Taylor Wimpey plc

Trading Update

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2016 Trading Update

Ryan Mangold

Group Finance Director, Taylor Wimpey plc

Good morning ladies and gentlemen. I am running the call for Pete today. The poor man has got severe laryngitis. He is planning to be on the call but he just cannot speak right now. This is thee trading update for the year ended December 2016 and I will include some forward-looking commentary on the wider markets, as well as the order books later in the call before the Q&As.

2016 for the Group is another record year for the business despite the result of the referendum and the resulting wider macroeconomic uncertainty in the middle of the year and we continue to make very good progress against our medium-term target that we set out in May 2016. Looking at the results, we expect to deliver an operating profit at the upper end of consensus that we believe is £755 million, and expect operating margins to be around 20.8% for the year versus the 20.3% achieved in the prior year.

In terms of housing demand this has remained good for the year despite the wider macroeconomic backdrop as a result of the EU referendum. Customer confidence combined with higher mortgage availability as well as interest rates that continued to improve during the course of 2016 resulted in the UK business delivering 13,881 homes, up 4% year-on-year, and a record closing order book by volume of over 7,500 homes. There is a slight reduction in joint ventures year-on-year in terms of number of completions, and so principally the underlying wholly-owned subsidiaries of the Group produced more than 4.5% increasing volumes.

The order book value at £1.7 billion is slightly below 2015, and this is principally due to a lower order book in our Central London business, as the result of a higher level of completions at the higher price points in the month of December with the rest of the country continuing to benefit from a sustained good demand.

Private average selling prices were up 13% at £286,000 and the total average selling price for the business at £255,000 was up 11% on 2015 benefitting from both mix and market-driven inflation. Sales rate for the year at 0.72 was marginally below 2015 of 0.73 and with the continued low level of cancellations that we saw during the course of the year.

Looking at Land, the short-term land market continued to be positive throughout 2016 and our land bank has remained broadly flat year-on-year at roughly 76,000 plots in the short-term land bank, and remains at optimal scale and in line with the Group's strategy. We converted over 9,000 plots from our strategic pipeline into our short-term land bank in the year, and this remains a key focus area of land supply into the future. Mindful of the wider macroeconomic backdrop created by the outcome of the EU referendum and our high quality and optimal scale land bank we remain selective in further land investment and expect this to largely remain in balance for 2017.

Our Spanish business has delivered a strong result in the period and is expected to report a significantly-improved operating profit versus the £10 million delivered in 2015. The business also remains well-positioned with a very strong order book at 293 homes and a decent land bank for delivery into 2017 and beyond.

Our net cash position for the business at the end of the year was slightly ahead of prior guidance at £365 million, and this is up £140 million on the prior year after paying out £356 million in dividends.

The improved profitability and continued focus on balance sheet discipline has meant that we expect to deliver a return on net operating assets of above 30% for 2016 versus the 27% achieved in 2015.

As we look forward we think that the positive housing market trend we saw in the summer and through the autumn after the EU referendum has continued and we are not expecting any change to that in the short-term. As noted in November 2016 in our trading update, we expect volume growth in 2017 of around 4 to 5% year-on-year and average selling price growth of around 3% for 2017. If we look at the change in build cost inflation and the build cost drivers, we expect the guidance to remain broadly the same with inflation running at around 3-4% for this year.

In summary, the strong order book, the high quality land bank position, as well as the strength of quality of the overall business positions us well for continued progress against our medium-term target that we set out in May 2016 which, just as a reminder, is an operating margin of 22%, a return on net operating assets of over 30% and returning £1.3 billion to shareholders by way of dividends through 2016-2018.

Q&A Session

Will Jones (Redburn): First, just coming back to the volume guidance for 2017 of +4-5%, clearly as you start the year with outlets lower and I doubt you are thinking that sales rates change much versus last year. Are you thinking that the order book at the end of the year could drop? You did say it is at record levels. I was wondering what you would be happy to run that order book at more generally to deliver completions.

The second was around margin. To get an idea when you talk about margin progress this year, I think you usually work on the basis of thinking that prices like-for-like stay flat from here forward but you bake in your build cost guidance that you are thinking through the year. Is that the case as you talk today?

The last one was around London. Clearly November you flagged in your Central London business that you were moving on price. I wondered to what extent that had worked in terms of gaining customer traction. Thanks.

