was in the teens rather than the 20s. But I think you need one exception that proves the rule.

Question 8

Charlie Campbell - Liberum Capital

A few questions please. First of all on optimal size, you would probably be the first housebuilder to reach that optimal size I guess. Lots of people have talked about optimal sizes, how do you retain people in that environment? I mean, it must be more fun to be working for something growing than something that's of optimal size?

And then secondly you do talk a lot about affordability and affordability being pretty good round the UK. Could you make a few more comments around London? Clearly more stretched in London and clearly that's a focus of investment at the moment, so how do you see London affordability?

Pete Redfern

That first question about retaining people when you're not growing felt like it came from the heart from a banking and analyst point of view! I'm probably tempted to refer back and say, "how do you do that?", but it's not an unfair question and it's not an unreasonable principle. but actually in some ways, when life's exciting and you're growing dramatically, then it's easier to recruit and arguably retain people. The reality is, having lived in that world, it's also phenomenally difficult to manage quality, and it's phenomenally difficult to give those same people a real sense on enthusiasm about what they're doing and we're finding that far more doable in this kind of environment.

You have to be careful, you do have to make sure that you're giving people the right next opportunity at the right point, and stretching them, and we've spent a lot of time on that. we probably have more training and development programmes, in fact we definitely have significantly more training and development programmes, today to move people around. We're far more likely to move people between businesses than we were in that environment, and that means that we can actually develop them properly and move then quicker. So it's not something that you can just ignore and assume will happen, but it is pretty doable.

And we are growing: profits grew at 50% last year. There'll be significant growth this [year], there is still plenty of growth there and new opportunities, [so] you don't need to open a new business to give new opportunities. And in a resource-constrained world that we've operated in really for the last two years, actually, on the balance, that's a better environment than one where you're trying to desperately hold on to people and stretch people into new jobs they're not quite ready for. So it's a balancing act.

Just on the question on affordability on London. It is a perfectly reasonable one, but I just wanted to pick up the second part where you said, "…which is the focus of investment…" What we were showing you on London in terms of capital is actually about sites that we already own and control, and as I said, we're already sold. So whilst we're still active in London and we'll buy sites, we're not more focused on buying sites in London today. The sites we've got already have got some selling price inflation and therefore some high margins in them and we're bringing them through, so impact on cash. But it's slightly misunderstanding to view that that's where we're predominantly focusing investment – we're pretty broadly spread.

Affordability in London is more difficult, and actually it's the one part of the country where in the last 12 months, even though prices have stabilised, it's got harder rather than easier for customers. Against that backdrop, we're actually seeing a bigger proportion of our customers are domestic and working in London, and you're not seeing or are likely to see the rampant price inflation that we saw in 2012 through 2014. So it's more stable; it feels more resilient but we've always said that London isn't a market like anywhere else, where you can just assume we can pay whatever price and prices will go up no problem.

So we prefer that environment, because it does screen out some of the more aggressive land buyers. I was almost tempted when Jeff asked the question about the overall land market to say the one place where I actually think the land market is a bit easier than it was 12 months ago is London. And not just easier because there's less competitors, but actually you just feel that you can work a deal and make it more effective, whereas 12 months ago, and for the two years before that, it was more difficult.

Question 9

Emily Biddulph – J.P. Morgan

I've got two questions, both on London. The first one how, much of the ASP uplift in the audit year how much of that is because the increase in proportion of London is sitting in the order book for longer?

And then secondly, I'm probably pushing my luck slightly, but you've been kind enough to give us that guidance on what the capital employed increase in London will be for 2015, but if we're thinking about 2016 from the comments you've made so far, shall we assume that it's very, very minimal? Thanks.

Ryan Mangold

London's got a much longer lead time for delivery and the London business has done a great job being forward sold on the schemes that we're operating on. Some of those will deliver in 2015, but some of them do dip into 2016 a bit more. That definitely does have a positive influence on the overall selling price in the order book from the London market and until that gets to steady states and becomes a steady part of our mix, then it's very difficult to strip it out individually, Emily. But it is a positive impact overall, probably about 5% overall I would have thought.

Pete Redfern

And in terms of net growth in the asset base in London in 2016, you're right, it should be significantly lower and we're fairly much into asset steady state at the end of 2015. We'll probably not increase assets by quite as much as we think this year. That's often the way it works that things just are a little bit slower and so then you get a little bit of growth. But that sort of level of £500m that we had on that slide is a reasonable indication of steady state. Somewhere between there and £550m is probably a good view. As I say, it's probably 12 to 18 months behind the rest of the business in terms of getting to that steady state level of investment.

Closing Comments

Looks like that's all the questions thank you very much for your time today. We look back and enjoyed 2014, 2015 we have to work a bit harder but we're in a very strong place to do so.

Thank you.