

OPERATING REVIEW

Introduction

The past year has been one of considerable change on the operating side of the business. We have introduced our new product, re-opened offices, strengthened and restructured our management teams, embarked upon an ambitious land buying programme, integrated Harrow Estates into the Group and doubled build output in response to an improved sales market.

Our regional teams have coped enthusiastically with the changes and are now well placed to respond to the demands of growing the business in a challenging environment.

Sales Market

The financial year started strongly with an opening order book of 600 private units compared to 492 units the year before. Reservations in July and August were better than anticipated and there was little evidence of a seasonal downturn. In the autumn year-on-year reservations remained ahead but were only marginally better than the levels seen during the summer. This remained the case for the balance of the financial year with the exception of a few weeks affected by Christmas and the bad weather that followed. The Group recorded 2,211 private reservations in the year an increase of 22% on the previous year. The cancellation rate in the year was 17% which was lower than the level experienced in previous years. We closed the year with a private order book of 597 units, in line with the previous year in terms of volume but ahead by 18% in revenue due to a higher average selling price of £177,200. Social housing reservations declined as a consequence of fewer new outlets coming through and the social order book reduced from 547 units to 468. Since the year end we have seen a seasonal downturn in the market in contrast to our experience last year.

The Group delivered 2,587 legal completions in the year including 373 social units.

We started the year with 75 selling outlets and ended the year with 74. In the period we opened 23 new outlets and closed 24. Our private sales rate per outlet was 0.58 per week helped by relatively strong performances from our three City apartment schemes in Birmingham and Barking. We ended the year with 225 unsold stock units on these schemes. On these and other apartment schemes we have successfully re-focused our sales strategies away from the investor market towards owner-occupiers. We also made good progress on our planned disposal of the remaining Debut units and ended the year with just 23 units on two sites. We continue to closely monitor stock and work in progress levels across all of our developments striking a balance between controlling capital employed and having an appropriate level of stock to support changing market conditions.

The average selling price for the year of plots legally completed was £149,300 compared to £137,400 in the previous year. The second half average selling price was 5% ahead of the first half largely due to mix. Prices moved in line with published housing indices during the first few months of the year and then remained fairly flat with some small increases secured in the spring. Prices on The New Heritage Collection were generally more resilient.

Trading in the north relied more upon incentives such as Home-Buy Direct (HBD) than the south. The Group secured 13% of its reservations using HBD and has been allocated a further 430 HBD units under Kickstart 2; the Group has only limited exposure to

shared equity, other than HBD, and has tightly controlled part exchange. The Group has also secured £2.9m of gap funding on its Devonport project under the Kickstart 2 scheme. The funds will be used to facilitate further infrastructure necessary to bring forward the next phases of the project.

The availability of mortgage funds was a constraint on the industry during the year and particularly affected first-time-buyers and those with small deposits. Net mortgage lending remains at historically low levels and lenders continue to be cautious; surveyors also remain hesitant and we continue to experience down valuations.

Land

The regional land teams were increased during the autumn of 2009 which coincided with more opportunities at realistic prices coming to the market. Including 584 plots acquired as part of the Harrow Estates acquisition, the Group acquired 3,281 plots in the year across 31 sites of which 1,462 plots were held under contract. Of those plots acquired, 338 were transferred from the Forward Land portfolio. The year end current land bank closed at 13,170 plots in line with the opening position after taking into account a reduction of 654 plots as a result of selling one site that no longer matched our strategy, and a review of plots under contract. We were particularly strong on acquiring land in the Midlands where our strategic need to replace low priced apartments with family housing has been most acute.

All the plots acquired in the year will be developed with The New Heritage Collection product and are in the main planned for two storey housing.

At Moston, in Manchester, the Group entered a joint venture with Manchester City Council to develop six previously cleared sites with over 400 two storey family houses. The first site is now well underway and the response from local home buyers has been very encouraging.

