

## **OPERATING REVIEW**

### **Introduction**

Trading, particularly in the first half, was more challenging than most anticipated. Thankfully, the far-reaching changes we made to the operational side of the business in the previous year meant we were better placed to deal with a more challenging business environment.

Although change featured less in 2011, we did make two notable announcements that will significantly affect the direction and performance of the business in the future: the opening of a new division in London and the sale of our business in Scotland.

London accounts for a large proportion of the nation's wealth and household growth, demand in the capital has been consistently high and there are plenty of attractive development opportunities to deliver good levels of return. By contrast, despite operating in Scotland for a number of years, we were not making acceptable returns and additionally incurred disproportionate costs in connection with the different planning, building regulation and legal systems. The release of capital from the disposal of the business will support our strategy to grow in London and the South East.

### **Sales and Marketing**

The market was weak at the start of the financial year and this remained the case throughout the first half. An opening private order book of 597 units was in line with the previous year but was 18% ahead in terms of revenue due to a higher average selling price. In the first half we reserved 985 units and £172m of turnover compared to 1,060 units and £161m in the stronger comparable period the previous year. The sales performance towards the end of the first half was also affected by unusually bad weather. Reservations per outlet per week in the first half averaged 0.47.

The year was very much one of two halves with much stronger trading in the second half. Enquiries to our website increased with the help of a regional TV campaign and site visitor levels improved, this all helped increase reservations per outlet to 0.54 for the full year. The cancellation rate in the year was 18%, broadly in line with the previous year.

Our experience during the year was one of stable prices overall. Our private average selling price increased by 13% to £174,100 due to the continuing shift in mix as a consequence of the roll out of the New Heritage Collection. The largest increases in selling price were achieved in the Midlands, North West and South Wales where we were able to bring on stream more New Heritage Collection sites sooner.

We started the year with 74 outlets. We opened 34 new outlets in the year and also closed 34, including 8 sold as part of the Scotland disposal, ending the year with 74 outlets. At the year end we were operating from 52 New Heritage outlets, c. 70% of the Group's sites and we expect to see this rise to c. 80% in the coming year.

Houses represented over 70% of legal completions in the year as a result of the switch to the New Heritage Collection and a move away from apartments. The average size of our private product increased from 892 sq ft to 956 sq ft.

We completed our 'In the City' schemes in Birmingham and carried over six plots at our remaining 'In the City' development in Barking. We also made considerable progress in

working out our last 'Debut' schemes and we ended the year with only 9 plots to sell on one site. Social housing accounted for just 13% of legal completions and 8% of residential turnover: a reduction on the previous year mainly due to the timing of social housing from new outlets coming on stream.

Part Exchange is an attractive option for many of our customers and we anticipate a higher take up of this incentive as we continue to grow the New Heritage business and raise our average selling price: Part Exchange accounted for 13% of private reservations in the financial year. Outside our Partnership scheme in Manchester, we sparingly use easi:buy, our own shared equity scheme. We have however continued to successfully use our remaining allocation of HomeBuy funds and, as a result, shared equity schemes in total were used in one form or another on 17% of private reservations. We were successful in securing an allocation of £5.5m under the FirstBuy scheme announced in the Budget, and we have already taken our first reservations under this initiative that is aimed at helping first time buyers.

Our website continues to be the predominant source of enquiries to our sites assisted by other mainstream property portals. The website recorded c.1.5m hits in the year, with visitors to the site in the second half almost double those in the first six months. Our award winning Redrow TV channel continues to expand its content and plays a key role in our overall marketing strategy.

### **Build Activity**

Year on year build output increased as a result of the higher number of operating outlets and the larger average floor areas of those units we constructed.

Quality alongside Health and Safety, are key measures for our build teams. In terms of quality, we monitor NHBC inspection records and the number of 'Reportable Items': over the past year, the number of items per inspection reduced to 0.25 (2010: 0.26). 13 of our site managers gained NHBC Pride in the Job Awards.

We employ an external independent agency to telephone survey all our customers about six weeks after taking occupation. Over the past year we have maintained our high levels of customer satisfaction; 93% (2010: 92%) are satisfied or very satisfied with their new home and 96% (2010: 96%) would recommend us to a friend. Our leading position on customer satisfaction was also endorsed by a five star award in the most recent HBF National New Home Customer Satisfaction Survey published in March: one of only two major housebuilders to receive the highest award.

The Health and Safety of our customers, employees, contractors and suppliers is a priority for the business. Our internal Health and Safety team ensure we maintain safe working environments through regular site inspections, training and on-the-job 'toolbox talks'. It is very pleasing to report that following receipt of a Gold Award for the sixth year running for our submission to RoSPA's independent adjudication panel, our hard work in this most important part of our business has been recognised by a second consecutive RoSPA Gold Medal Award for Occupational Health and Safety.

