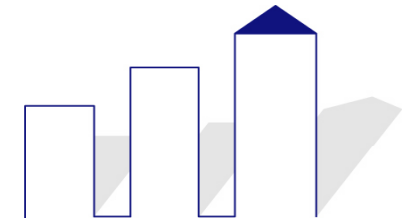


BUILDING VALUE



UK Housebuilding Sector



2011

Great Depression of 1929 to 1941

- There is little doubt about when the Great Depression started i.e. October 1929 with the Wall Street Crash
- But many esteemed academics say that it did not end until 12 years later on 7 December 1941
- This was the day on which the Japanese bombed Pearl Harbor and the United States entered WW2
- Only then did the process of recovery in the World's largest economy accelerate

“GD2”

- As we begin a new calendar year, the tumult of the last one on the global socio, economic and political stage remains fluid
- Close to home, too, there are palpable risks of a Eurozone breakdown and sovereign debt default which would condemn the entire region to the “Great Depression 2: the sequel”
- As with “GD1”, it would be hard and long; and an alternative title - “The Lost Decade” - is already being bandied about
- GD2’s conclusion might also only be wrought by armed conflict; for which there are plenty of candidates

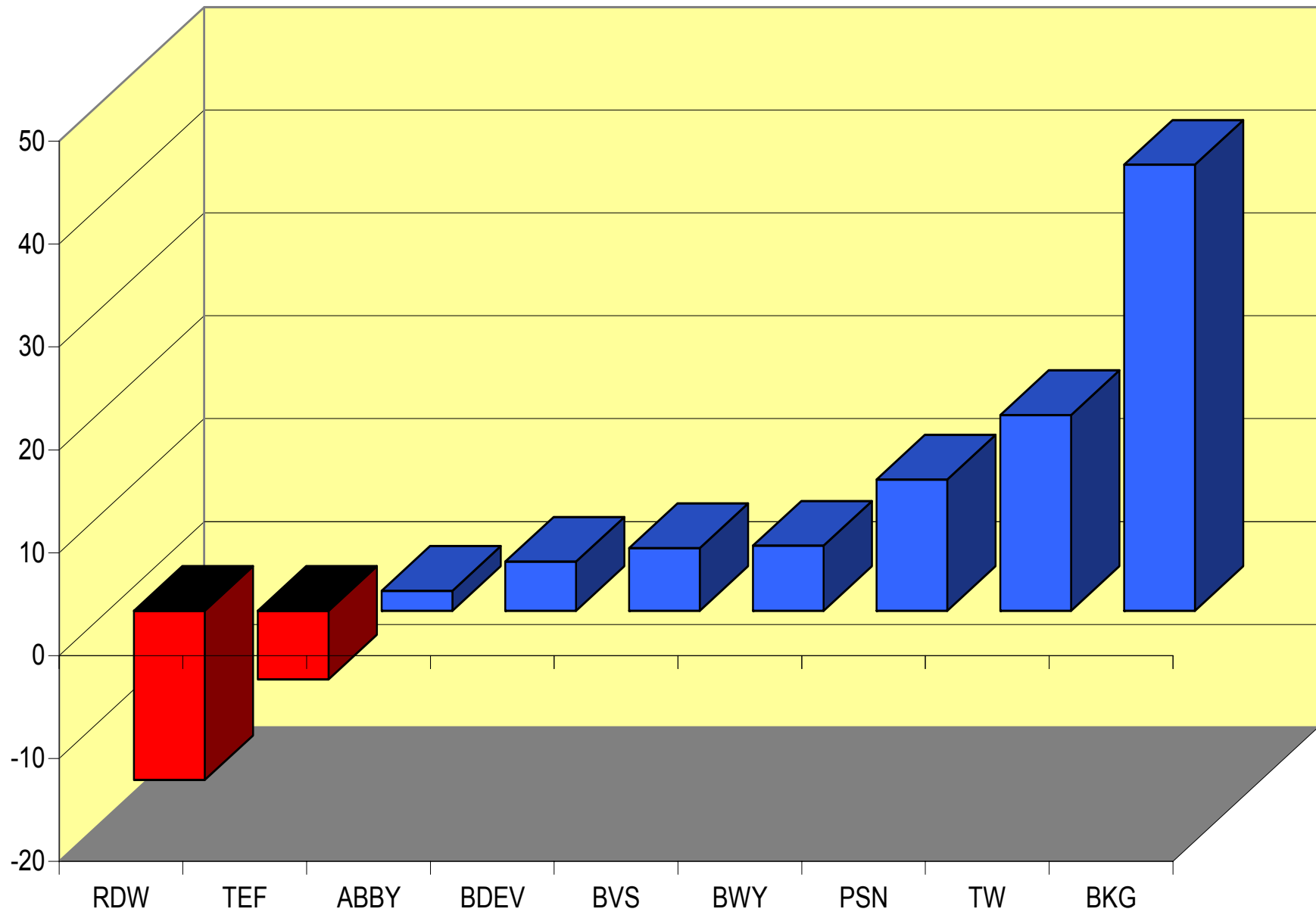
Plan B

- Risk is one thing, actuality another - and while it would be errant to ignore it, you can't sit around worrying about it either; otherwise we would still be sitting in damp caves
- Day follows night, as it always does; and, in particular, it is very encouraging to see the scale of global mergers and acquisitions which continue to occur
- For example in 2011, the amount committed here rose 3.2% to \$2.26 trillion according to Bloomberg (despite a poor Q4 and a number of regulatory locked doors); and the OECD is even more optimistic with a forecast rise of at least 7%
- Someone is planning for sunny uplit lands again

Plan C

- Looking through the mist also applies in the UK residential market, when the likes of Berkeley buys a big site like Beetham Tower on Blackfriars Road in London - out of administration
- Property Week guessed it was worth up to £85 million and that it has a potential gross development value of £700 million
- This same rule applied to the UK Housebuilding Sector and its share prices in 2011