Ryan Mangold: On the volume guidance that is principally on outlets as opposed to sales rates. As we have said before, a sales rate of about 0.72 to 0.75 for us would be the normal healthy mortgage market sales rate. The volume growth then will be hanging off more outlets than it does out of sales rates. There has been a slight shift during the course of 2016 by the way that we measure outlets from a technical point of view. We still classify an outlet as any place that you can buy a home but what we have delayed is the business's ability to launch an outlet for promotion / for marketing until we are far more progressed on the infrastructure and installing, and dealing with some of the technical complexities, as a consequence this will reduce the outlets ever so slightly.

In the wider marketplace, certainly what we are seeing on the ground from a customer interest point of view, from a reservation perspective, we believe that the outlets which will be opening during the course of this year for sure should continue to have the same level of demand as we have seen in the second half of last year. That is the underpin really of the volume guidance. It is not really an order book position from our perspective because there is an ever so slight difference if you look at 2015 versus 2016.

Will Jones: It is not that you are banking that the order book drops at December 2017 on December 2016 particularly. It is more the outlet position that should deliver the volume growth.

Ryan Mangold: Yes. We are not expecting the order book to decline in the number of units and arguably in pound notes at the end of 2017 versus the end of 2016.

Then on margin guidance, as we have indicated, we expect sales prices all things being equal without any sort of market inflation to be up roughly about 2-3% year-on-year. There is a small amount of mix still to come through as well as capturing some of the pricing growth from a market perspective that we would have seen during the course of 2016 that sits in the order book. We are pretty certain on the build costs for this year, as you can imagine we secure these relatively far ahead. We do not think that that will necessarily be an influence on the margin.

Will Jones: Just to be clear, when you say margins overall rise this year, that is with the expectation that you see some gentle like-for-like inflation from here?

Ryan Mangold: That is correct, Will. If you think from an operations point of view, we generally are procuring relatively far forward so we have got a good understanding of what it is going to cost us, certainly for the first six to nine months on average for delivery from a cost perspective. We have contemplated that margin and build cost will increase from an inflation perspective in our guidance on margin.

Then you had a question on the London markets, specifically with regards to the order book. As we flagged during the course of 2016, the London markets, certainly the prime London market, not the Greater London market, but the prime London market was slightly slower during the course of 2016 than it was for 2015. We enter this year with a lower order book relatively-speaking and a forward-sold position relatively-speaking for London in 2017 versus 2016. That is contributing to some of that reduction.

Will Jones: In terms of on-the-ground feedback from the sites around the price move that was made in the second half of the year and to what extent that is generating an initial interest or reservations, is it too early to tell? What is the latest from that part?

Ryan Mangold: I think we saw an increase in interest in the fourth quarter of last year where I think there is a bit more certainty on the exchange rate fundamentals. The prime London market for us is completely underpinned by the foreign buyer, and I think that there was probably a little bit more comfort and certainty on the exchange rate fundamentals which I presume is making it and resulting in it being a bit more attractive for the foreign buyer. It is probably slightly too early to call it but the interest level does seem to have increased.

Clyde Lewis (Peel Hunt): Just a couple on land, if I may, and also maybe on regional plans. Ryan, you referred to land bank level being optimal, but increasingly we are hearing more and more moves from central government to try and increase and speed up the planning system. How your thoughts about that land bank level are evolving post-Brexit and what you are seeing regionally in terms of prices and margins? How have things moved on that front?

The second one I had was on regional plans. Have you got any current thoughts about whether or not you want to start opening any more new regions in 2017?

Ryan Mangold: On the land bank being optimal scale, it is 76,000 plots or so. We have not really shifted from our position, Clyde, on the length of a land bank for the execution of our business model being roughly about five and a quarter years or so. At 76,000 plus that certainly gives us a strong ability to deliver the growth aspirations that we are wanting to do, and also to do them in the right way. There is no doubt that the government's continued support in trying to ease the planning process to make more land available and to expedite the planning process does mean that we in theory can get onto sites slightly faster. That positive focus by government has meant that we have had a more significant and continue to have a significant contribution of strategic land promotions into our short-term land market. It is also into our short-term land bank, so we are not overly reliant on the short-term market for delivery of our requirements so that is why we use the words of optimal scale in the land bank.

If you look at the prices and margins from the investment point of view, given that we have got a strong land bank generally and in great locations that we want to operate from, it does give us a huge amount of optionality and clearly significantly underpinned by strategic land bank as a form of land supply into our delivery process. We still continue to remain selective, we indicated last year that we nudged margins a fraction during the course of 2016 and we expect that to broadly stay. Where we are at today we are not looking to push those margins much further than they are, we think they are about at the right level but we will continue to pursue sites that we think are right for our business from a delivery point of view.