Our Accident Incident Rate (AIR), an industry standard measure of accident occurrence, increased in the year to 685 from 426 the previous year. The rise was largely due to a higher number of minor injuries associated with manual handling and an increase in the number of workers directly employed on site to meet rising levels of output.

Build costs remained relatively stable throughout the year although there was growing pressure on the cost of those materials where the manufacturing process consumes high levels of energy. There was also some emerging price pressure on timber and timber related products. Overall the Group has managed to contain any significant increase in its build cost base by largely offsetting any rises with volume related reductions elsewhere. Wider use of the New Heritage Collection assists in expanding the use of Group-wide supplier deals and also allows us to more tightly monitor and control build costs.

## **Land**

We focused on buying land for the New Heritage Collection during the year, and bought or acquired under contract 2,367 plots across 31 sites. We disposed of 831 plots through the sale of the Scottish Division and the land bank was further reduced by 890 plots as a consequence of re-planning some sites to more marketable lower density mixes together with a small number of strategic land sales. The net impact was to reduce the land bank to 11,190 plots (2010: 12,030) representing 4.6 years. Whilst the land bank has reduced in terms of plots, the quality has increased as we replace lower value plots with higher value land suitable for the New Heritage Collection product.

Geographically we have increased the weighting of our land bank to the south which now accounts for 36% (2010: 32%) of plots owned or under contract.

Forward land remains an important future source of land for the Group and has considerable potential to deliver a high proportion of the Group's land over the coming years. The emerging changes to the planning system coupled with a pro-growth agenda have identified opportunities to bring forward sites earlier than anticipated. However, pulling land through the planning system and finalising land owner negotiations remains a frustrating and lengthy process. At the end of the year, after transferring 207 plots to the current land bank, the forward land bank stood at 22,150 plots (2010: 21,500) of which, over 41% were allocated.

## **London**

We formed a new division in Central London at the beginning of the financial year to explore opportunities in the Capital. London's global standing makes it a unique market in the UK and strong worldwide demand coupled with high household growth projections, make it an attractive location to expand the Group and increase its weighting in the South East.

The new team was quickly established and consists of specialists with extensive knowledge of developing in London balanced with a number of existing managers transferred from within the Group. The business acquired or contracted 342 high value plots across five sites over the course of the year.

The first site for six large houses at Ealing is well underway and we expect to be commencing construction later this calendar year on a large riverside site in Kingston. We also have planning applications running on sites at Marble Arch and Wapping where we are working jointly with Galliard.

Development in London is by its very nature complex and although the team have made an excellent start and has now relocated to larger offices, the Division is not expected to make a significant contribution to the Group's profits until 2013/14.

## **Harrow**

Following its acquisition last year, Harrow has made good progress on managing the remediation works at Hauxton, near Cambridge and now anticipate land being released for development in 2012. Planning has been progressed on a number of other schemes and they were notably successful in securing a resolution to grant planning at South Cerney, a site acquired in the Cotswolds in the previous year.

During the year Harrow acquired one site with the development potential for 200 residential units and entered into a joint venture for the promotion and development of smaller brownfield sites in the south of England.

Harrow also manage the Group's remaining commercial interests and have overseen the disposal of £0.7m of commercial property during the year.

## **People**

To meet the planned growth of the business we have created many new jobs and increased our directly employed workforce by over 100 to 949. Staff turnover levels remain low at 7.6%, a small increase on the previous year reflecting greater mobility in the job market.

Redrow has a committed and skilled workforce and we are determined to provide them with opportunities to develop their careers. We increased our training days by over 70% in the year to 2,267 days. We also recruited 50 apprentices and have a programme to encourage young people into the building trade.

We have reinstated our Graduate programme with an intake of 6 joining us in September. We have also recruited 7 placement students for 12 months replacing the 5 from last year who are returning to university to complete their studies.

John Tutte  
Group Managing Director

## FINANCIAL REVIEW

### Profit before tax and earnings per share

The Group generated turnover of £452.7m in the year ended 30 June 2011 (2010: £396.9m). This was mainly the result of a 16% increase in the average selling price of our homes together with a 2% increase in residential legal completions.

Revenue (£m)	2011	2010
Residential	432.8	386.2
Land sales	18.7	8.7
Commercial	1.2	2.0
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	452.7	396.9

Land sales revenue increased by £10.0m reflecting the successful completion of a number of strategic land swaps.

The Group delivered an operating profit of £31.2m (2010: £12.7m) representing a 6.9% operating margin (2010: 3.2%). This is a significant step forward towards returning our operating margin to pre downturn levels.

Net financing costs at £5.9m were £6.1m lower than the previous year reflecting the benefits of the November 2009 Rights Issue for the full year and reduced interest rates.

The Group generated a profit before tax of £25.3m (2010: £0.7m). Basic earnings per share were 4.4p (2010: 0.2p). Basic earnings per share excluding the impact of rate changes on our deferred tax asset (see below) were 6.0p.