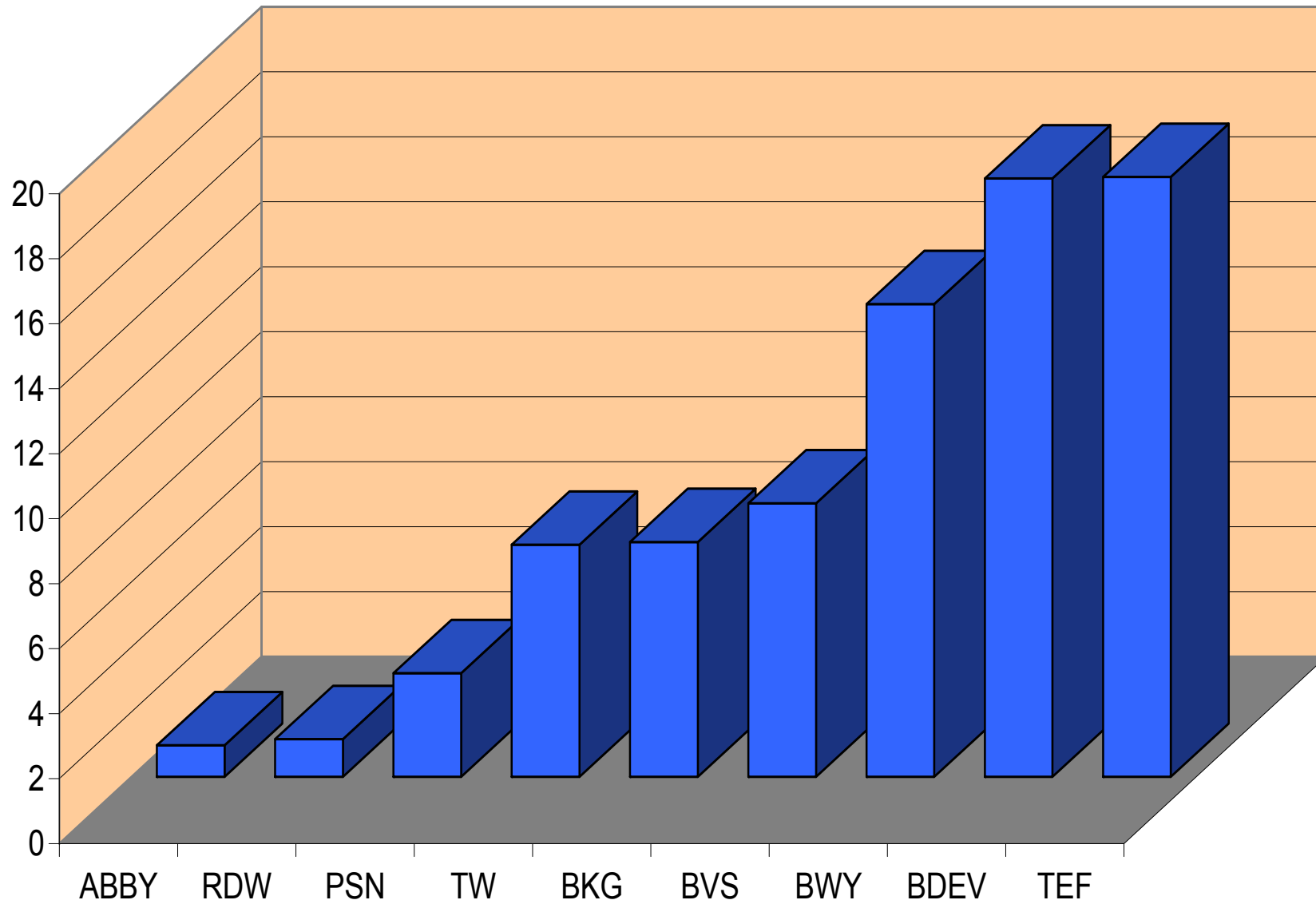
Share prices in 2011 - % change



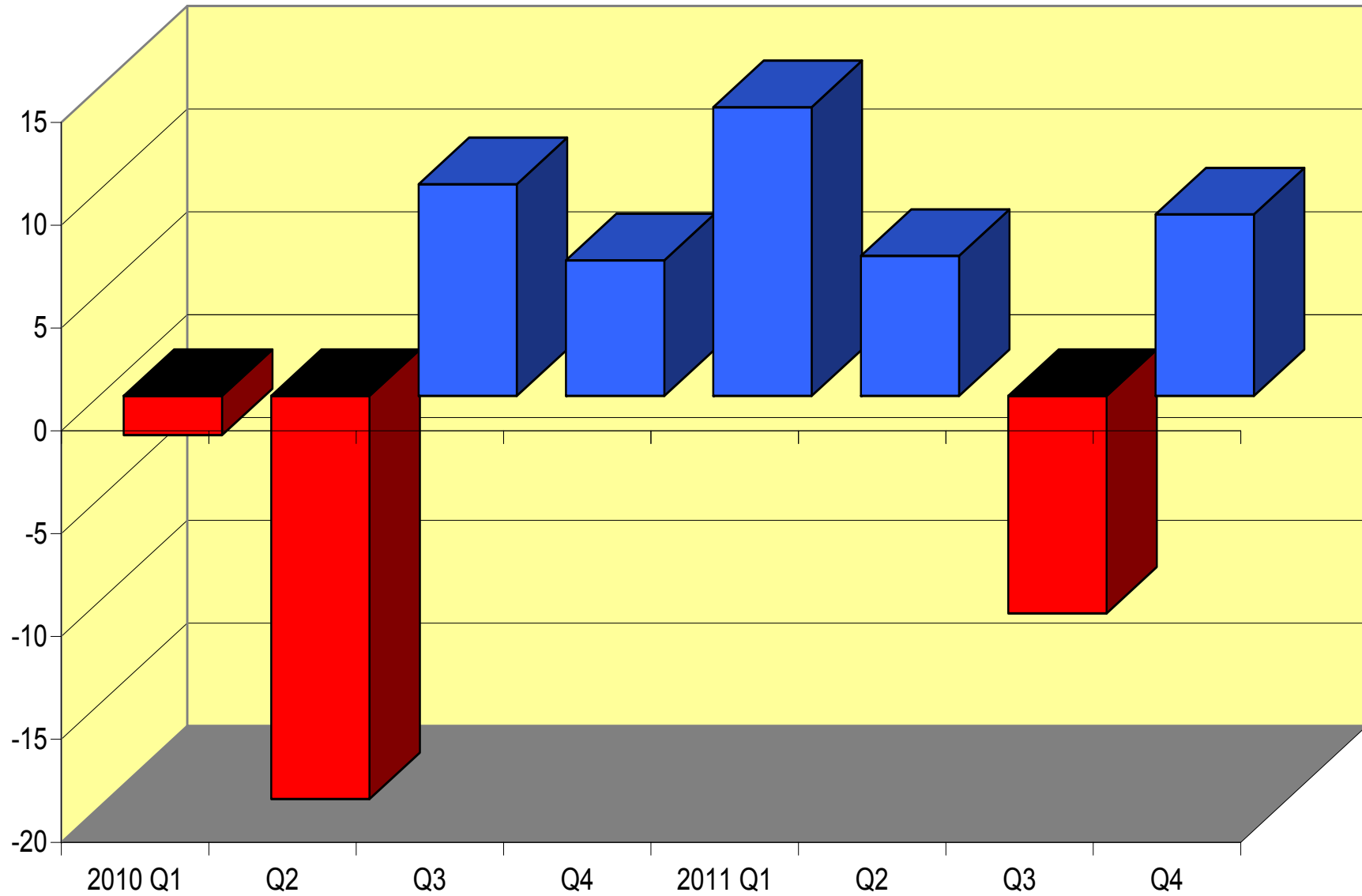
2011

- Housebuilders' share prices rose by an average 8% in 2011, on an actual basis, and 17% weighted by market value
- However, without Berkeley's 40%+ surge the gains were 4 and 9% respectively