How does that then translate back into land prices and actual land cost onto the balance sheet? I think that that percentage land cost as percentage of revenue should stay broadly static which you will recall was roughly in our land bank 16-17%. Clearly there is some mix variation on that, the closer you get to London and the South East the higher the percentage land cost is of the total. We are not looking to make any massive regional shifts or open up new regional businesses for delivery of our strategy. We think that we have got the business in the right place in the right shape and the right locations for doing what we are wanting to achieve, which translates roughly to 4-5% volume growth year-on-year which we think is about right for our business.

Glynis Johnson (Deutsche Bank): Two very simple ones, if I may? First one, is there any update in terms of the timing of the Housing White Paper? Do you have any update that perhaps you can give us?

Then second of all in terms of your strategic land, the 9,000 conversions is obviously a strong number. I am wondering, is that just greater success than necessarily you gave us in terms of the risk rated number or is there some sort of element of timing in there that may have an impact for 2017 strategic land conversions? Thank you.

Ryan Mangold: I think our latest understanding on the White Paper is that it comes out next week, I know that is that it has moved in the lead-up to Christmas they had changed the date. Our understanding is that it is published next week, Glynis.

On strategic land, the 9,000 unit promotions, there is probably if you got back three years or four years ago it is probably slightly ahead of what we thought that we might be able to get out of the strategic land bank. If you go back to the analyst presentation we did in 2014, we were looking to convert roughly about 7,000-7,500 units out of our strategic pipeline so it is slightly stronger than we originally set our stall out a few years ago. I think that probably points to the planning process being ever so slightly better and improving which overall for housing supply purposes has got to be good for the wider UK and the business as a whole.

On a look-forward basis, are we going to expect the run-rate now to be at about 9,000 every year? It certainly has been that for the last two years but we cannot necessarily promise that is going to continue. That very much depends on the planning environment at a very local level.

Gregor Kuglitsch (UBS): First, can you maybe summarise what you actually think the White Paper will say from your perspective? What is your feel?

Secondly, this may be linked, can you update us on what is happening on starter homes? It is a bit of a relic I think from a policy perspective but what are you thinking on that front for this year? Thank you.

Ryan Mangold: I cannot really comment on the content of the White Paper. My general sentiment though is clearly the government is massively focused on increasing housing delivery and housing supply, given the imbalance between demand and supply fundamentals that has existed for such a long period of time. As a consequence, being a pragmatist I would expect it to be supportive of the industry as opposed to unsupportive. However, I am not a politician and I cannot conclude on that so I cannot say much more.

On starter homes, there have been some recent announcements of a few schemes that have actually launched with the context of starter homes. From our perspective, provided we have got an understanding of the shape of what the planning permission is going to look like then the starter homes clearly hang off the planning permission and the planning permission that hangs off the price of the underlying land itself because that influences the greater development value and the cost of execution. In theory that should not have a big influence either way to us. Net-net you would expect it to be a positive, but clearly the devil is going to be a lot in the detail in terms of how this is going to evolve, and also most importantly be embraced and executed at a very local level when we go for planning in all of the committees around the country.

Andy Murphy (Bank of America Merrill Lynch): I was just interested in the Redfern Review. Obviously as a firm you are quite closely linked to that. I noticed in reading it the distorting impacts of the Help to Buy was highlighted. I wondered with the White Paper coming up what your current views are as a firm around whether that might or might not be altered or become more focused in some respects?

The second question was around cancellations. I wondered what changes you have seen there, considering there were about 12% in half-one and 13% for the full year simplistically implies 14% in the second half. I was wondering whether that increase in the second half was all around the July / August time or whether there has been some other change that you could perhaps highlight to us. Thanks.

Ryan Mangold: It is a pity the author of the Redfern Review is unable to speak right now but I will do the best I possibly can to answer that question, Andy. If you go back to why Help to Buy launched. Help to Buy was launched in order to fill a massive gap in the mortgage market where the customer could acquire a mortgage at sensible interest rates with only a 5% deposit, which was the long-term average for people to be able to get onto the property ladder and arguably move in the first few rungs of the property ladder. As a consequence, it was a massive filler for customers who had access to the 5% and no more from a mortgage lending point of view and hence it has been so positive for our customers. About 40-45% of our private sales are Help to Buy, so it certainly is a solution and a policy by government in supporting the customers to be able to get onto the property ladder and move within the property ladder.