The Return on Capital Employed for 2011 was 6.1%, a major improvement on the 2.6% achieved in the previous year.

### Tax

As a consequence of tax losses brought forward, the Group paid no corporation tax in the year and received a small refund (£0.5m) on an earlier overpayment (2010: £nil paid or received).

The Group's tax rate for the year was 27.5% (2010: 28%) before taking into account the impact of the reduction in the corporation tax rate to 26% on deferred tax assets (£4.8m (2010: £nil)).

A deferred tax asset of £63.8m (2010: £77.2m), primarily in relation to pre tax losses was carried at 26.0% at 30 June 2011 for use against future profits. Following the enactment of the 2011 Finance Bill, the corporation tax rate will fall to 25% from 1 April 2012. The carrying value of the deferred tax asset based on a 25% rate would be £61.3m.

The normalised rate of tax for the year ending 30 June 2012 is 25.75%.

## **Dividends**

No dividends have been proposed in respect of the financial year ended 30 June 2011 (2010: nil).

## **Balance Sheet**

Net assets at June 2011 were £458.6m (2010: £435.9m), an increase of c.5%, as a consequence of the retained profit generated in the year and the improved position of the defined benefit pension scheme under IAS 19: "Employee Benefits".

In June, the Group sold its business in Scotland to Springfield Properties plc for £49.0m. This had the impact of reducing our land holdings by £29.2m and our work in progress by £19.0m. £5.0m of the proceeds were received on completion with the balance to be received as the developments are built out by Springfield and the 831 plots sold. There was no profit or loss on this disposal.

Our investment in work in progress continues to be carefully managed and it is pleasing to report that the number of equivalent units in work in progress reduced by 11% to 1,231 units, of which 685 were unsold (2010: 796).

Trade and other receivables increased by £50.0m during the year to £69.6m. This increase related primarily to the disposal of our Scottish business.

Capital employed increased by £51.0m to £534.0m mainly due to increases in land holdings.

Our net realisable value (NRV) provision reduced by £98.6m in the year, of which £31.0m results from the Scotland disposal with the balance from legal completions and the sale of land.

Plots which have been written down and therefore have a related NRV provision decreased from c.7,500 plots at June 2010 to c.4,400 plots at June 2011.

Land creditors increased by £7.2m to £44.8m in the year as a result of 50% of land purchases in the year including some element of deferred purchase consideration offset in part by the scheduled settlement of a number of significant land creditors.

## **Pensions**

Redrow provides both funded defined benefit pension arrangements and funded defined contribution arrangements.

As reported in previous years, the defined benefits section of the pension scheme is closed to new entrants and increases in pensionable salary are limited. 138 current staff are members of the defined benefits section of the scheme.

At 30 June 2011, the Group's financial statements showed a £5.0m surplus (2010: £4.4m deficit) in respect of the defined benefits section of the pension scheme, as calculated in accordance with IAS 19. The £9.4m improvement is due to a £9.0m increase in the market value of scheme assets.

## **Cash flow and Net Debt**

Net debt increased by £28.3m to £75.4m during the year, with gearing increasing slightly to 16% (2010: 11%) reflecting our investment in land.

In December 2010, the Group signed a new £200m syndicated loan facility which matures in December 2014. This replaced a £250m facility due to mature in September 2011.

## **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

### **(i) Liquidity**

The Group regularly prepares and reviews its cash flow forecasts which are used to manage liquidity risks in conjunction with the maintenance of appropriate committed banking facilities to ensure adequate headroom.

Facilities are kept under regular review and the Group maintains regular contact with its banks and other financial institutions. This ensures Redrow remains attuned to new developments and opportunities and that our facilities remain aligned to our strategic and operational objectives and market conditions.

Our current banking syndicate comprises four banks and in addition to our committed facilities, Redrow also has further uncommitted bank facilities which are used to assist day to day cash management.

### **(ii) Interest rate risk**

The Group is exposed to interest rate risk as it borrows money at floating rates. Redrow uses simple risk management products, notably sterling denominated interest rate swaps, as appropriate to manage this risk. Such products are not used for speculative or trading purposes.

Redrow regularly reviews its hedging requirements. During the year the Group's outstanding interest rate swaps matured and the Board decided, taking into account current predicted LIBOR rates and the pricing of interest rate swaps, to retain all its debt at floating rates. This decision is subject to regular review.

Financial management at Redrow is conducted centrally using policies approved by the Board.

## **Improvements to business processes**

During the year a team from across the functions of Finance, Commercial and Construction led the implementation of changes to Redrow's business processes for internal reporting to improve the timeliness and efficiency of the internal financial management reporting cycle. This has enabled the timescale for the production of monthly management accounts to be reduced to 3 days post month end.

Barbara Richmond  
Group Finance Director