- Honourable mentions also go to Persimmon (+13%) and Taylor Wimpey (+19%)
- But two share prices finished the year lower: Redrow by 16%; and Telford by 7%

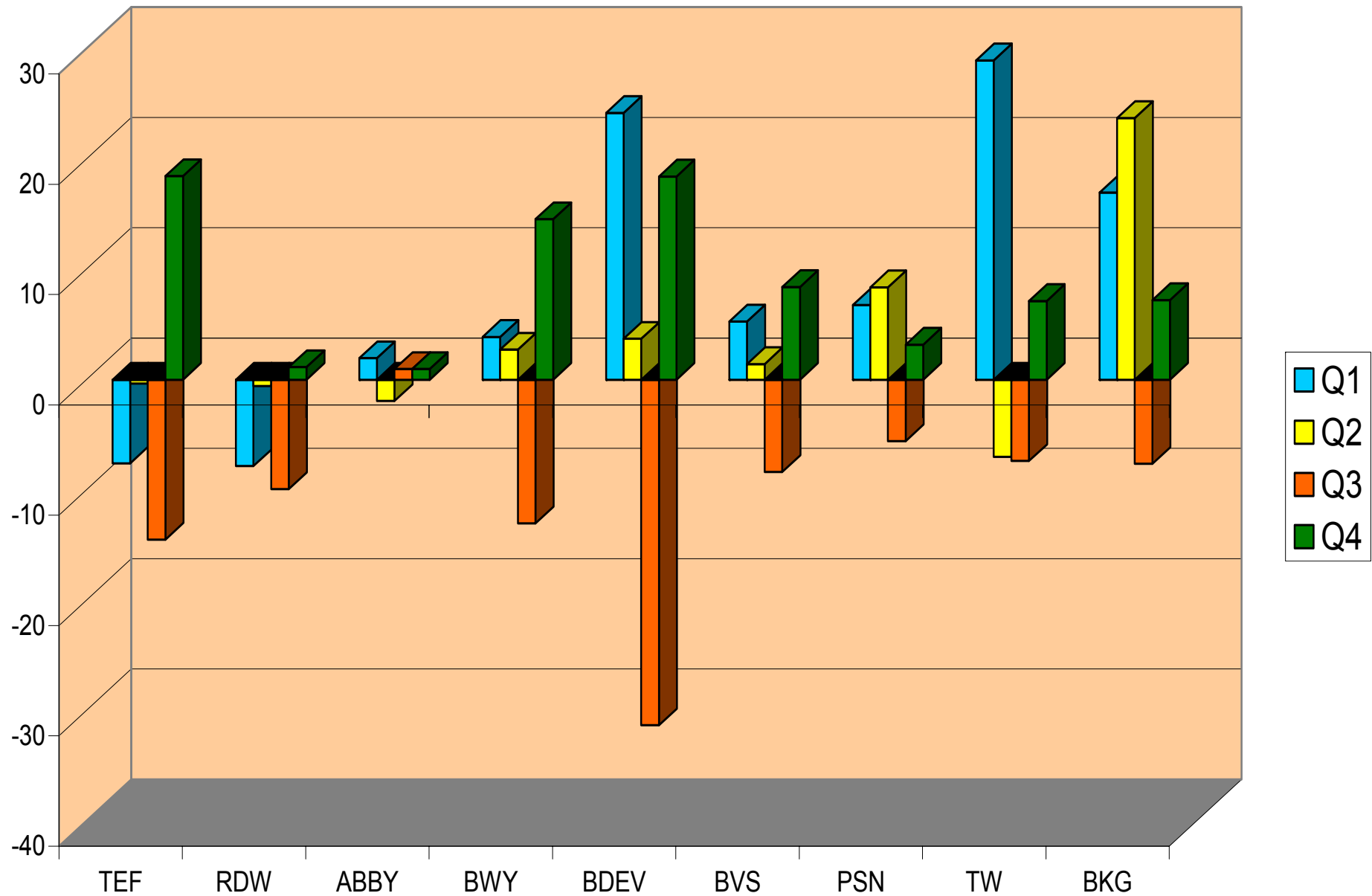
Share price performance in Q4 vs Q3 2011 (% change)



