Taylor Wimpey plc

Half Year Results 2016

Wednesday 27th July 2016

Pete Redfern, Chief Executive

Good morning everybody thank you for joining us. We've got a slightly different structure this morning because we thought you'd be probably far more interested in the trading and the outlook than the historical results; so we've flipped it on its head a little and we'll spend longer on the detail of trading, we'll go through some quite granular pieces on that. Ryan will then go back and review the first half of the year, talk about also some of the forward-looking cash flow measures, and just in a sense try to give you the data points so you can adjust your own modelling if things were to be softer than previous expectations. And I'll round off at the end just going back over strategy talking about how that feels in a slightly different environment and conclusions. And both Ryan and I will touch on the dividend and our thoughts and conclusions on that as we go through as well. And that probably will be the concluding point. But as I say I will start off with trading and with outlook.

Before I start that though I should say if you roll the clock back about a month to the morning of 24th June we were probably as bearish as anybody else and our initial actions were probably as bearish as anybody's in the sector, and you know over the course of the last five or six years that I've tended to be more cautious about the prospects of a downturn at some point than almost anybody else. So we weren't sitting there thinking, "Oh no this is all going to be fine; this is going to be amazing." What we're trying to say to you today and what we're presenting to you today is just our factual data from the last month.

If it was a week's data we wouldn't present it to you, not because the first week was particularly bad but because it would risk being significantly misleading. But I think a month in, with a month's data, geographically spread, and we have some very good granular, forward-looking, data, we have a reasonably good picture of what's happening at the moment, and we think it's right for us to put that data in front of you to talk it through, to talk it through what we think it means and what we should conclude from it. But you shouldn't read our comments as us saying that all Referendum-related risks are now sort of history. Yeah we're still cautious on some of the things we're doing. We'll talk a little bit about where we sit on land purchase, where we sit on investment in work in progress on sites, but please don't think this is us standing up trying to persuade you the whole world is totally rosy and there are no risks. That's not where we started off. It's not quite where we've got to today, but we are encouraged far more than we expected to be by both the substance of early trading and the granularity of what's actually happening under the surface.

And we'll, as I say, go through more data than we might normally on that just to give you a sense of that. But you have to form your own conclusions about where it might trend from there. I'll give you a view about what I think is happening but you do have to form your own conclusions because it's not certain.

Briefly going back to the first half of the year trading was good but if you look, with the benefit of hindsight, at the whole pattern it was slightly behind 2015. It's hard to say whether that's the impact of stamp duty on the higher end of the market, a bit more London-centric effect, sort of caution aboutthe Referendum. Slight, it's almost impossible to put a figure on it, is it 5% below. Sales rates were good but if you look at some of those forward indicators which you'll see just slightly behind, just slightly less bullish than a strong 2015.

Central London was slow, and by slow I'm talking in volume terms, so sales rates were slower but pricing was stable. You know, we said to you a couple of times during the course of the first half that we hadn't seen any change in our Central London pricing, we still haven't today. Looking back I think that's more to do with stamp duty than it is to do with the Referendum but as you roll forward into July, which we'll do in a second, you would probably say that it's more stamp duty but the Referendum hasn't helped.

Very little signs that we could really detect though of a meaningful pre-Referendum impact. And it doesn't say it on the slide but for us also very little impact of the stamp duty changes for investors. We didn't see a big pull forward of completions into the first quarter. We then didn't see a big delay in either reservations or completions in the second quarter. Our investors in the sort of first half of the year were 4% of completions and probably not too different on reservations. That's certainly a 15 year low: it could be a low for a lot longer than that, I haven't gone back and checked. But very much selling to ordinary home owners who wanted to buy their house, very little feel of kind of nervousness and fever in the market, very normal, very solid through most of it.

In July 2016, and I'm really now talking about a period from 24th June through to date generally the market has performed very well. You see that coming through in our statement far better than we would have expected. One or two small initial blips in data and we'll talk about these specifically. You saw a handful of cancellations, you're talking sort of probably 30 cancellations that we wouldn't have expected to see, which against an order book of 8,000 units shouldn't give us too much concern.

Even in Central London cancellation rates were not particularly high. Again that was a positive surprise in the conditions we saw we would have expected to see more in the way of cancellations from the existing order book. Clearly a large part of that part of the order book is contracted which makes a massive difference. But even in the uncontracted part cancellations were small. In that five weeks, in that sort of Central London and the upper end of London business you're talking about ten cancellations maybe in total. So not particularly significant even there.

And appointment bookings which we'll talk about and show you the trend on, we've tended to see over the course of the last year or so it's newish data to us that we can collect in a quality way but it's a really, really good lead indicator. It tends to lead reservations by something like two weeks. People don't book an appointment to come in and see one of our sales execs unless they're fairly committed to reserving. They don't do it casually. Whereas some of the other data website enquiries, and even people visiting a show home actually can be generated by people's curiosity about what's happening in the housing market. So bad news actually can have as much of an impact on that in terms of increasing it as good news; whereas people do not take the time out to book an appointment without being serious.

We saw that blip for literally two days where it fell to sort of about 50% of its normal level and then recover and actually more recently it's been slightly ahead of where it was pre-Referendum. So again, you know it just supports the overall feel that the market is relatively stable and normal out there. Most of those stats are now pretty much at the level they were before the Referendum and so we'll take you through some specifics.

A couple of down sides, the second-hand lump market definitely lower. You see the bearishness in some of the estate agents' comments, that in itself has a risk. We'll probably talk a little bit about that as we got through about why that might be different, clearly help to buy is one impact but it's not the only one. And as I say in Central London that trend in the first half, that transaction levels are lower but pricing is still pretty stable and cancellation rates remain low is true through to today.

So the normal stats that we give you but rather than giving you after the half year we've given you cleanly the post-Referendum period, because we thought you'd be most interested. I think the number that we've focused on for years, that everybody in this room understands, that private sales rate I don't think any of you would have had us with a private sales rate of 0.65 for that month; we certainly wouldn't if you'd have asked me to forecast it a month ago. There is nothing unusual in that number. We've done nothing on incentives on any of our sites and in any of our businesses, we're not driving that at all and there's no big bulk investor sales or anything else. I would estimate that investor sales are at most at the level they were in for the first half of the year. So it is a clean, fair number.

Cancellation rates a bit higher. They've started to fall the last two weeks were 15 point something. So I think the peak week was either 19% or 20%. If you look back over the last 15 years we'd see a long-term normal being anything up to about 20%. And extremes when the market has changed dramatically going back to 2008 were into the 40s, 50s, 60s for the peak weeks when sentiment was shifting. So to have cancellation rates given the uncertainty over that four week period at 17% again we've been pleasantly surprised by.

The comparative for 2015 was unusually strong. That 0.81 in 2015 is a very unusual July sales rate as we put on the bullet points at the bottom, the comparative for 2014 was 0.56. So we're comfortably ahead of the 2014 equivalent period and we'd be comfortably ahead of the 2013 period. And both of those were reasonably strong years. So we feel very comfortable with that. And if you look at that private sales rate last year it came back to a relatively normal 0.65 for the second half, probably also pretty strong by the end of 2015.

Prices in that period I would say have gone up fractionally, no major change. And largely gone up because new sites have tended to come in at slightly higher price points than is the trend, rather than we've been pushing them hard. But there's been no change in our tactics on pricing. We might have put a hold on new price increases if we'd seen transactions fall. We wouldn't at this point have reduced pricing but at the moment we haven't changed that plan and our direction at all on that.

As I said we'll show you a bit more granularity and I'll split each of these graphs out but if you remember over the course of the last probably three years we've tended to show you one graph showing a hash total of different customer interest measures. What we've done this time is split that hash total out so you can see four other customer interest measures. These are lead, lead indicators ahead of sales rates, ahead of cancellation rates. I'm going to blow up each of these graphs and just briefly talk through each one because I do think it gives an overall story. And it's not black and white. You wouldn't expect it to be. But on none of those graphs do you see a precipitous change either before the Referendum or at the point of the Referendum. You see some churn in some of the numbers and these are weekly data that you're seeing on there. So the volatility is weekly. And you'd expect some volatility.

What I would say before I move into the individual graphs is you will see some underlying trend differences. So you would expect website visits to be up year-on-year as we shift from a more paper-based way of selling to a more electronic-based. So it shouldn't concern you that brochure requests are generally down over the course of the last few months but probably more of a trend in the fact that website visits are actually flat with last year rather than down over the last few months. So, you know there's some other movements going on rather than just short-term trading. As I say I think we see the appointments booked as a particularly interesting data point.