Forward Land remains an important source of land for the Group. During the year we acquired a further 3,095 plots including 1,100 plots as part of the Harrow Estates acquisition. The Forward Land portfolio was reviewed in light of emerging planning policy and reduced by 3,657 to close at 21,900 a net 900 plot reduction on the opening position. The Group has enjoyed some planning success with its Forward Land portfolio, and subject to agreeing satisfactory draw-down terms, expects the Forward Land portfolio to make a strong contribution to the current land bank in 2010/2011.

Product

The New Heritage Collection was launched in February and is now being built on over 30% of sites. In the coming year the New Heritage Collection is expected to account for over 40% of output.

The launch was accompanied by new marketing material that reflects the spirit of the new collection. The web site was also completely revamped and is an increasingly essential sales and marketing tool for attracting customers to our sites; the new web site has had over 400,000 unique visitors since it was launched in February.

We have also launched Redrow TV; the first housebuilder to do so. Redrow TV is a broadband based TV channel that runs news bulletins and provides information on our developments and product; Redrow TV can be accessed through the web site.

The New Heritage Collection returns the business to its successful roots of building family housing, housing that is traditional in its appearance but internally planned and specified with modern day living in mind. The external elevations are reminiscent of the Arts & Crafts movement which can generally be found in the best parts of most towns. Internally space is arranged around family living and the specification is high. Kitchens are functional and attractive with built-in bookcases and integrated appliances. Bathrooms have clean lines with contemporary sanitaryware.

The New Heritage Collection has been meticulously designed in response to market research with particular attention paid to the smallest details. The New Heritage Collection is as much aimed at those looking to buy in the second-hand market as those that prefer new.

The New Heritage Collection currently consists of 40 house types ranging from one bed apartments to large six bedroom detached houses. Despite a higher internal and external specification, increased costs have been mitigated by expanding Group deals, limiting the range of materials used and achieving more efficient build. The overriding objective has been to ensure that perceived value significantly outweighs cost.

Alongside the quality of the design of the product sits the quality of build and the level of service we give to our customers. A record number of 14 of our site managers have gained NHBC Pride in the Job Awards in the past year and go forward to the next round. We have also achieved record levels of customer satisfaction as measured by an external source carrying out monthly telephone surveys. Across the year 92% of our customers were satisfied or very satisfied with their new home and 96% would recommend us to a friend; it is pleasing to note our results improved as we progressed through the year. We received a 4 star rating in the nationally published Home Builders Federation survey.

Delivering our product responsibly and safely is fundamental to our business, and it is reassuring to report our focus on this area has for the fifth year running been recognised by a Gold Award from RoSPA.

Harrow Estates

Harrow was acquired in October 2009 and was quickly integrated into the business. Harrow specialises in adding value to land through the planning and where appropriate, remediation process and has particular skills in cleaning up contaminated brownfield land. It also uses its master planning skills to promote greenfield land. Harrow will be both an additional source of land for the Group as well as a source of profit through land trading.

Harrow acquired c.500 plots on 2 sites in the year and has made good progress on the options under its control, in particular, the large site in Cambridge has gained planning permission for around 300 units and decontamination works are well underway.

Harrow also now oversees all the commercial development activities in the Group and successfully disposed of 4 properties and 3 parcels of land during the year.

People

Central to our business are our people. After two very difficult years when we had to drastically reduce our workforce it is encouraging to report we have been recruiting at all levels in the business. At the end of June we employed 840 people, an increase of over 20% on the previous year. It is also even more satisfying to report that many of those that have joined us are returning to the Group.

We re-opened our offices in Yorkshire, North West and South Midlands in the year to regain much of the geographical coverage we lost in the downturn. We now operate from nine regional offices and cover most of the stronger housing markets in the country; there remains scope however to further expand in the South East, South, South West and Midlands and we will look to do so when the time is right.

Whilst we have expanded the business at the divisional level, we have streamlined the overall organisational structure by removing a regional tier of management. The divisions now report directly into Group. This has improved lines of communications and simplified the decision-making process. As a consequence the divisional teams are now more responsible and accountable for the day-to-day operation of their businesses. Group departments that service and support the divisions are represented on the Executive Board and meet monthly.