UK housing sector: % change in value quarter by quarter in 2010 and 2011



Individual share prices in Q1, Q2, Q3 & Q4 of 2011 - % change

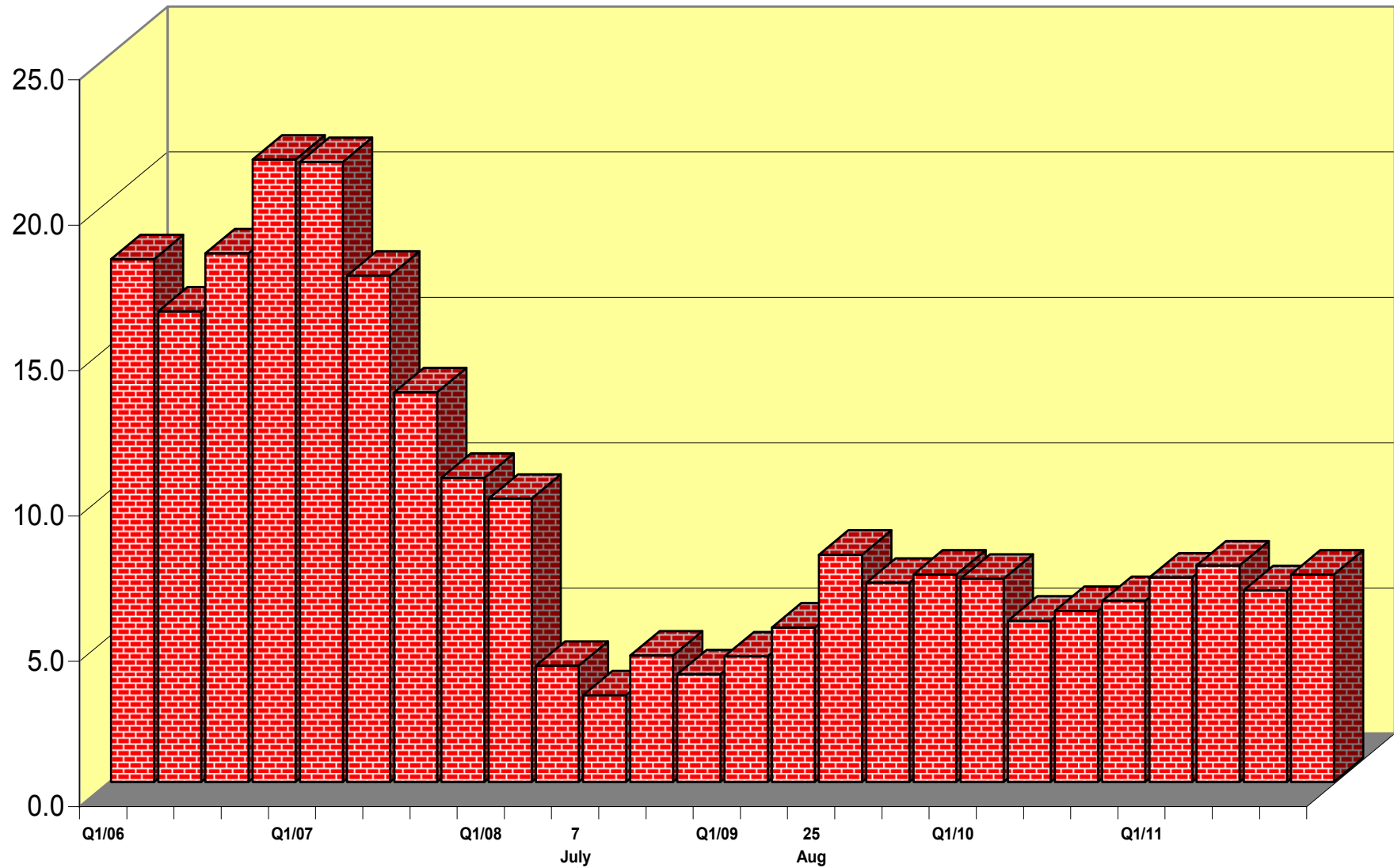


Quarter by quarter

- Q4 was a good one with an average share price gain of 9% (actual & weighted) with all stocks in the black and both Barratt and Telford ahead 18%
- For the record Telford (20/09/11) has forecast it will double profits by 2013
- There were also Sector gains in three out of the year's four quarters, with only Q3 letting the side down with a loss of almost 11%
- Individually five stocks rose in three out of four quarters (Barratt, Bellway, Berkeley, Bovis and Persimmon)
- Only Redrow fell in three out of the four quarters

UK Housebuilding Sector - market capitalisation (£bn): quarterly from Q1 2006 to Q4 2011

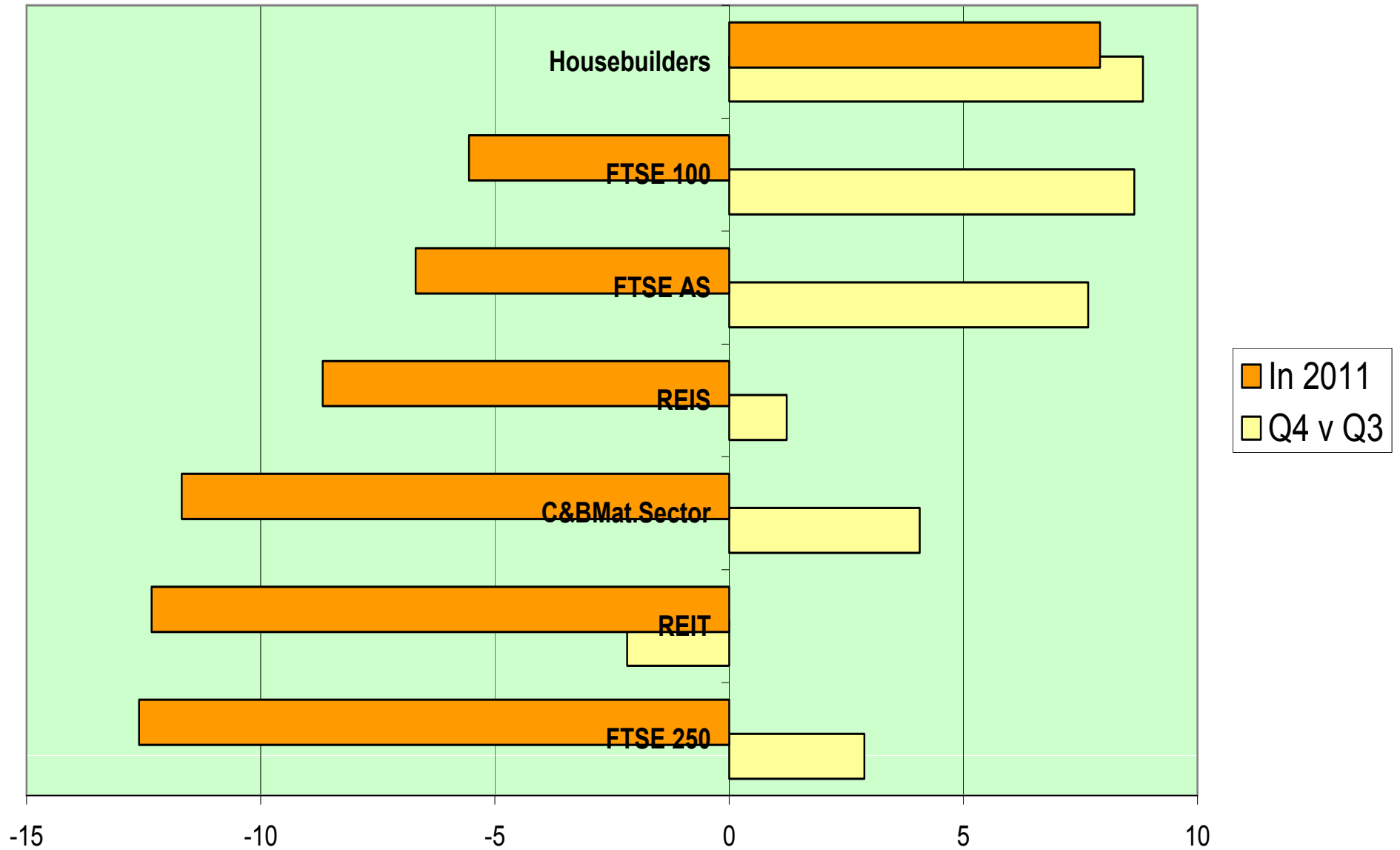
- 7 July 08 (most recent low); 25 August 09 (most recent high) -