But looking at the website visits you can see 2014, '15 and '16 data. We'd have expected to see 2016, everything being equal, to have continued to be above, 2016 to be above 2015. So the fact that it's down a bit don't put too much store into the one week's movement, that will bounce up again because it depends on when we do exercises to drive traffic to the website. But you can see overall trends slightly down from where we were in the first quarter. If you look at website calls it follows a similar pattern, not surprisingly. No major change it was just slightly, slightly down but tracking last year.

Brochure requests are generally down but again no major change but we'd expect that. And that key measure of appointments booked was probably the one we saw the most stark change on in the immediate week after the Referendum, you can see that spiked down but then it spiked up above where we were last year and running roughly at that same sort of level.

So overall those forward indicators you could say are showing total activity down maybe 5% if you adjusted out all of the noise factors of seasonality, of the trend towards more electronic sales, they're flat but you'd expect them to be up. But in true terms down 5%. That 5% pretty much all London and southeast centric and towards the top end of the market. And I would estimate over the course of the last three years and certainly as we look forward at our plans for 2016/17 we have been constrained by our ability to build to the tune of probably 10% to 15% less than we could sell at.

So a 5% movement in demand doesn't really change our expectations and our plans whatsoever and it certainly doesn't change pricing expectations which is probably more fundamental to us. So nobody's saying it is exactly the same but the changes are actually quite small and those small changes come through all of the data that we've got.

Why is that? I think we were concerned about two things on the 24th June. One was mortgage lending. One was confidence. I'll talk a little bit more about confidence in a second. But mortgage lending has been surprising robust, both the signals from the banks and what they've actually done in practice. There was much speculation about the cost of lending going up, actually it's already started to come down slightly which we would never have predicted. We don't necessarily need it to come down, in fact I wouldn't necessarily argue that it coming down is a good thing in the long run. I think we'd like to see it pretty stable. It's at an all-time low and we don't pick up any signs, either from the banks or from government or the Bank of England about anything that's going to change that in the near future.

And that makes a massive difference. For our customers, and touching on that customer confidence piece, actually unless they're in Central London, in financial services, what they care about is, is my job secure, and can I borrow reasonably cheaply on a long enough term deal that I think it's worth the risk? And probably, do I think house prices are going to go down long-term? And most of them don't. So that confidence piece is also linked into lending. And we don't really see that trend changing in the short-term. And that makes quite a big difference.

I think if you also look through a customer's view you have that long-term trend. This is new data in the way that we've shown. And what we've tried to do is look at the cost of buying versus renting with that significant steady drop in interest rates and the real interest rates that our customers are paying over the course of the last sort of two years the rent versus buy choice, particularly if you're supported by Help to Buy to enable you to get on the ladder in a way you couldn't two to three years ago, is a pretty stark one. And there's no doubt that combination of factors, low cost of debt, plus the Help to Buy, is helping new-build property in relation to second-hand which I'll come onto in a second.

Things we should be aware of – I don't think we should necessarily be deeply concerned but be aware of – the second-hand market is likely to be slower. I think what's interesting is that's actually more driven by new instructions and sellers than it is by buyers. Confidence amongst second-hand buyers isn't too different to confidence amongst new-build buyers. I think it's the sellers that are making a bigger difference. And that is impacting on agents' confidence, particularly the Central London agents, you can see it in their statements, you can see it in its impact on their profitability; and it is something that we need to be aware of. We do see it occasionally having an impact on the confidence of people in the market overall because our buyers will talk to agents as well and you can see that flow through sometimes. So definitely one to watch.

But because actually the level of supply in the second-hand market is being quite tightly restricted because of that confidence of sellers, we don't think that's likely to have a particularly significant impact on price unless something changes. In fact actually the pressure is the other way because there are slightly more buyers than sellers still.

I think one thing we were concerned about in a detailed way if you roll the clock back a month was that valuers would tend to prejudge a fall and therefore create the conditions for a fall. There's one area that we did have a discussion with government on and actually there's been some quite strong instructions and I think yes, RICS has done quite a strong job in saying to valuers it's not your job to create a fall in the market, it's your job to say what's happening at the moment. And that's the action we see, we see very isolated incidences of valuers down valuing on the basis of all prices are going to fall aren't they. And I think that's encouraging because we saw that as quite a big concern in 2009 '10 as valuers were sort of prejudging where they thought the market would go rather than valuing on the basis of what the market is today.

So overall the second-hand market is something to watch, it would be very surprising if summer transactions were not materially lower than the second quarter, but I don't think we should pre-judge that that means that there's a lack of demand in the marketplace, it's a lot more about supply I think on that side than it is about the demand.

So overall, the underlying long-term fundamentals remain good, the demand and supply imbalance has not changed, I think you have to be very brave to say that immigration drops to a level where it has a material impact on the supply and demand imbalance that we've seen in the long-term; customer confidence in the housing market does remain strong, you know, recent data show people thought their house price had probably gone down in the last month but would be higher in a years' time than it was today. And that's actually the mind set we tend to pick up from customers in the field.

Outside London people have stopped talking about it, which is surprising but it's true pretty much everywhere, certainly in the context of the housing market. It's far too early to cover the full impact, we're telling you what's happened today and giving you some sense of what we see in the near future about the flow-through of those impacts but the initial signs are encouraging and we'll keep monitoring the data. And you probably will get a sense in our actions that we're not sort of saying oh no, all risks are gone, we're saying this is what we're seeing at the moment.

I think there are other potential long-term implications, there's labour and material questions. On the labour side we don't expect any short-term movements, we're certainly not seeing any changes at the moment and the signals from government are that people already working in this country are likely to be able to continue working in this country and that's not likely to change. What you may see over the course of two, three, five years is a degradation in the number of new people coming into our sector into the trade base from overseas, and so we're going to have to work even harder to invest in new apprenticeship programmes and new skills. And that was a pretty tough job anyway, so over time that will create a sort of an ongoing pressure point.

On the material side we've seen no change in costs thus far, it's hard with the exchange rate not to believe there's a little bit of upward pressure on the material prices that we pay, but you know our results are not particularly sensitive to those material prices. So again you've got a couple of degrading issues there that we want to watch, but certainly at the moment sort of your views are probably as clear as ours and we don't see either any immediate impact or any major long-term impact, they're pressure points we've been dealing with in different ways for the last sort of four or five years.

And so what actions have we taken? They do speak louder than words. As I said right at the beginning we were as bearish as anyone else on day one, you know, 8:00 am on 24th June we pulled back from most of our major investment decisions. I don't mean we pulled out, we pulled back, we didn't exit the market but we pushed up our hurdle rates and we said well let's review everything that we've already signed off and we sort of raised authority levels, so sort of I was seeing every piece of conditional land as well as unconditional land, so every planning application in terms of it triggering conditionality.

That particular control we've already started to relax, we haven't changed the hurdle rates back down, and I have to be honest, we'll probably use the opportunity as a way of pushing up our hurdle rates past the level that we're at because strategically that would have made sense for us anyway; but we're not out of the land market but you should probably expect us to buy less land in the second half as we assess what's actually going to happen sort of medium to long-term. But with the length of landbank that we've got I don't think that changes our plans for the future, it's mostly just timing.

We reviewed our major WIP commitments, I don't think there's a single less person working on one of our sites today than there would have been if we'd voted to remain in the EU, but particularly when we talked to you in May about those large sites and where we might push up volumes, those would have been infrastructure commitments we'd be making in late 2016 and going into 2017 and '18. It's likely that not all of those will be quite as big as they would have been without this risk because they depend on high sales rates in particular locations and I don't think we can have quite as much confidence in that in this world as we did before.

But they're relatively small changes at the moment and we did say on day one that we would maintain all of our investment in apprentices, graduates, management development roles. We looked at new overhead recruitment roles into new sort of very cautiously and still are today, but again it's kind of an opportunity to get an extra level of discipline that we were talking about anyway. So not major changes, but still cautious on land, we've not not bought any and we've certainly progressed things we were working on anyway, but we've slowed things down quite a lot at the moment and gradually are sort of releasing that as we go through the summer.

So overall summary on the outlook: the underlying supply and demand balance remains good, mortgage lending is absolutely fundamental and remains very good. Government policy continues to be favourable and I don't see, I think the chances of that changing are lower than they were sort of before the Referendum than higher, there's certainly a clear signal that they don't want to see sort of real volatility and negativity in the housing market. Initial signs are encouraging. There are some risks remaining, second-hand is one of them and the data around that business confidence is another, we definitely saw the sort of withdrawal of sales from the property investment funds as being a big signal of confidence and those things do make a difference to people, there hasn't been enough that our customers have really been affected by it but they could over time and prime London does remain a risk.