Clearly what it does do though for a sector, supplying new-build housing, it does create an environment which has an overdependence potentially on a government-sponsored scheme, and that is what we are a little bit more reticent on in the longer-term unless it can be continually underwritten for a long period of time. We do not think that that is necessarily the right answer to have that constant underwriting. However, for the time being it is a very attractive tool for customers. The government has extended it to 2021. We are not necessarily expecting to see any change against that in the coming out of the White Paper. Over time it should be adjusted as the mortgage market returns back to normality when 95% loan-to-value at sensible interest rates is reasonable. I think that second point probably hangs off a little bit about bank regulation and mortgage regulation. We cannot really go there, which came as a consequence of the financial crisis and a more regulated environment for both customers and lenders. I am not too sure what kind of influence that might well have on the decisions in the future because that is the only real other avenue for mortgage availability to be available at 95% loan-to-value is that the bank regulation needs to soften for first-time buyers which is an unlikely outcome.

Andy Murphy: OK, and on the cancellations?

Ryan Mangold: On the cancellation rates running a fraction higher, half and half, you are right in pointing out there is nothing really systemic that we have seen in that being a fraction up. We did see a relative increase in cancellations just post-Brexit, but nothing that we could really read into the numbers would indicate any issue in the wider market.

Charlie Campbell (Liberum Capital): I have got three, if I may, hopefully quite quick. On land creditors, I was just wondering if there is any movement in there to speak about to help us understand the cash position.

Secondly, on the margin in 2016, it is up 50 basis points. I was just wondering if you could help us with the underlying build cost inflation and underlying selling price inflation through 2016 just to understand that because clearly quite a few mix shifts going on there.

Then lastly, a quite topical point given the press today, if you could remind us some of the safeguards you have in place about build quality and year-end completions, just as a point of interest over the last few days. If you could help us with that, thank you.

Ryan Mangold: On land creditors, we are expecting to end this year a fraction down on land creditors versus 2015. I think 2015 ended at about just over £630 million worth of land creditors. We are expecting to end in the £500 millions for 2016. There is nothing really in that in terms of driving the cash dynamic in terms of 2016 performance versus 2015, so broadly static but the gross land value is staying broadly static as well. No significant moves overall.

On the margin in terms of the margin reconciliation about how much of that average selling price and how much of that build cost we will give a full update to that on 28th February with the traditional table of reconciling margin year-on-year. Clearly there are quite a number of moving factors, and you also do need to bear in mind that charge that we took in the first half of the year for remedying some previously-closed sites from a build perspective. That is taken out about 0.3/0.4% of the margin year-on-year. Stripping that out we have made about 0.8 percentage points of growth. We do need to bear that in mind.

On build quality and build delivery and build timetabling, as I indicated upfront, Charlie, what we have done during the course of 2016 is massively focus on customer services. That is not only the quality of the home that we are delivering but it is also the actual customer journey that the customer goes on from the moment of reservation all the way to final delivery. As a consequence, we have added approximately two weeks to our build programme that sits somewhere between the CML and final delivery of the keys where we can go back into homes and do what we call our Home Quality Inspection. That sits outside of sales and sits outside of production to ensure that the unit that we are delivering to the customers is of the quality that we are trying to strive for as a business.

On the point of a customer journey, what customers get quite frustrated about is not delivering on our promises in terms of timescales of delivery. As a consequence to that, we have shifted when we are willing the business to be able to go onto market a site and only under exceptional circumstances will we be marketing from a cabin or before we have got to at least oversight of the showhome complex so at least all the technical challenges or any other kind of planning challenges or site challenges can be resolved before we make that promise early doors to customers before we go on sale. That second point probably also contributed a little bit to the order book being a fraction down year-on-year because we simply are not marketing before we believe that the site is ready to market to ensure that we start customer journey in the right way and deliver in a far more sensible and balanced fashion. We are not in the game of rushing this at the end because that is not what we are trying to achieve as a business.

Kevin Cammack (Cenkos Securities): I am glad to see it takes illness for Mr Redfern to be lost for words on these occasions. Two points of clarification for me. In relation to the comments you have made, Ryan, around this reclassification of what constitutes an outlet or at least a timing from when you will take a sale or reservation on that outlet, could you talk me through again what exactly you have changed? In relation to the decline in what you declare as outlets, on the new definition what would be the like-for-like change? Would it still be down or would it be flat?

The second point, again clarification point, are you effectively saying that all or frankly more than all of the £100 million decline in the forward-sold position is accountable by London?