Market value of £7.1 billion

- At 30 December, the Sector's market capitalisation was £7.1 billion, which compares with £6.2 billion at the end of 2010
- Note, too, that at end June and September the value was £7.5 billion and £6.5 billion respectively
- In the Spring/Summer of 2007 the Sector's peak value was £21 billion
- The most recent 'peak' was 25 August 2009 (£7.8 billion) - which was challenged in early May - with its 'low' on 7 July 2008 at just under £3 billion

Relative % change to in 2011 - and Q4 vs Q3 -

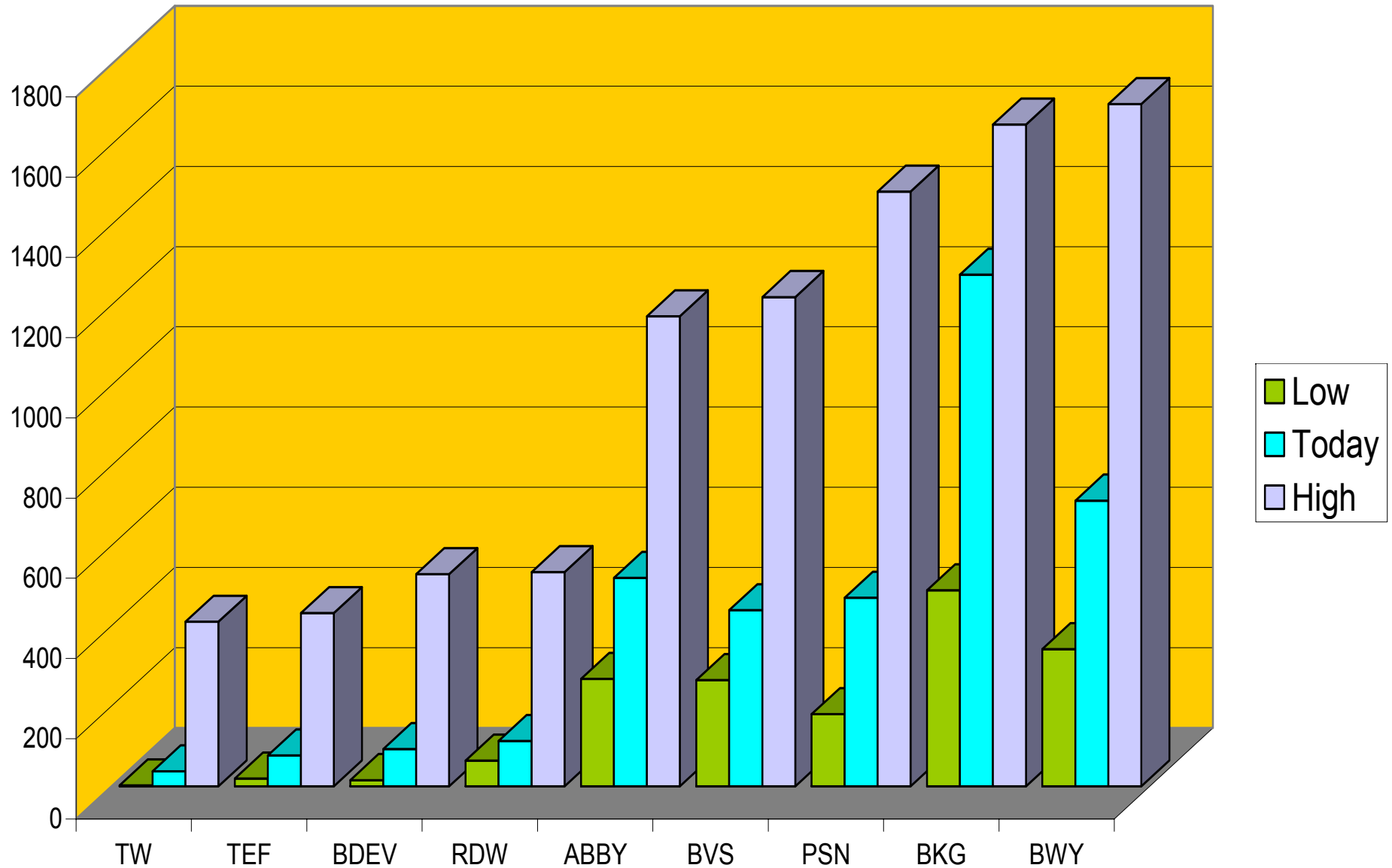


Relative performance

- In 2010, the Housebuilding Sector (+9%) saw off the principal FTSE indices which all fell by between 6 and 13%
- Similarly, Construction & Materials (-12%) plus both REITs (-12%) and Real Estate Investment & Services (-9%) had a poor year
- In Q4, Housebuilding (+9%) did well again but so did pretty much everyone else with the FTSE 100 also ahead by a rounded 9%; albeit REITs (-2%) dipped again