Land environment is very encouraging but we're not filling our boots, we're being cautious, but cautious doesn't mean we're out of that market at all, but we are progressing strategic land particularly; and materials and labour supply, under control, but we can't say that there aren't any long-term impacts that are slightly degrading to the sort of pressures on that.

I'll hand over to Ryan and I'll come back and talk about the more sort of strategic things and our dividend plan at the end, but Ryan.

Ryan Mangold, Group Finance Director

Thanks Pete, and good morning ladies and gentlemen. I'm going to be covering the financial performance in the first half, review some of the key drivers of value and balance sheet strength and quality of the underlying business.

Just a reminder, the Group result includes our Spanish business, it's the only time I really comment on that in terms of implications for our P&L and balance sheet, Spain made a very small profit in the first half of the period but there's a strong high quality order book which now stands at £123m, positions them really well for the second half andthe years ahead. The comparative figure in the prior year was £75m and there's some more detail in the appendix on the Spanish operations that we normally include.

It's very pleasing that almost all the KPIs for the Group have increased and we've got growth in all of them. We have booked a £10m provision in the period relating to remediation costs on two specific sites which has dampened some of the performance measures, notably the operating margin, but despite that we've achieved a 9.1% growth in operating profit to £279m and with lower finance costs means a 10.2% growth in earnings per share to 6.5 pence.

Return on net operating assets, at 25.2% is two percentage points up on the equivalent period of prior year, despite the higher balance sheet lock up that we normally have at the June period ends and hence a little bit softer than the full year 2015.

From a UK performance perspective, the volumes are up by 3% year-on-year, we've implemented a far greater focus on customer services as you would have heard in the May presentation, and that focus on customer services means there's a bit more time for delivery and getting the street scene absolutely right and the immediate environment that customers move in immediately right. We are expecting a volume profile fairly similar to 2015 so it's approximately 55% in the second half and 45% in the first half; and that volume growth into the second half is underpinned by the very strong forward order book that people talk about.

Private average selling prices continue to trend upwards, being up by 7.3% year-on-year to £266,000 and those benefiting both from the market fundamentals being positive over the past sort of 18 months to more recently, as well as the benefit of mix improvement in terms of the quality of locations that we're trading from which continues to improve. Total ASPs are up by 5.8% with affordable housing staying largely flat year-on-year.

Gross operating profit margin for the UK business at 25.1%, that is dampened a little bit by that provision for remediation costs I spoke about before which takes approximately 0.7 percentage points off that performance, so year-on-year relatively a strong progress.

We've used this chart in the past which is our indicative movement of operating margins to give you a sense of some of the key drivers, bearing in mind that this is just an indicative movement of margins and it's quite difficult for us to do it 100% scientifically. And the operating margin in the UK moved by 0.2 percentage points. And what we compare here is our performance relative to the marketplace, so both from a sales pricing perspective where we use an average of Nationwide and Halifax, as well as what we think the build costs have changed year-on-year from a market inflation perspective. Now there's no true build cost inflation measure that we can benchmark to externally specifically for home builders and so we've struck that at about 3.5 percentage points which is slightly above in terms of what we're seeing on the ground.

Land overage which is the concept that creeps in particularly on deferred payment terms and large long dated sites and has resulted in a slightly bigger increase in land costs to the P&L in the period, and we'll talk a bit about the growth on the balance sheet from a land creditor point of view as a consequence as well. That takes a small amount of margin out of the market indicators. Clearly a more positive market environment results in a slightly higher land cost if there's overage attached to the contract which then obviously doesn't mean you capture as much of that market uplift. But that being said the total net market impact we think in the period that we've been able to capture is 1.4 percentage points.

The specification improvements in build costs, a little bit about further commitment overhead on site in terms of physical delivery, of costs has taken out about 0.5 percentage points in margin, meaning that the net land improvement, because there hasn't been really a material change in mix affect in the period which sits at zero, so the net land improvement is at 0.5 percentage point change.

Slight increase in profit and sale of land in the period, albeit the quantum's relatively small in the pound notes and the overall affordable housing pricing, whilst it's static, broadly static in terms of absolute units, the way the model works in terms of the link between build costs and actual delivery means that there's a slight improvement in margin from affordable housing.

Overheads slightly negative in the half as we commit more to people and other initiatives in terms of improving efficiencies and another negative variance of one percentage point, that includes the remediation provision that we've made, so this is not quite a gross margin to operating margin reconciliation, this is the total margin reconciliation.

If we look at our overheads on a go forward basis, as Pete noted before we expect that to largely stabilise and so the increase that we've seen in the second half, we're not expecting that trend of increase going forwards.

We've got a small exceptional item booked in the period following the detailed review of our net realisable value of our inventory, so net release of £2.2m which is a release of £4m offset by £1.8m further booking on specific sites that are currently impaired.

And just a reminder, there's £142m worth of inventory that's carried at the balance sheet date and that's impaired covering approximately 4% of our short-term landbank.

The taxation charge for the period at 20% largely reflects the UK statutory rate; and the UK tax charge is predominantly current tax following the full utilisation of our deferred tax assets during the course of 2015 and the early part of ’16. And with that being current tax we are now starting to pay cash tax in anger from July onwards from this year.

If you look at the balance sheet the operating assets for the Group have grown by £306m, clearly predominantly into inventory, higher land and work in progress. That’s partly funded by a growth in payables including land creditors as well as the business scale overall from a delivery point of view, however a large portion of the growth in net operating assets is just simply done through profitability.

Tangible net asset value per share, before the accrual of the £300m dividend paid in July of this year, has increased by 7.8 percentage points. If you take out the accrual of that dividend of £300m net assets year-on-year have essentially grown by 21.9% which is effectively a reflection of the return on equity which has either been returned to investors by way of dividends or invested into the business.

From the UK landbank perspective on balance sheet, as at the balance sheet date we have a continued low plot cost to average selling price ratio remaining at 16.3%. We have an invested capital in our UK landbank of approximately £2.6bn covering the 78,000 plots in our short-term landbank with planning permission which is covering an estimated £20bn of future revenues.

We have an invested capital of £174m in our strategic pipeline which covers 104 potential plots with very attractive valuation fundamentals with an estimated potential revenue of £20bn.

These strong fundamentals of both the short-term landbank, in terms of quality, as well as the strategic landbank, is a significant underpin of our confidence of delivery and of our medium-term targets.

If we look at our commitments with regards to that landbank, we continue to fund land acquisition with land creditors on a very selective basis and deal-specific. It’s to enhance returns, not done in order to make returns work for us. Deferred payment terms are generally agreed on the larger, longer dated sites, which takes slightly longer to get through the planning permission or slightly more infrastructure-heavy upfront, in order for those matured return metrics to be more positive.

The UK land creditor balance as at balance sheet date of £640m, of which £338m is payable within one year of balance sheet date, and there’s a further £50m worth of conditional contracts within that number.

Included within land creditors, as I mentioned before with regards to site overage, there’s an accrual now of £147m as a consequence of the more buoyant marketplace, and that compares with £77m in the prior period.

If you look at the management of our working capital, we continue to have a greater level of work in progress spend than what we are recovering through to the P&L as we expand our footprint from a delivery perspective, as well as greater investment into the London business, which has had another £80m effectively invested year-on-year. This is also combined with a slightly stronger sales rate. If you think of us delivering homes at the pace of sales, almost as a built to order type measure, the consequence of that enhanced sales rate does mean that there’s more work in progress committed.

The improvement initiatives on customer services and the customer journey, in terms of getting the home quality right and the immediate street scene and the environment that we're delivering customers into, naturally takes a fraction more time to deliver that, and that itself also consumes a small amount of work in progress. However, the majority of the business has made strong progress in this regard and so we're not expecting a trend of additional consumption of capital as a result of customer services change in future periods.

The stable land cost per square foot in the period of £39 per square foot is partly offset by slightly higher build costs, which is a combination of both the specification we mentioned before, a little bit about mix, particularly coming from the London market which is slightly more expensive, build cost inflation, but as well as high infrastructure cost that come with the greater proportion of sites traded on from strategic land.

On the pensions, the deficit has stayed fairly stable year-on-year, and this is to the end of June. This is primarily driven by better performance from assets as at the period end, but also benefiting hugely from the hedging programme that the trustees have put in place to mitigate interest and inflation volatility, with over 60% of those liability drivers being hedged by the end of June.

The accounting deficit stays broadly static and we contributed £14.1m to the scheme during the first half of this year in line with last year's first half. The next triennial valuation is of the balance sheet date 31st December 2016 and we will agree that with the trustees from a funding perspective during the course of 2017.