We have continued to develop our people through training during the year and have delivered 1,324 training days to our employees, and in addition we have provided a significant level of training to our subcontractors. This training ranged from induction programmes on joining, to management training and on-site Health and Safety training. It is pleasing to report that 7 of our site managers studied for and passed NVQ level 4 during the year. We have resumed recruiting trade apprentices and expect an intake of 50 new apprentices to commence this month. Finally we are planning to reintroduce our graduate training programme next year.

John Tutte
Group Managing Director

FINANCIAL REVIEW

Profit before tax and earnings per share

The Group generated turnover of £396.9m in the year ended 30 June 2010 (2009: £301.8m).

Revenue (£m)	2010	2009
Residential	386.2	290.3
Land sales	8.7	3.4
Commercial	2.0	8.1
	<u>396.9</u>	<u>301.8</u>

This reflected a 22% rise in residential legal completions to 2,587 (2009: 2,113) and a 9% increase in average selling prices to £149,300 (2009: £137,400).

The Group delivered an operating profit of £12.7m (2009: loss £22.4m pre-exceptional items) representing a 3.2% operating margin. Whilst margins were below historic norms due to the effect of selling plots of land acquired before the downturn, this is a welcome return to profitability at the operating level and is testament to the impact of the impetus to the business generated by the response to the new management team and the success of initiatives put in place to drive the business forward which include significant investment in brand and product.

Following the successful £150.3m Rights Issue, net financing costs at £12.0m were £9.6m lower than the previous year.

The Group generated a profit before tax of £0.7m (2009: loss £44.2m pre-exceptional items). Basic earnings per share were 0.2p (2009: 14.7p loss pre-exceptional items).

Tax

As a consequence of tax losses brought forward from 2009, the Group paid no corporation tax in the year (2009: £40.4m refund of corporation tax previously paid).

The Group's tax rate for the year was 28.0% and the expected effective rate for the financial year ending 30 June 2011 is 27.75%.

A deferred tax asset of £77.2m, primarily in relation to pre tax losses is carried at 28.0% at 30 June 2010 for use against future profits and is considered to be fully recoverable. The Finance Bill received Royal Assent on 20 July 2010 and as a consequence the corporation tax rate will fall to 27.0% from 1 April 2011. The carrying value of the deferred tax asset at 30 June 2010 based on a 27.0% rate would be £74.4m.

Dividends

No dividends have been proposed in respect of the financial year ended 30 June 2010.

Rights Issue

In the first half of the financial year, the Group successfully completed a 13 for 14 Rights Issue of 148,586,495 new shares at 105 pence per new share. This generated £150.3m of funds net of expenses of £5.7m of which £14.9m has been credited to Share capital and £135.4m to Retained earnings.

In conjunction with this, the Group completed the acquisition of the Harrow Estates business (see note 10).

Balance Sheet

Net assets at June 2010 were £435.9m (2009: £293.5m), an increase of 49% due primarily to the Rights Issue.

Capital employed reduced by £25.1m to £483.0m as a result of careful management of inventory.

Our investment in land and work in progress pre net realisable value (NRV) provision reduced by £89.1m reflecting the further progress made in reducing the number of stock plots held. This was partly offset by our targeted investment in the land market in the year which saw over 3,200 new plots (including Harrow) purchased and contracted and terms agreed on a further c.1,100 plots with over 40% of these contracted post year end.

During 2010 £62.4m of the NRV provision was utilised against legal completions. As a consequence, at 30 June 2010, the NRV provision against land and work in progress was £256.9m (2009: £319.4m) with £233.6m against land and £23.3m against work in progress. In addition, £39.2m of provision was released in the year relating to Type 1 plots and £39.1m of provision created in the year, with £21.8m relating to Type 1 plots and £17.3m relating to Type 2 plots.

In 2010 we have reclassified a significant number of plots from our Type 2 land category to the Type 1 land category to reflect operational decisions taken to develop land we previously expected to sell undeveloped. In determining the basis for the provision at 30 June 2010 we took cognizance of the increase in our average selling price during the year. A significant element of the price increase was due to the change in mix. This, together with the continued uncertainty of future house price movements, lead us to conclude the basis of provisioning we used at the end of the 2009 financial year remained appropriate for 2010.