Peak share price, today's price (30/12/11) & recent lows

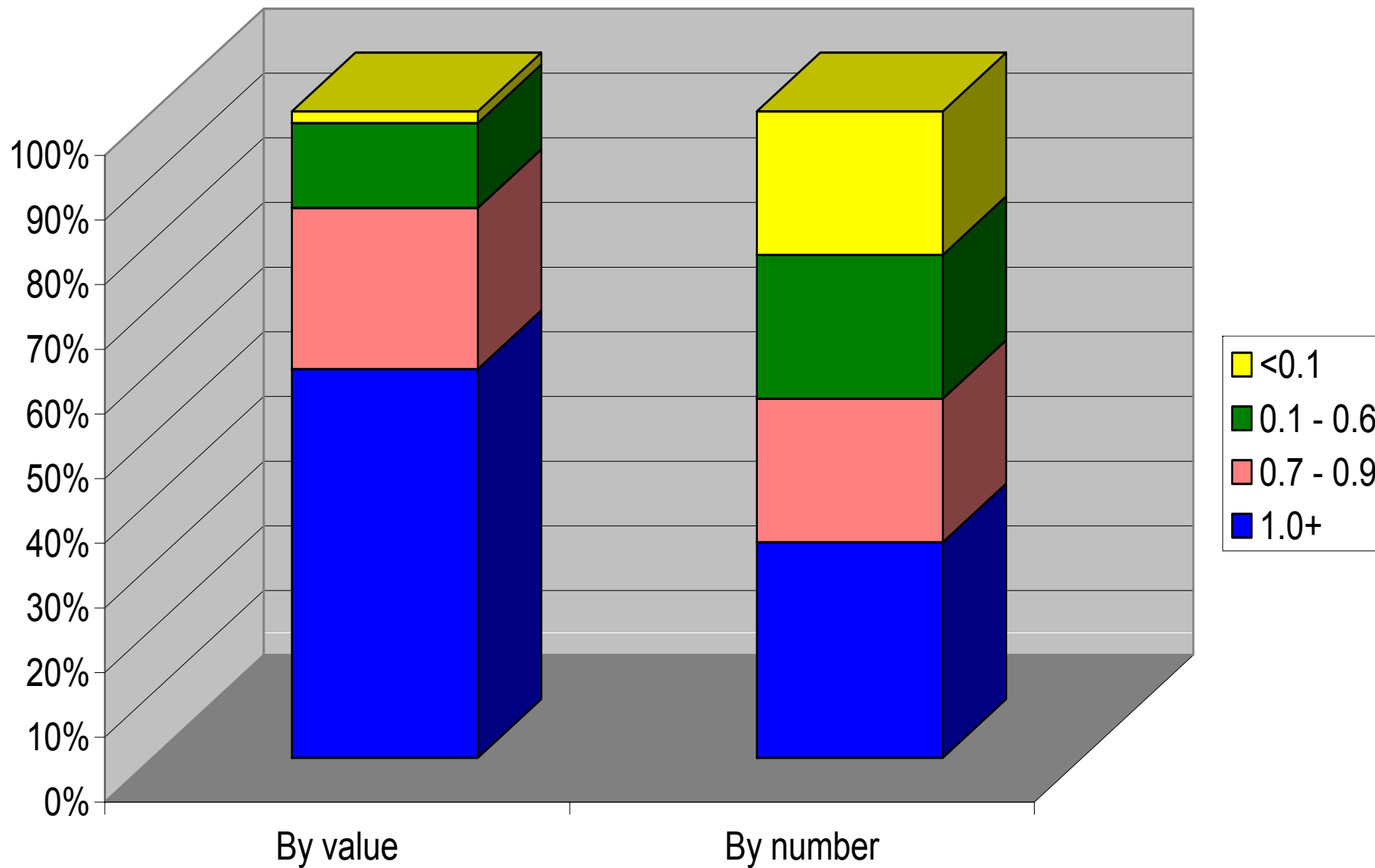
since 2002 in pence per share; except Abbey in Euro cents



Peak values / Sector structure

- Prices are, on average, three-fold up from their all-time lows of Q2 and Q4 of 2008 (mostly) and, on a weighted basis, nearly four; plus they are 31% above their current 52 week lows (37% weighted)
- Conversely, they are also 67% below their 2007 peaks (62% weighted); and 12 to 13% below 52 week highs
- This means the Sector is worth a little less than Old Mutual, the insurer, which is 48th in the FTSE 100
- Three stocks - Berkeley, Persimmon and Taylor Wimpey - are worth more than £1 billion each and together account for 60% of total Sector value

**Sector structure by market capitalisation (£7.1 billion)
& number (9) of companies [legend is in £bn]**



Price Earning Ratios (PER)