Turning profit into cash, this chart reflects on a trailing 12-month's basis at each of the half-year periods. Total working capital investments to the first half 2016 is broadly similar to the first half 2015, despite investing an additional £80m odd into the central London business, year-on-year, as well as the greater work in progress as a consequence of the customer services that I spoke about before. The greater level of profitability and cash generated has been returned by way of dividends; and despite all of that, we ended net cash £29m higher than the first half of last year.

The favourite acronym of mine on EBITLA, earnings before interest, tax, depreciation and land amortisation, I haven't invented any new acronyms for this half-year presentation you'll be pleased to know! But the EBITLA is slightly softer in this first half relative to the previous year and most of that is a consequence of the booking of that £10m provision, as well as a slightly higher overhead spend.

The cash generation and profitability remains strong with greater investment in the first half in both land and work in progress, producing the total cash generated in the 12-month period to the half year. But we expect a stronger second half delivery based on the quality of the order book, which is 90% forward-sold for the year, as well as that weighting of more second half being 55% that I mentioned before in terms of completion.

The Group ended the half net cash of £117m during the period. On the 28th June we issued €100m, 2.02% private placement notes, fixed for seven years, as principally as a hedge for investment in our Spanish business. The average net cash balance for the half was £3m and that compares with a £44m net debt in the equivalent period of the prior year.

Both Fitch and Standard & Poor's have recently maintained our investment grade rating with both as a stable outlook, recognising the strength and the quality of the business.

The Group's ordinary dividend policy, as announced in May, is an ordinary dividend of 5% of net assets with a minimum return of £150m. This policy struck of net assets avoids any kind of volatility from the P&L, due to, say, for example, market disruptive events. And this dividend policy has been stress tested with a 30% decline in volumes and a 20% decline in average selling prices, so it's a fairly robust policy that we believe that we can pay throughout the cycle.

The ordinary dividend declared for 2017 at £150m, announced in May, we paid in equal tranches, both in May and November, and the Board also remains committed to the £300m dividend announced in with the May results, so it's £450m return for next year in total. And the method of return of that £300m worth of capital remains under review with the share buyback also a possibility, and we will update in due course.

The total cash dividend and cash return paid for 2017 will therefore be £450m versus the circa £356m that we're going to be returning during the course of 2016. Both the ordinary dividend and the special dividend will be subject to shareholder approval at the AGM next year.

For the interim this year, we have declared a maintenance dividend for 2016 of £0.53p and that will be paid on the 7th October.

So, in summary, we've continued to make good progress against our medium term targets that we set out in May covering years 2016 to 2018. The Group's strong balance sheet and operational business execution and performance positions us really well for delivery of our targets and our strategy. And in these uncertain times, as Pete noted, the balance sheet discipline and focus in the short-term remains our priority.

And I'll hand back to Pete to cover strategy and conclusions.

Pete Redfern

Thanks, Ryan. I'm conscious that a couple of things that I'm going to say that repeat what Ryan said and particularly touch on the dividend, but I think they're important and I think it's actually quite important for you to hear thoughts from both of us on that particular issue.

But in terms of strategy, nothing has changed. We built the strategy five years ago and when we reviewed it this year, having the ability to manage through a cycle built into it, rather than it be something we decided what we do when we got there, was always fundamentally important. So over the course of last month when we have been more cautious and looked at downside scenarios, we knew what we were planning to do, and so nothing has really changed in that. And I think the balance street structure with, as Ryan has touched on, low or no debt, tightening on land creditors, making sure that we don't overstretch on that. Tightening our land policies around hurdle rates, but also the whole trend towards major development type sites without full land commitment - all of that is about managing the cycle longer-term. And so nothing that's happened in the last month, or nothing that could have happened in the last month, I think, would have particularly fazed us. And for the first time it's actually a chance to put things that we've thought about in theory and that we've planned to do into operational practice and the business responded very well very quickly to us pulling the levers, which I think is very important, but we are in a very strong place.

And I'm not going to labour this slide, I know you all know this and I see it coming through in your notes, the position for us as a business, and for the sector as a whole, is fundamentally different to 2007/2008, whether you look at debt, whether you look at how money is locked up in land, whether you look at the length of the landbank and the flexibility that gives us, and the input from strategic land, it's a totally different position. So even if conditions were significantly tougher than current trends are starting to suggest, then we're in a good place to work through that and still create value. And we do think that dividend piece is a core part of that value.

In terms of land and our land strategy, you can see in the first half of the year our landbank went up, and not massively but back to the 77,000/78,000 units, we still see that as reasonable level. I don't expect it to dramatically change in the second half, and as I said, there will probably be some delays on land purchase that we would otherwise have done, so the second half acquisition numbers may be a bit lower, but I don't think it's going to have a particularly significant impact on the level at the end of the year. And you'll probably see an even greater weighting of the new acquisitions that come from strategic land than you've been seeing. And you can see from the numbers on the bullet points at the bottom that the strategic land conversion continues to be strong and the conversion of that into completions has continued to be strong.

I'm also not going to labour this slide, but we still believe that in tougher conditions, being in places where people want to buy homes is a significantly stronger strategy. We've tracked since 2004 the number of sites that we have that haven't sold in the last week, in the last two weeks, in the last three weeks, as well as sales rates, and it gives you a level of granularity, because what you find is you can disguise by, particularly at a local business unit level, an underlying softness of performance in 25%/30% of your sites by an outperformance on others, and in the end that catches up with you because you're still left with that land and those sites. And we track that closely and what that shows you very clearly is the number where we have those low sales rates for a longer period of time have reduced year by year by year as this land strategy has shifted. The quality of location makes a massive difference to your strength in any kind of softness of condition.

So, as I said, I think the dividend is key but we've tried to give you, Ryan has given you some land creditor numbers to give you numbers to model yourself. And this is almost a plot-by-plot version of Ryan's EBITLA target, just cash generated by unit and different market scenarios. We become a very cash generative business when we stop buying land and we could turn that tap off very, very quickly. And that means, that combination of where we are as a business, that we do remain fully committed to that dividend policy.

I think the thing I'd add to what Ryan said on the ordinary dividend is whilst over the last month we've checked and tested everything to make sure we haven't missed anything, to make sure that we're set up as well as possible for tougher conditions, the one thing that we didn't actually have a real need to go back and check was the ordinary dividend. We did test it through a whole range of scenarios. We've given you one worst case example to give you a sense of it, but actually it could still be worse than that and we still have confidence in that ordinary dividend. It hasn't been something that we've had to challenge ourselves on particularly strongly, and you can give that sense to investors as you talk to them and in your notes.

Of course the special dividends are always the next level of certainty, but having retested and looked at different scenarios again, we remain fully committed to that. Something would have to change significantly, not just over and above where it is in the last month, but over and above the sorts of market scenarios that we've looked at and I think most of you have tested. We don't expect that to change. And that three-year dividend target, I would stress, still, it's a target, it's not the same as an announced dividend, but we still remain of the view, and I'll talk about our views on all the targets, that that is a sensible target for us to go through, and that actually we don't need to the market to be at the level that it's been in 2014/2015 to still achieve that target on dividends. We remain of the view that's a sensible target for the business to go through.

And talking about the targets overall, including that one, it's the same sort of scenario. Clearly things have got slightly tougher in the course of the last few weeks, and we said to you in May, when we announced these targets, that we felt particularly the operating margin averaging over three years at 22% was a stretching target. We still think it is; and clearly some of the headwinds are a little bit greater, but we're not planning to change those targets any time soon and something would have to significantly change in a way that we haven't seen it. We remain of the view they're the right measures and we remain of the view that if we do the right things and that if things go to plan, we can achieve them and nothing in conditions has changed that perspective on returns or on margins or the scale of dividends. They're not absolutely nailed on but they're targets and they shouldn't be absolutely nailed on. They're stretching but we think we can get there unless things change more significantly than we've seen.

So overall, the market outlook long-term, I don't think anything has fundamentally changed, short-term, better than we all expected. The value proposition for shareholders remains high earnings quality, we still believe chasing a high margin over volume scale is absolutely right.

We've been pretty disciplined, you know I do think you'll see some slightly different levels of confidence from people with stronger growth plans that have been underpinning the value of the business. It's tougher to do in a slightly less certain environment and tougher to see through every single site as a land acquisition. And actually it's a good place for us to be in that we don't need to. We can take six months out of the land market and it wouldn't faze us at all in terms of our future growth.

And we still think there are potential improvements on capital efficiency and that they can come through, and in that underlying performance, by which I mean margin, we still think there's growth in a stable market. It's clearly around the low 20s it gets tougher to add every incremental piece, but we still think there's a way to go if conditions are stable. And that dual dividend strength of us I think is the underpinning of value, in tougher conditions but also in positive conditions as well.