Ryan Mangold: On the question of outlets what would have traditionally happened in the past, not in every circumstance, but in quite a few circumstances, is that we would have established some kind of cabin to sell from whilst we would be trying to get on site to break ground and put in some of the infrastructure. Once you have got that cabin open we would have pulled a trigger as to say when you can start marketing on the expectation that we will be able to deliver against that forward-sales positon and the promise you are making to customers at that point in time. As I have said, it is only in exceptional circumstances now that we are actually willing to be selling from a cabin in advance. As a consequence, I think that there is approximately probably 12 to 15 outlets from 2015 would not be outlets on this new way of doing the execution from a delivery. Bearing in mind that the definition of an outlet is somewhere where you can go and buy a home from us, so it is open for you to be able to buy a home. That has not changed from a technical point of view. It is just the timing that where we are on the delivery of the infrastructure and accessing the outlet has changed. It is probably three to four months slightly behind from where we traditionally would have done in quite a few circumstances.

It is back to that point on the customer journey. If you are coming to one of our outlets to buy a home and we are promising to give you the keys in six months and we have got a huge amount of dependence on somebody else doing, for example, 278 works, or something that is completely out of our control or something gets stuck in the final knockings of discharging planning obligations before we can physically get on site and start breaking ground, that is out of our control then it is really hard for us to make a promise to customer we are going to deliver you the keys if that is out of our control. It is all that we are trying to do to address that point, to make it far more in our control when we are opening outlets that when we are marketing we are far more confident on hitting the timescales of delivery of those keys, to what is generally an aspirational purchase for almost all of our customers.

Kevin Cammack: In a sense, is the next step not simply to say, 'Okay, we will not take the reservation until we are at slab?' Then there is almost no question that the delivery cannot happen.

Ryan Mangold: That is exactly where we are at. We generally are only going on to market now when the show home complex is at least at slab. When the show home complex is at slab we have got the basic infrastructure into the site, which means that we have addressed the technical challenges of doing that. We might still take a little bit on a risk-rated balanced basis on how far, for example, off-site 278 works on roads have been progressed. However, we are trying to be far, far more sophisticated upfront on sites from a delivery point of view. Far, far more sophisticated, because on the back of that customer journey the biggest frustration is simply not delivering the home against the promise of the timescale that we said. The second point against it which is clearly very, very important, is that the quality of the home is much better.

On the quality point we have added two more weeks to our build programme to ensure that we get it absolutely right and that is an independent part of our business that is going to check the quality to ensure that meets our requirements and our standards. The upfront, in terms of opening or classifying an outlet as available until the infrastructure is in place and at least the show home complex is at slab level, also remains valid.

We have had circumstances, Kevin, there are one or two sites that I have been two where we are far, far beyond that, where we actually have not launched for marketing. The show home complex has been completed, and this is a slightly smaller site that I am talking about, we have got slab for about 50% of the site and we still have not classified it as an outlet simply because the 278 works have not been discharged, which is something that is out of our control. We are not ready to take that risk in that circumstance because we were not confident that the 278 works would be addressed at the timescale that we thought were reasonable for us to market the scheme.

Kevin Cammack: That is brilliant, understood. And the London...?

Ryan Mangold: In terms of the London order book, we started 2016 approximately 75% forward-sold for 2016 delivery in London. We are starting 2017 a fraction lower than that, bearing in mind that London only does about 300 homes a year in terms of the Central London business. We are fractionally lower than that, but the price point that we sell at in Central London is relatively high. You do the maths on a relatively higher price point against a very small number of units, you still end up with a relatively large number from an order book perspective. Overall, we are not concerned about the London market. As I said, the interest in activity in the fourth quarter seemed to improve. It is a matter of taking that interest in activity and converting it to actual reservations and then on to completion and would be the opportunity for us in 2017.

Kevin Cammack: That would be the only region in which the order book into this year is lower?

Ryan Mangold: Yes, in terms of overall price points, regionally there are some individual regions where the order book might be slightly lower. Our target generally is to start the year above 30% forward-sold for the following year's volumes. All three regions, outside of Central London are above that threshold. London and the South East is much above that threshold given it has got a slightly higher weighting towards apartments. Those that are more traditionally built homes in the North and Central and South West they are above that entry point at the start of the year. That positions us well in that tactical approach that we implemented about three years ago. It is partly being in a very strong position ahead of the spring selling season so we can draw out the best value for every home sale that we make.

Closing Comments

Ryan Mangold

Group Finance Director, Taylor Wimpey plc

As you can see from the trading update and from the outlook comments I think that the business remains well-positioned for delivery of our medium-term targets we set out back in May, as well as the strong forward-order book and strong land position. It allows us a greater level of flexibility during the course of 2017, and I look forward to catching up with you and, Pete catching up with you, most importantly on 28th February with the Full Year Results Announcement. Thank you very much.