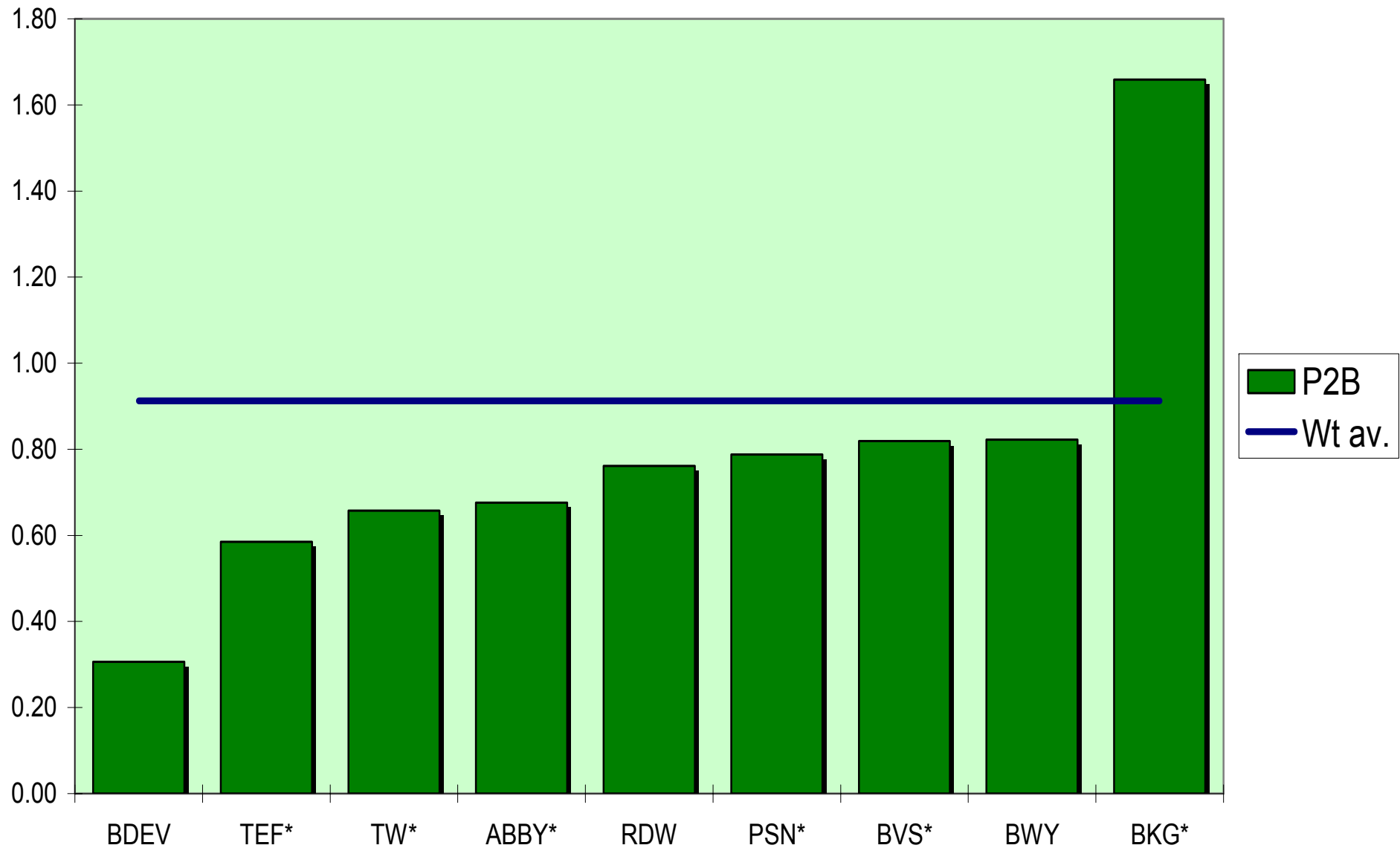
- Amid a number of loss making or marginally profitable companies, calculating a 'real' PER is a challenge
- Our educated guess, is 17.9x actual and 19.6x weighted on an historic basis; a year ago they were 14.4x and 18.3x respectively; dividends are also re-appearing and the yield is around 1.8% with cover of 3.3x (all at 30 December prices)
- At the same time, the PER for the FTSE 100, All Share Index and FTSE 250 were in a band from 10.1 to 15.3x
- Similarly, the equity market (as above) yields between 3.1 and 3.6% with cover of 2.1 to 2.8x

Price-to-book

- The Housebuilding Sector's average price-to-book valuation is 0.79 on an actual basis and 0.91 weighted (as at 30 December 2011)
- Berkeley is at 1.66 and, if it is excluded, the actual and weighted ratios fall to 0.68 on both counts
- A year ago the averages were 0.67 actual and 0.81 weighted; and the peak was circa 2.0 in the Spring of 2007
- For the record, price-to-book-value relates a company's current market capitalisation to its stated net assets at the last balance sheet date

Price-to-book-value at year end/latest interim* & priced at 30/12/11

weighted average is 0.91 (ex-Berkeley's 1.66, this falls to 0.68); actual averages are 0.79 (and 0.68 ex-BKG)



Q4 results (19 Oct. – 30 Dec.)

- Only three companies reported figures in Q4 (as above) and they were Telford, Berkeley and Abbey – all interims
- This is a thin sample but it does show average pretax profit margins in double figures on revenue up 16% at £493 million
- Overall, balance sheet gearing is not a Sector issue either
- RONA or Return on Net Assets is looking better, too, with an individual adjusted average of 7.9% (with two on sub-5% i.e. Telford and Abbey; and Berkeley at 14.9% ex-exceptionals)
- Meantime, the Sector's average RONA here is 13.1% taking total interim pretax profits and period-adjusted net assets

Q4 results

PROFIT & LOSS											
Date	Company	Event	Period ending	Provisions (£m)		PBT (£m)		Adjusted PBT (£m)		Adjusted margins (%)	
				Old	New	Old	New	Adjust old	Adjust new	Old	New
01-Dec	Telford	Half Year	30-Sep	0	0	2.00	1.45	1.49	1.45	2.6	2.5
02-Dec	Berkeley	Half Year	31-Oct	0	0	61.60	101.10	61.60	75.44	18.3	18.6
08-Dec	Abbey	Half Year	30-Sep	0	0	4.69	2.94	4.69	2.94	15.1	10.1
TOTAL				0	0	68	105	68	80		
Individual average change (%)											
Sector average change (%)											
Individual average margin (%)										12.0	10.4
Sector average margin (%)										15.9	16.2
Notes:											
<i>(i) Adjusted PBT for Berkeley in 2011 and Telford in 2010 exclude exceptional credits of £30.7m and £0.5m respectively</i>											
<i>(ii) Abbey reports in Euros but its results are shown here in GBP</i>											

BALANCE SHEET										
Date	Company	Event	Period ending	Net Assets (£m)		Net (Debt)/Cash (£m)		Gearing	Gearing	Share
				Old	New	Old	New	Old %	New %	Issue (£m)
01-Dec	Telford	Half Year	30-Sep	64	65	-54	-46	83	70	0
02-Dec	Berkeley	Half Year	31-Oct	878	1010	253	14	-29	-1	0
08-Dec	Abbey	Half Year	30-Sep	145	139	37	17	-25	-12	0
TOTAL				1,087	1,215	236	-15			
Individual average change (%)										
Sector average change (%)										
Individual average RONA (%) adjusted					8.4	7.9				
Sector average RONA(%) adjusted					12.5	13.1				
Individual average gearing (%)								10	19	
Sector average gearing (%)								22	-1	
Notes:										
<i>(i) in addition to the GBP above Abbey held Euro 54.0 million of UK gilts at 30/09/11 (2010 = Euro 55.3 million) plus restricted cash</i>										
<i>(ii) RONA is calculated using six months worth of net assets</i>										