And just kind of summing up with updating our guidance for the balance of 2016; overall not a lot has changed. We said right at the beginning of the year 50 to 100 basis points of margin growth, and I think I steered you towards the upper end of that with our full year results. I'd still say 50 to 100 basis points. I wouldn't necessarily steer you towards the top end there, there are a few risks out there. You've seen the one-off costs that we've taken in the first half, they don't make a big difference, but still feel that is a reasonable range for our guidance so not really changed. I'd steer you towards a similar level of volume growth, 5% we've said since the beginning of the year, a fraction of downside against that but not much so no real change. And on average selling price I think there's a bit of upside. I steered you towards 7% to 8%; I'd say today 9% to 10%. And actually if London completions see through in the order book there's upside on that 9% to 10%.

So, overall, you put all that together, perhaps a fraction softer on margin, a fraction more bullish on selling price and you're more or less at the same place overall. We're certainly comfortable with where consensus sits today.

Q&A Session

Question 1

Gavin Jago, Peel Hunt

A couple if I could please. First of all just a look on the outlet numbers, Pete, I was wondering if you could give us a bit of colour on what's going on there. They're down by 6% or 7%. What the plans are for the second half and what's been driving that? Are you still have issues with the planning there or has it been more of a conscious move?

And the second one was just on government. There has been a lot of chat over the last month as to what the government could, should or will do in terms of helping the market. Given what you've seen over the last month Help to Buy is clearly very important, but it's been holding up, the second-hand market obviously has been slowing considerably. What do you think the government is more likely to do at this point? Is it more likely to maybe pull a lever on the stamp duty holiday rather than Help to Buy or a bit of both?

Pete Redfern

Outlet numbers no new story really. The first half sales rates continue to be strong. The order book has continued to build, and that tends to mean you close outlets earlier. Our openings are pretty much in line with what expected. I think it's likely in the second half, both because the sales rate is naturally a bit slower in the second half, and you'd expect, is it 5% off overall over the course of the second half, you'd expect that to help a little bit the outlet numbers by the end of the year, plus slightly more opening plans. I would say up closer to 300 rather than the high 280s at the end of the year. But as I've said before, it doesn't really affect our completion volumes because as they'd come into the order book just that bit earlier, come out of outlet numbers, it just shifts the balance of those two numbers rather than change the position. But as I say, probably more upside in the second half than we've seen because I think the dynamic will be slightly different.

On government we've had – this has been, certainly in the early stages, reasonably well publicised – some pretty high-level early urgent conversations with government. What our ask would be today is, be ready to monitor: monitor the statistics; listen to our statistics; listen to the second-hand. But I actually don't think, based on what we're seeing, that we could call for significant changes to where Help to Buy is, or in a general sense to stamp duty.

I think the one thing that over time needs to be looked at is the impact on stamp duty on the upper end of the market. I think the double whammy of the changes to underlying levels plus the 3% on the upper end of the market, and not just prime Central London, I think more general London, family housing in London, is slowing things down more than it should. It's not particularly affecting prices. It may affect prices in prime Central London, it's not particularly affecting prices. But I don't think anybody should want the resistance to movement in that market that we're seeing at the moment.

I hope they take the chance over the next six, 12 months to look at that with a different group of people, people in power; but right now I think it's monitor and be ready, look at the stats. But excessive reaction actually makes people think well why did you need to do that, so we wouldn't be pushing for anything particularly strongly.

But there is a good dialogue and an open conversation, so it's not that they're saying, "We're not doing anything". There is a sense of them watching it quite closely and being alive to the sorts of things we might suggest if conditions were softer.

Question 2

Chris Millington, Numis Securities

A couple of straightforward ones. First of all the percentage of the order book which is contracted at the moment or exchanged?

The second one is just really about capital employed in London, and maybe just a quick comment about recent experience on overseas buyers there?

And then the final one for me is really net cash trends in H2, just in light of this slightly more cautious approach to land acquisition, and maybe where you'll end up with net cash from your view?

Pete Redfern

If I take London and just give my overview on net cash from a land point of view, and then maybe Ryan if you round up net cash and gives you a chance just to check the number on contracted because I can't remember the percentage.

On London, and particularly Central London, we actually saw, as I'm sure you'll see reported elsewhere, some new additional sales we wouldn't have expected from overseas buyers in the first week because of the movement in exchange rates. There was a flush of that and it still impacts on those buyers' decisions today, but to a certain extent people thought they were jumping in because they thought exchange rates might bounce back; whereas now it's balanced so they are what they are. So it's not bringing forward decisions, but obviously it's a positive for overseas buyers.

What we're seeing is a large amount of interest in Central London. Actually more interest I would say than before the Referendum, there's an awful lot of conversations. You always get a few opportunistic potential buyers who are purely price. But even those buyers in Central London at the moment who are genuine underlying buyers, whether they be investors or potential owner-occupiers, are concerned about price in those prime markets understandably and so there are a lot of conversations but it's hard to pin them down. There's a lot of action, there are sales, but that's why I say sales rates are definitely slower but it's not a total lack of interest, it's people trying to work out well what's the right underlying price for me to invest at. You do get the large investors who want big bulk discounts, but it's not just that, there are plenty of ordinary smaller investors and it's just they're trying to work out where it gets to. If they were confident prices might move by 5% they'd probably buy at a discount of 5%, but they're not quite sure where it pans out. And I do think there's a bit of a sense building of, we'll wait and see what happens in September. We'd have expected to be saying that to you on the whole market; the only place where it's true is in that prime London market.

And then on net cash I think the trends will be more positive in the second half because of what's happening. I think land is the biggest one. We will probably lose a few completions in London, a handful, because of that mix of sales that we would have taken. But I don't think that makes a big difference to cash coming in the door. I don't think work in progress spend will be fundamentally different it might start to tail off a little bit on those big sites at the end of the year, but I don't think you'd see it. But there will be a bit of a slowdown in land, so you should see a more positive net cash balance than you would have seen. But I don't think that immediately flows through into our dividend plans that we'd announce next year because it will depend on how we see the market overall about whether that's just a short-term timing difference or whether that's long-term. But certainly the caution I'm talking about in land should flow through that.

Ryan, I don't know if there's anything you'd add on cash?

Ryan Mangold

On cash I'd completely agree with Pete. We started the year £223m; we'd expect to end the year slightly stronger than that, despite the change in operational execution from a land commitment and work in progress commitment in any event based on profitability and profits generated. But the slowdown of WIP and the slowdown of land that's naturally going to manifest itself into cash we should end up in a slightly stronger position. But I'd agree with Pete, it might just be a timing issue as opposed to a permanent issue, and we'll have to judge what the market's doing at that point before we start to commit more capital to the business or have surplus to return to shareholders from a strategy point of view.

In terms of the order book that's divided between affordable housing and private housing. The affordable housing is generally all contracted, so it's just the timing of delivery, and that makes it a relatively significant quantum of the total. For the order book on the private side we generally are getting from reservation to exchange of contracts within about five to six weeks, and that's what our business model is from a turnaround perspective. And so as a consequence there's probably only about 10% of the private order book – I haven't got the exact number – but I would say approximately 10% is not contracted but is actually reserved.

Pete Redfern

What I should say on cash, Chris, just tying up, the link between landbank won't necessarily change that much, but cash will probably be better. I do expect to see more conditional deals in the southeast. Most of the business is heavily weighted towards conditional deals anyway. The only place where it's hard to drive as many conditional deals on planning tends to be in the southeast, in the environment we're talking about where softness is more London weighted, than at the moment what we're seeing is you're more able to drive those terms. And from our point of view it's not just about cash, that gives us control if things are significantly softer. So tying things up that you can work through the planning, but if the market is softer you've got choices is a sensible place to be. So you can see landbank relatively stable and cash better as a result.

Chris Millington

And where we are on London capital employed?

Ryan Mangold

London capital employed is pretty much to the level that we wanted to take it to in terms of overall commitment. They are trading effectively from the eight outlets, which is broadly the kind of scale that we put out to the market in terms of our intentions in Central London, and sits at approximately £350m, with a substantial number of schemes that complete in December this year, which is what we were expecting. One or two of them might just nudge over into January 2017, but principally looking to complete this year.

<u>Question 3</u>

Gregor Kuglitsch, UBS

I've also got a few questions; some I think are simple. The first one is just on the reservation rate, just to be clear, it's net of the 17% cancellation rates.

Pete Redfern

That's right.

Gregor Kuglitsch

In other words your gross has actually dropped quite a bit less than the headlines?

Pete Redfern

Yes.

Gregor Kuglitsch

The second question, I think if I look at the segmental reporting it's visible that the London and southeast margin had come down quite substantially in the first half. I want to understand if that £10m is booked in that particular segment or whether there's something else going on there?