The net realisable value provisions will continue to be reviewed at future reporting dates to assess their appropriateness in the context of prevailing market conditions and the re-assessment of net realisable value and costs.

Non-current trade debtors increased by £1.1m during the year to £7.1m due to our use of the HomeBuy Direct scheme to facilitate first time buyer purchases.

Land creditors reduced by £15.8m to £37.6m in the year in line with the scheduled settlement of a number of significant land creditors.

Cashflow and Net Debt

Net debt reduced by £167.5m to £47.1m during the year, with gearing reducing from 73% at June 2009 to 11% at June 2010.

The cash generated from operations was £50.0m (2009: £12.1m outflow).

In June 2010, the Group via its Employee Benefit Trust completed the purchase of 4.22m of its own shares at a cost of £5.2m to fund its share option schemes, thus avoiding dilution for existing shareholders.

In addition, as a consequence of shares in the whole of the housebuilding sector, including ourselves, trading at a significant discount to net asset value we are proposing a resolution at the forthcoming AGM to enable the Board to buy back up to 10% of the Company's share capital either as treasury stock or for cancellation.

Plot costing and margin measurement

With effect from the financial year ending June 2011 the Group has changed its methodology for plot costing and margin measurement. The changes are as follows:

- When a site is acquired the cost of the land is allocated over the private plots only. Social plots will carry no land value. This is because social plots are part of the 'cost' of acquiring those private plots for development.
- Build cost is calculated on the basis of house type.
- Gross profit on each plot and house type is therefore measured on the full cost of the specific plot.

Previously the margins on all plots (both private and social) on a site were equalled and thus all reported the same margin rather than reflecting their true individual profitability.

The change has been made to improve the accuracy of internal profit reporting and management information.

The average cost per plot for private owned plots on the above basis at 30 June 2009 was £29,300. With the acquisition of new land and completions in the year, the equivalent plot cost at 30 June 2010 was £31,200.

The Group has a partnership development in Moston, Manchester where it does not own the land but builds and sells the houses in conjunction with Manchester City Council. These particular plots have no land value in our balance sheet and have therefore been excluded in the above calculation.

Financing and Treasury Management

Redrow is a UK based housebuilder and therefore the main focus of its financial risk management surrounds the management of liquidity and interest rate risk. Financial management is conducted centrally using policies approved by the Board.

(i) Liquidity and facilities

Liquidity risks are managed through the regular preparation and review of cashflow forecasts and by maintaining appropriate committed banking facilities to ensure adequate headroom.

It is considered appropriate that the Group maintains relationships with a number of banks. The current syndicate comprises five banks.

During the year, in conjunction with the Rights Issue, the Group agreed with its banking syndicate to amend the terms of the existing syndicated facility agreement including a reduction in the total facility size to £250.0m from £450.0m. The £250.0m is made available as a revolving credit facility for utilisation by the Group up to and including 30 September 2011.

In addition to the committed facilities, the Group also has further uncommitted bank facilities which are used to assist in day-to-day cash management.

Facilities are kept under review and the Group maintains regular contact with its banks and other financial institutions to ensure that it remains attuned to new developments and that its facilities remain appropriate to strategic and operational objectives and market conditions.

(ii) Interest rate risk

The Group is exposed to interest rate risk as it borrows money at floating rates. Its interest rate risk arises primarily from long term borrowings. In order to manage this risk, the Group enters into simple risk management products, notably interest rate swaps. All interest rate swaps are sterling denominated and are not used for speculative or trading purposes.

Pensions

The Group provides funded defined benefit pension arrangements and funded defined contribution arrangements. The defined benefits section of the pension scheme is closed to new entrants and from 1 July 2009 increases in pensionable salary are limited to the lower of base salary increases, increases in inflation or 2.5% for defined benefit members.

As at 30 June 2010, the Group financial statements showed a £4.4m deficit (2009: £2.8m surplus) in respect of the defined benefits section of the pension scheme, as calculated in accordance with IAS19.

Barbara Richmond
Group Finance Director