Outlook 1

- In addition to three sets of interims in Q4, there were five IMSs and one AGM in Q4 (post Bellway's prelims on 18/10)
- Taking selected market comments in chronological order sees Redrow (AGM on 03/11) saying: “yet despite the poor economic news there remains strong underlying demand for new homes”
- Similarly, Taylor Wimpey (07/11) added: “although we continue to monitor the uncertainty in the wider economy, conditions within the UK housing market remain stable”
- Barratt (16/11): “without an increase in the availability of mortgage finance, industry growth will remain constrained”

Outlook 2

- Berkeley (02/12) reflected on “the current challenging economic environment” but also said that “The Localism Agenda and the Government’s Plan for Growth represent the most significant changes to the housing industry for a generation”
- Abbey’s view (08/12) was as follows: “the outlook for the foreseeable future continues to be difficult”
- Abbey also continues with its share buyback and since our last review in October has added some 300,000 to reach almost 2.8 million shares (11.3% from a target 14.9%); and the Company remains enviably solvent
- Finally, Persimmon (09/01) added ”challenging” but ”encouraging”

Economics corner 1

- Q3 GDP in the UK rose by an annualised 0.5%; however it has averaged just 0.1% over the last four quarters which compares with 2.6% over the same period in 2009-10
- But inflation is finally abating with CPI at 4.8% in November compared with 5.0% in October and 5.2% in September (this equalled the highest comparable number since 1997)
- Unemployment hit 8.3% (2.64 million souls) in the October quarter which is up 0.4% on the previous quarter and the highest since 1996
- Retail sales, by volume, fell in November by 0.4% after growth of 0.6% and 1.0% in September and October

Economics corner 2

- Mortgage approvals in November were little changed (+2%) at 52,440 but higher than the six month average (50,266) according to Bank of England data
- Meantime, CML loans for house purchase at 44,500 in October were down both month on month (-8%) and annually (-5%)
- In 2011, Private Housing Output is expected to have risen 7%, in real terms, according to Experian* and then by 5% this year followed by +6% in 2013 and +10% in 2014
- Public Housing Output should have dipped slightly last year (-2%) but is forecast, as above, to fall 25% in 2012 and by a further 10% in 2013 before flattening out in 2014 (+5%)

*where Building Value is an advisor

House price corner

- **Nationwide:** -0.2% in December (after +0.4% in November) but managed a 1.0% gain in 2011; outlook is for a sideways move-to-modestly down in 2012
- The **Halifax** was at -0.9% in December and -1.3% for the year as a whole; and like the economy “the outlook for house prices is also uncertain”
- **Hometrack** in December said prices fell 0.2% and for 2011 the deficit was 2.1% (despite London rising 1% and its more affluent postcodes by 5%); its forecast for 2012 is -3%
- The December **Reuters poll** of 23 economists showed UK house prices forecast to slip by a median 1.7% this year (in a band from -6.4 to +4.0%); this compares with a flat outlook in September

Conclusion 1

- Building Value works with Experian on the formulation of UK construction output figures (as noted earlier); and its latest batch was promulgated this week (commencing 09/01)
- Overall it warns of a tough year in 2012 exacerbated by a worsening domestic (and international) economic environment; and by drastic cuts in public works expenditure by a newly thrifty UK Government
- GDP is forecast to be barely positive this year (+0.2%) with construction output likely to fall by around 6% in real terms
- Similarly, any substantial recovery will be postponed until 2014 when construction activity will still be more than 7% below its 2007 peak

Conclusion 2

- Turning specifically to private housing output, it was estimated to be - at the end of last year - equivalent to only two thirds of its 2007 peak (even with growth in 2010-11)
- As noted earlier, Experian is forecasting growth over the next three years 2012, 2013 and 2014: +5%, +6% and +10% respectively
- However it is only in the final forecast year (2014) that there is any acceleration and, even then, activity will still be almost one fifth down on 2007
- The Government has announced a number of Housing Strategy initiatives which will help; but unemployment is the biggest enemy with the rate expected to rise above 9% in 2012 and stay there in 2013, before moderating slightly

Conclusion 3

- Translating output to private house completions, this means 110,000 in the UK in 2014 which compares with 183,000 in 2007
- And, as if this was not bad enough, Experian underlines a 'health warning' on its forecasts
- “A Eurozone collapse and consequent failures in the banking sector would undoubtedly result in a much worse scenario for the construction industry and the UK as a whole”
- The UK publicly listed housebuilders have made provisions and recapitalised where necessary (which we have applauded in previous issues)

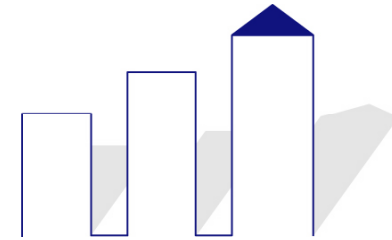
Conclusion 4

- Nonetheless, the paradigm has shifted in terms of housing demand for the foreseeable future
- In turn, this means further dynamism will be required in terms of capacity: both intra mural and in terms of the number of housebuilders - listed and private)
- Franklin D Roosevelt, the US President in 1941 was an optimist by nature and a master of the pithy quote
- He said: “there are many ways of going forward, but only one way of standing still”

Legend

- Abbey (**ABBY**), Barratt Developments (**BDEV**), Bellway (**BWY**), Berkeley Group Holdings (**BKG**), Bovis Homes Group (**BVS**), Redrow (**RDW**), Persimmon (**PSN**), Taylor Wimpey (**TW**) and Telford Homes (**TEF**)
- Bellway's market capitalisation incl. quoted preferred shares
- Share prices are at 30/12/2011 unless stated otherwise; REIS and REIT = Real Estate Investment & Services and Investment Trusts; CPI = Consumer Price Index; CML = Council for Mortgage Lenders; and IMS = Interim Management Statement
- Adjustments made to comparative changes where required
- Selected stocks are excluded from charts and Sector averages due to extreme % movements or for structural reasons

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