And then the third question is on investment. I think you've hinted obviously at lower land buying, recent pullback in WIP. I just want to understand say in a scenario where sales rate holds steady from here, as you look into 2017 obviously the sales rate is the big variable, but would you actually expect volumes to be flat or even down, because obviously there's an element of self-fulfilling from a volume perspective? I just want to understand where you head up, even if sales rates are flat and obviously then we can flex for our own assumptions on sales rates.

Pete Redfern

I might need you to repeat the second because I was thinking about the first when you were going through.

Gregor Kuglitsch

The London margin or London to southeast, I think your segmental reporting is by geography.

Pete Redfern

Yeah.

Gregor Kuglitsch

So I think the profitability was down on similar revenues. I just want to understand if the £10m one-off was in there or if there was something else?

Ryan Mangold

It's in there, yes. The scheme in East London business is part of the provision, one of the two.

Gregor Kuglitsch

But it's also down on an underlying basis therefore? The margins are still down on underlying?

Ryan Mangold

You've got to bear in mind as well the recoverability particularly in the Central London business being completions from a second half weighted, which does skew the overhead recovery. You've just got to bear that in mind as well in terms of the margin trajectory.

Pete Redfern

And if you look at the selling price guidance that we've given you, the 5.8% in the first half going to 9% to 10% in the second, you can see the recoverability in the Central London business is weighted towards the second half contracted sales, no cancellations. But that drives that mix so that has quite a big impact in Central London, and East London to a lesser extent as well, in terms of timing.

Just on the reservation rate, the answer to the question is absolutely yes, it's after cancellations. But you then went on to say it means the gross rate is down more…

Gregor Kuglitsch

No, less.

Pete Redfern

That's right. Sorry, I must have misheard what you said. Yes, the gross rate is down less, that's absolutely right.

In terms of investment, and I think what you were really driving at was where do we see 2017 volumes in the mix of sales rates and investments and everything else. I think if sales rates are flat, volumes will be up. And it goes back to what I said going through the presentation that we've been constrained more by build than by sales. We've said our order book has continued to be ahead of where we expect it to be in volume terms. So with flat sales rates effectively what will happen is build will just catch up and our order book, which is six months out on ordinary sites, which is more than we would choose it to be from a pure balance point of view we're quite comfortable; as long as it's over about 4% we're pretty relaxed about it giving us enough of a side to the market. So even with flat sales rates there's still volume growth. It's why a year ago I was pretty sanguine about exact balance of outlook numbers and sales rates because there's a lot of flex in there.

If you were chasing your volume growth at the maximum possible rate, or if you weren't constrained by build then it's harder to have that sort of flex. But long order book and not having been chasing it, it gives you quite a lot of flex. So our volume expectations today – and we're not going to give too much guidance for 2017 – but today they haven't really fundamentally changed. The only bit I'd steer away from, and nobody had really put it in their forecasts is where we'd said there's actually a bit extra that wasn't in our original underlying assumptions on these large sites, we'd be a bit more cautious about that today, as I said earlier, because that assumes quite high sales rates on a small number of larger sites. It's harder to be confident that's right. But where forecasts are generally on volume today, actually based on what we know today, it's still pretty sensible.

Gregor Kuglitsch

And then I'm going to be cheeky, and similarly on sales pricing, because obviously you've got a lot of London schemes in the second half, do they roll off and that's sort of it or is there stuff coming back?

Pete Redfern

No, I wouldn't expect to see that same sort of 9% to 10% overall selling price uplift into 2017. But there is still some mix driven uplift into next year; there's not a big distorting effect.

Now, for the London market you make no sales, and for some of the schemes coming forward don't have that, then that starts to make that tougher. Because obviously for this year we're totally contracted; for next year we're substantially contracted in Central London but not completely. There's not zero risk against that into 2017. But I think going beyond that we've got to get through the next couple of months, getting into trading update later in the year, and we're talk to you a bit more about how we see 2017. But right now nothing fundamentally has changed. But probably the one visible risk is around Central London, and it's not a kind of balance sheet value risk; it's just about trading and where that pans out particularly into 2018.

<u>Question 4</u>

Will Jones, Redburn

Just firstly making sure I definitely understand slide 21, the land commitments, correctly. I think there's about £820m there combined in the two lines over the longer term. Is that including the £650m of land creditors?

Ryan Mangold

So one of them is, almost, the way to look at is one of them is a fair value, which is a present value calculation, and the other one is an absolute value. And that's the difference between the two if you added them up. So it's the time value of money gets booked taking into account from an accounting standards point of view.

Pete Redfern

But the £650m and the £675m are the same number, except for that fair value piece Ryan is talking about.

Will Jones

I think you've got 17,000 controlled plots, which I would guess is £700m or £800m of plot value potentially, which I doubt, there are maybe some small deposits for those, but you haven't paid for them. To what extent are they obligations on top or is that the second line?

Ryan Mangold

That would subject to. So depending on where it is on from a control point of view, whose control it's under: if it's subject to vacant possession then generally it's under the land vendor's control; if it's subject to satisfactory planning then it's under our control.

Will Jones

So there are some numbers above and beyond in the seller's?

Ryan Mangold

Yes.

Pete Redfern

I'm not sure where you go to your £700m to £800m though, Will. You're paying more for land than we are I think! It's hundreds of millions, but it's more like £400m or £500m.You're talking probably more about £500m give or take.

Will Jones

Right, okay.

Pete Redfern

Which includes that £146m. When I say conditional contracts give us a lot more control, they give us a lot, lot more control. What we tend to find historically if things soften dramatically we have more control than we expect over the time we had the £675m, that actually even that has degrees of conditionality and timing impacted it. We have a lot of control over the £146m. But it does depend when you take the decision. Before you submit a planning application you've got absolute complete control. So if you look at those numbers, and it's why they're not in land creditors, it's why they're things at the moment that we'd expect to pay, and if we decided actually no, things are terrible, those are bad deals, half of them we'd renegotiate because we can walk away, and the other half we'd walk away from. But it gives you a sense of where the flex is on sort of land spend, what's in the landbank already and what's committed.

Will Jones

And the second one just about the dividend and the special components of that, I think the message in May was more or less: operating cash flow less maintenance dividend gives us our scope essentially to pay the special. Does that policy or that approach change in an environment where profits are significantly lower? Because obviously we could have a scenario where profits fall a fair bit but free cash flow on that measure doesn't fall as much. Would you think about the special in the same vein in that scenario? Or would you actually then say actually we might want to build up some more net cash in the balance sheet?

Ryan Mangold

I think in that scenario that you're positioning I suspect we would overshoot quite strongly on cash generation. And if there is a strong overshoot on cash generation as there's a release out of inventory as a consequence because we're not investing as much in a falling market then the logical outcome for us behaviourally would be to invest slightly less as a quantum coming out of the cash flow, and the operating result onto the balance sheet, so effectively released from the balance sheet. We would have to take a view as to what we would want to do with that surplus cash, whether we would keep some for a time when its right to reinvest in the business or to return that to shareholders. We make a judgement. We've got four options: we either do share buyback; we do a non-special dividend; or we invest in the business; or we sit on the cash. Those are the four options, and we'd need to make judgement depending on how the cycle potentially evolves.

Pete Redfern

We sort of see the cash invested in our landbank as being a long-term pretty sensible stable number. If we throw off excess we'll give it back. If we're reducing it significantly as a timing difference we won't necessarily, unless we see structurally something has changed.

Will Jones

And the final one was a more hypothetical one, hopefully it won't come to this, but when you think about if sales rates were to fall by a certain amount and a significant amount at what point that triggers A), a change in incentives and B), then a reaction on underlying pricing? And I guess where you'd be governed by the second-hand market as well and there's lots of things going on in there but have you thought about big picture and how that might play out?

Pete Redfern

Of course you think about it, and it's a really hard question to answer because it's never about one trigger. It depends how much sales rates fall; where they fall; by how much; what impact you think price would have; and what the balance is. You'll remember Malcolm Harris standing up and pointing out that they made more money if they held on to price, and then about three months later realising that that math didn't really work. Of course if the market changes structurally in terms of pricing you change your pricing, because making no sales over the course of three months is not going to work and you're just delaying the inevitable.

But I think the balance is, and I think this is generally true across the sector, everybody's in a strong enough place not to spark that off and to create it. So that to a degree becomes a bit of a self-sustaining prophecy if everybody's kind of holding their nerve reasonably well. But if the markets change and the second-hand market prices change significantly then you adjust. And of course the obvious area where you look at the moment is in Central London. There will be, in some of those prime sites, some degree of price movement. It's happening a bit around incentives there but not massively. But there will be something, it's just quite hard to work out what. But I think we'd be following rather than leading on this occasion.

<u>Question 5</u>

Glynis Johnson, Deutsche Bank

I have four if I may, but hopefully very quickly. The first one is on those lovely four charts that you gave us. I'm just wondering if there are any other influences that we need to maybe just be aware of; whether there are site openings make a big difference in terms of any of those metrics that we just need to keep an eye on?

The second one was just in terms of you gave us the stats of how much build constraint had restricted or how much that had been below what you thought you could sell. I'm wondering how you came to that number. Is it the number of people that signed up as interested? I'm just wondering how you can measure how your build rate has constrained your selling.

Thirdly, just in terms of land buying, you talked about moving up the hurdle rates. I'm just wondering how the land vendors are reacting. Are their expectations starting to move? Are you starting to add conditionality in terms of viability? When planning comes through are you increasing the number and types of conditions?

And then lastly, overage. How much of your landbank has overage on it? And is that increasing?

Pete Redfern

Are you okay to the take the last one, Ryan?

Ryan Mangold

Yes.

Pete Redfern

Influence on sales rates. There is nothing unusual, as I said before, in the July data, so we have some site openings but we always have some site openings and there's not a particularly significant number. We're tending to see sales rates higher on site opening still. When Redrow reported queues around the building, I could show you photos of queues around a building on a couple of sites that opened in the last month, but I don't think it helps you, if you see what I mean, because it's a couple of sites and it's local interest. It's not a fair reflection overall. When we open a new site we've got lots of interest and, as I say, we're finding a climate in which we can move prices slightly ahead of where we thought they would be, but it's not distorting that data particularly.

The only bit of data in all those comparables in previous years and this year that is a bit odd is a sales rate in July 2015. I think if we went back we'd probably find that was a record for any July ever. Whether that was because of the General Election or whether we did have a particular mix there, we certainly did have one Central London site, and when we launch we'll often have pre-sold, so sometimes on a Central London site when we launch it then we end up booking a lot of sales mechanically at that point, so that could have pushed that. So that one is a bit odd. But the others are all pretty reasonable reflections of what's happening overall.

On build restrictions, it's not that our ability to build has particularly constrained our ability to sell, although there is a bit of that because if we don't have plots to release then we can't sell any more on that site or we tend to release them at a rate so we've always got something to sell but that will naturally slow it down. But our ability to build has restricted our ability to complete, and therefore the order book gets longer, outlet numbers goes down and that we can measure very precisely because we know what we've sold and what normal time we would have expected. In a sense the maths is just about the order book has lengthened from what we'd probably see as a norm of four and a half months to closer to six months on ordinary sites, on low-rise sites. You'd expect more than that on an apartment site, but not on an ordinary detached product or smaller build product.

On hurdle rates our initial step was push up hurdle rates so that you're not out of the market, you're still having the conversation, but we didn't want to immediately contract on any land. Within a couple of weeks you've kind of moved to well actually I want to contract on land if I can find that hurdle rate, but it's too early to say what sellers' reactions are to that. I think sellers, and I would be the same if I were them, are we'll wait and see, thanks very much.

In terms of terms, we've already seen those change. Over the course of the last month, and it varies massively from site to site, there is no one set piece, but the ability, as I say, to move from unconditional deals in the southeast on sort of prime sites to more conditional deals definitely is greater. The ability to put in underage rather than overage, which I've never seen before, and I've always talked about it, "If we've got overage, we've got to have underage", but it's never actually happened. That actually I've seen on a couple of sites talked about. So sellers want to sell, but they're prepared to accept that things might be tough and therefore they need to give something and it tends to be in terms, and terms doesn't just mean the creditor terms, it can mean the risk we take and the balance.

Where that will be in six weeks' time, where hurdle rates, and it's why I'm not giving you a number on hurdle rates, because, as I say, we'll probably use it as an opportunity, because it works strategically, to push up our underlying hurdle rates anyway, but where it will settle down we'll probably know in September or October right now it's a bit too early to say. It feels right to be cautious, to be pushing things out, we don't think we're losing anything, and we'll see what happens.

Ryan Mangold

In terms of sites with overage, out of the 438 sites that we've got in our short-term landbanks, approximately 10% would have overage attached to them.

Glynis Johnson

And is that increasing in general?

Ryan Mangold

No, I wouldn't say that the trend is necessarily increasing. The quantum is increasing because it's the length of time that those sites have been on the balance sheet that we've had this more positive environment, and clearly in a scenario which is not as positive, you only pay the overage once you get to the end and that trigger as to what causes the overage is therefore completed it does give you a bit of downside protection actually, arguably from a cash flow demand point of view.

<u>Question 6</u>

Kevin Cammack, Cenkos Securities

I've got two and I'll try for three.

But just firstly on a point of, again, clarification, on the slide on the short-term landbank, you're quoting 438 sites as calculated from. And obviously you've referred in the statement to 287 being the end June selling outlets. Is that a normal relationship between active and sites that you're on, or is that actually stretched out a bit?

The second question I had was around your comments on the second-hand market and I assume what's going through your mind there is the reliability of chains and to what extent they may affect your ability to complete rather than reserve. If you look at measures like PX and that sort of thing, have you already seen a degree of stress in that relationship, or is it something that, as you said, you just need to keep an eye on?

And the last one I had was picking up a number of questions that there have been around the July data. Without wishing to ask you specifically what the nominal numbers are, can you just give us a broad indication of the relevance of July in the context of the months of the year, as it were?

Pete Redfern

So is 287 outlets and 438 sites a reasonably normal relationship? Yes, it is. There's one caveat to that, there's one trend for us that's been different to the sector and different to our history in the 287. We've talked a lot over the last three or four years about not pushing out the numbers. We've touched on, as well, we just do not double-head outlets and also don't compete directly with our competitors on multiphase sites to anything like the degree. I mean our level of double-heading is tiny and it tends to be sites where we have got either a totally different product or different access points. Whereas others in the industry will tend to drive up their outlet numbers by putting two phases on the same site. We do that significantly less than we used to and significantly less than any of the other major players.

So that means you would expect our outlet number to our number of sites to be proportionately lower. But on that same outlet, we may be doing more from that one outlet, so you would expect to have the sales rate to generally trend above and our build rate to generally trend above.

We just think that double-heading, as we've looked at it, and it's a continual push and pull, unless you can really offer the customer something different. It's like you've seen the site at Didcot, it's so big that actually we've got different access points, they're different places. There we have a couple of outlets, but they're the exception rather than the rule.

And you've seen one of our competitors reduce their quoted outlet number and effectively they're kind of moving in the same direction. We fell into the trap back in 2008 of chasing an outlet target of 500 sites, and then local businesses become obsessed about the number of outlets rather than the quality and what it actually means and how it impacts. So we do think it gives us more robustness than the other numbers, but it tends to mean the outlet numbers are relatively softer and we're pretty relaxed about that.

So it's a normal relationship for us in the last four or five years, it's not changed. Planning has got arguably easier, but the final stage of getting the outlet open arguably harder, but that hasn't massively changed in timing terms to change that relationship, but there is that dynamic of how we consider an outlet opening in the plan of what we're doing on a site and we put less emphasis on it than we used to. We put a lot of emphasis on getting show homes open, being open for sale and having the right quality, but not on can we report an outlet or not, if you see what I mean so it does shift the balance.

In the second-hand market, there are three things that interest us, in a way, directly for our business about the second-hand market.

The first is those direct pieces that you talk about, but it's probably also the least, so it is about chains and it is about PX, and we see very isolated instances over the last month where our cancellations - and you've seen the cancellation rates so this is included in there - are driven by something happening in the second-hand market. And it's generally somebody pulling from their own sale further down the tree, and often because of their job position. It's often about somebody who's in financial services or a business with a strong European overseas link. But you're talking about three or four, so you see them but they're very, very isolated.

The other two I think are more significant, though. We do worry a little bit at the moment about the impact of second-hand data on confidence. Agents can be very bullish and very negative. They tend to swing a lot in their comments and it worries us that that actually sends a signal about what's happening in the market that's potentially a little bit distorted or short-term. And it does flow through into what buyers expect to see and what sellers expect to see, so we worry a little bit about its confidence impact, but also there's the long-term piece. I don't think you can have, long-term, a really healthy new build sector without a healthy second-hand market.

Help to Buy is making a big difference, but actually I don't like the industry being as reliant on Help to Buy as it is, so unless you get a strong second-hand market recovering and rebuilding, and not just the last month's downturn but in fact the second-hand market has been quite slow in transaction volume terms in the recovery over the last few years. I don't think that's an ideal set of market conditions for us. So there are three levels.

But I think from a Referendum point of view, the only one of those that's material is the confidence one. The long-term one was there anyway, and it really is long-term, and the specific detail bits, they're actually quite small for us, but it's the potential to impact on confidence.

And then is July an important month? I think what we've seen through this cycle is a different seasonal pattern. And we haven't really talked about it today, but if we did go back and show you those sales rates graphs through the previous cycle, in really good years, July 2015 is a stonking year in terms of sales rates.

If you go back long-term memory, we're used to see July and August as being 0.4, not .55, .65 or 0.8. So historically, July has not been particularly relevant as a sales month. But you look at the last five months and you look at what's actually been sold in absolute number terms in July, it is much more relevant. Because the only time we see a seasonal downturn really, of scale, is in the last three weeks in December, when people really are focused on other things.

And I think a lot of the reason for that change in seasonality on sales is simply people buy electronically or they go through a lot of the phases electronically, so they can be sat on a beach somewhere, on holiday, looking at Right Move, looking at our website, and thinking, what house do I want to buy. It's not, I'll go away for the summer and not come back. So the seasonality is smooth. But just roughly, and it gives you a bit of a sense, we've sold 750 houses since 24 June, give or take. In the context of our year, that's a pretty sizeable number of houses, so it's not 10s, 20s, it's significant.

<u>Question 7</u>

Scott Fulton, Whitman Howard

I have two and a half I think. The first one is the improvement in ASP guidance for the year, is that due to London delivery in the second half? And if it isn't, why is the margin guidance slightly softer?

And my second question is, if one looks at slide 34, you've obviously performed an analysis on price declines and the cash generation per unit. Have you done a similar analysis on volume declines and build costs per unit? I suppose the question really is: does build cost per unit vary if you reduce your volumes?

Peter Redfern

I think I missed the second one. I got the improvement in average selling price guidance and I got the build cost guidance.

Scott Fulton

So the second part of the first question really is if the ASP guidance improvement is not due to London delivery why is the margin going slightly soft there?

Pete Redfern

The improvement in average selling price guidance is largely because I was pretty cautious with the guidance I gave you before and what we're seeing now is what we would have hoped would have happened at that point, whereas the margin guidance had what we were already seeing in it a bit more clearly. London delivery is not massively different between those two periods but we were looking at some quite bullish numbers at the beginning of the year with lots of other potential risks out there; so giving you all of the upsides, letting that go into forecast and then having to wind something back because something was bound to happen and we don't know what. So it's that caution that lets us really be pretty robust now that we're actually and our underlying guidance hasn't really changed.

On the build cost sensitivities on the sort of, in market downturns, I think whilst we're pretty sanguine about the build cost risks in a reasonably stable market, there will be some pressure but we can absorb them; it's a lot harder to work out if we have a short-term downturn how quickly this time round do build costs correct? It's really quite hard to know in the dynamic that we've got.

Clearly if housing volumes in the UK drop off then build costs come down. The environment we've been in switches significantly. But if housing volumes remain relatively resilient in an area where we've had supply constraint, particularly on the labour side, it's harder to call. So it really is quite difficult to know what the downside protection on build cost is. It's quite easy to calculate it on cash. But on build cost as I say it doesn't have a massive impact on the cash drivers. But it's hard for us to really give you a good sense of what would happen to build costs in that environment. There's clearly some savings but I do suspect the relative savings are less than we saw in 2008 where we had such a dramatic fall off in numbers. But we've never really recovered totally from the resourcing side. So it's a slightly different balance.

Question 8

Clyde Lewis, Peel Hunt

Just one for me Pete please, maybe more Ryan, but in terms of net realisable value…

Pete Redfern

It's definitely more Ryan.

John Messenger

…definitely exactly it's an accounting one but the market, the industry, your business is obviously in a better position margin-wise than it was back in 2007, 2008, I mean margins peaked in 2004 I think didn't they, but at what point do you think your business needs to start looking net realisable values in terms of house price declines? Is it 300 to 400 basis points higher than it was back in 2008, 2009? I'm just trying to get a little bit of guidance from you as to where it starts to kick in and I suppose maybe just tidying up that loose end of that small write down as well in the first half what was going on? Was that a particular site issue rather than obviously some other wider issues?

Ryan Mangold

Sure. I think if you take our land bank and you categorise it into its heritage we've got a fairly small element, now only 4% of the landbank is at that sort of cusp of pricing sensitivity. Now clearly we do this to a gross margin as opposed to an operating margin and so we're therefore quite cautious on our assumptions in terms of doing NRV in terms of some of the recoverability. So a 5% price decline, for example, wouldn't result in any further impairment on those sites, broadly speaking, one or two sites might pop out as I suppose there's one or two that popped out this half year. A 10% price decline you start eating a little bit more into that impaired sites because that level of cushion has almost gone by that point.

And then there's quite a wide range to a sort of 20% decline, if you think about our margins from an investment perspective, gross margin as being mid-20s and outperforming those gross margins by 1.7 percentage points in the period, you've actually got quite a large level of headroom before any of those sites then become subject to impairment.

Now to the extent that we've got something slightly wrong on a site, for example, expectation of a planning gain or, for example, the ground conditions or the technical challenge or to the build cost being a bit more challenging, there will be a few sites that we've aborted post-2009 that could be somewhere between the 15% to 20% range, but the majority of it is actually 20% to 30% as a price decline before an NRV. And in that circumstance I suspect, assuming that the land market is more open for business, we would still be substantially more cash generative because trading out of site where a historical plot cost of say £40,000 per unit, I think we'd be replacing it at probably 20%, sorry £10,000 to £20,000 a unit. So the cash generation whilst margin might be quite low, the cash generation is actually incredibly strong.

Pete Redfern

Just to be clear Clyde it was a write back in the first half not a write down.

Ryan Mangold

Yeah it's a net write back. There is one specific site that we had a write back on which the performance has just been much stronger than our expectation. And then there were a few sites, I think it's two sites that actually had a net write down of the £1.8m.

<u>Question 9</u>

John Messenger, Redburn

Two if I could. Almost just the £10m remediation you'd normally think of that as in the context of your build costs incurred in a six month period as not really being that relevant, obviously you've drawn it out; could you just give us a bit of a flavour as to, were these London sites with some very specific things that you didn't identify when you bought the land? Just to have a bit of an understanding there.

And the second one was just on the pensions and obviously post-Brexit, obviously fantastic control of that at the half-year, are there any corridors or caps as to the insurability of that pension position if we think about an inflation rate at the end of the year or any further shift on corporate bond yields?

Pete Redfern

So do the pension ones first and I'll pick up the £10m.

Ryan Mangold

We've got an active hedging programme to hedge that interest rate and inflation rate volatility. The scheme had achieved 60% by the time we got to June but the plan is to fully hedge that exposure by the time we get to the year-end to take out the volatility. But if you think about it mathematically the biggest exposure we've got is the liabilities themselves. Clearly we need to ensure that the assets are invested appropriately to give us the reasonable amount of return at the expected risk profile that the pension trustees are willing to run, which is naturally going to be more conservative than ourselves in terms of how the trustees will look at it.

And so to the extent that we can hedge the liability then that reduces the volatility and we are fully supportive of the scheme continuing to do that and at the same time expectation of a reasonable return on those assets that are invested which are in excess of £2bn worth of assets.

We've done a small slice of mortality hedging when we did the buy-in about 18 months ago, where the top slice of the pension scheme deficit has been hedged from a mortality perspective. But arguably we've got a natural hedge against mortality, the longer people live the more houses the country needs. So I have this constant debate with the trustees as to saying we are the mortality hedge for you which they struggle to get their minds around but I continue to push the point.

Pete Redfern

And on the £10m I think there's a slight confusing there John in the use of the word 'remediation' these are sites that are closed and done and there are historic construction issues to go back and put right rather than the remediation of ground conditions, if you see what I mean. And you're absolutely right they're not things that would have ever been picked up in a land exercise.

One of them is the Milton Keynes site that has been very painful to us all along. And the other one is not a central London site but a historic apartment site going back to a closed business unit from the mid-2000's. And they are things that are natural in the nature of our business it's just in a half-year with two of them falling in one period they tend to have a slightly bigger notable effect which is why we've pulled them out so you can see the movement. I think if we'd have felt it was right to take them in the full-year we'd have probably not drawn them out because they are fairly natural underlying things. We have a long tail of sites but there's not anything particularly significant there.

I mean that Milton Keynes site has been painful for us because it was an unfamiliar product build and it's just getting the balance right between the exact remediation costs on each unit and the insurance and claim recoveries. And it's actually more the latter that's changed in the first half than the former.

Closing Comments: Pete Redfern

I think we're pretty much there with questions. Thank you very much for your time this morning and we're happy to be around for a few minutes to take questions afterwards but thank you.