OPERATING REVIEW

Introduction

Everyone at Redrow is immensely proud of our achievements during our 40th anniversary year. As well as delivering record turnover and profits, we have expanded our business creating over 230 new jobs and developing the careers of many more of those that work for us. We have increased the number of outlets from which we operate and substantially grown our land bank. The product range has been broadened and our London division has made its first significant contribution to the Group's results. We retained our five stars rating in the annual HBF Customer Satisfaction Survey and made good progress against our targets to make our business more sustainable. Above all, we have positioned ourselves to increase output to meet the nation's demand for more new homes.

The Market

The financial year started strongly following the launch of the highly successful government's Help to Buy scheme which resulted in the peak selling season for new homes extending through the summer of 2013. Mortgage approvals steadily increased throughout the first half of the financial year and peaked in January before falling back with a modest recovery in June. More stringent lending rules introduced in April 2014 as a result of the Mortgage Market Review (MMR) have affected borrowers and in particular the time taken to process mortgage applications.

Help to Buy Wales was launched in January of this year and provided a much needed lift to a depressed market.

House prices according to Land Registry rose 6.4% across England and Wales in the twelve months to the end of June with the strongest growth in London and the weakest in the North East. There are signs that price rises are now moderating, particularly in London.

Against an extraordinarily strong comparable period last year, new home sales in recent months have returned to a more seasonal trend.

Delivering Strong Growth

Net private reservations increased by 28% in the year to 3,455 as a result of the weekly sales rate increasing by 13% to 0.70 and the average number of outlets from which we operated rising by 13% to 94. The increased number of reservations combined with a higher average selling price resulted in over £1bn of private reservations being taken in the year. The use of incentives reduced and the cancellation rate was just 13% compared to 16% the previous year. As a result of this strong sales performance we enter the new financial year with a private forward order book of 1,322 plots representing £482m of revenue: £222m ahead of the same time last year.

With most of our outlets holding healthy forward order books we now expect the private sales rate per outlet per week to reduce compared to last year which was boosted by the initial Help to Buy take-up.

The strong sales performance in the year resulted in private legal completions rising by 20% to 2,963 from 2,474. Social housing completions increased by 80% to 634 and represented 18% of total completions which rose to 3,597 (2013: 2,827).

The private average selling price increased by 19% to £269,600 whilst the average social selling price fell by 8% to £98,800 due to a larger proportion of apartments. The overall average selling price increased by 13% to £239,500 and together with the increase in volume helped lift turnover to a record £865m.

The average selling price increased due to mix, changing geographical spread and a modest level of house price inflation. We expect to see the average selling price continue to rise in financial year 2015 as more higher-priced homes are completed in London.

Help to Buy accounted for 35% of private completions in the year and was particularly popular in our divisions in the Midlands and North.

Profits grew strongly in the year as the number of completions from plots on impaired land reduced and more new sites acquired since the downturn came on-stream. Operating margins increased to 15.9% which helped improve return on capital employed a key measure for the Group, to 18%. Operating expenses increased in absolute terms reflecting ongoing investment in growing the business but reduced as a percentage of turnover to 5.8% (2013: 6.7%).

London made its first significant contribution to Group turnover and profits. The division delivered 293 legal completions including 70 social plots at One Commercial Street and accounted for £124m of Group turnover. London and our divisions in the south accounted for over 50% of Group revenues in 2014 reflecting the significant land investment we have made in this geographical area in recent years.

Harrow Estates made progress on a number of fronts during the year. The option at Horsforth in Leeds was exercised and the site transferred to the local Homes' division. Planning permissions were achieved at appeal on two sites in Hartford, Cheshire for a total of 650 plots with development already underway on one, and the final environmental clearances have been received at Hauxton, Cambridge which clears the way for a start on site in 2015.

Harrow also realised a land profit of £2.8m and acquired an interest in a site for 180 plots through its Joint Venture.

A new site with the potential for 250 plots was also acquired during the year.

Investing for the Future

To further expand our presence in the south we opened a new Southern Counties division based in Camberley at the start of the financial year. We also opened a new West Country division operating from an office in Exeter in July 2014 to capitalise on the exceptional growth we have achieved in the South West region.

We opened 44 new outlets in the year and closed 33 increasing the number of active outlets to 103 at the financial year-end. Increasing outlets is fundamental to our future underlying growth strategy but planning delays continue to be an obstacle to bringing more outlets on-stream. We therefore very much welcome the government's latest published technical consultation on planning that amongst other things seeks to reduce the number of planning conditions imposed and the time it takes to discharge them.

During the year we acquired 6,092 plots across 54 new sites. Of these, 2,139 on 18 sites were pulled-through from our Forward Land bank. These new sites will ensure we are able to continue to increase the number of outlets from which we operate to both grow the business and compensate for an anticipated easing in the private sales rate per outlet.

After accounting for legal completions, re-plans and a land sale, the current owned and contracted land bank increased by 2,562 plots to 16,724 plots, representing c.£4bn of future revenues.

We also continued to invest in Forward Land and after transfers to the current land bank and our normal strategic review, we increased the number of plots allocated or with a realistic prospect of gaining planning to 28,245 (2013: 26,024). We anticipate our strong performance in pulling-through Forward Land will continue throughout the coming year.

Geographically land investment remains weighted to the south where, including London, the owned and contracted land bank stands at 8,967 plots representing over half the Group's holdings. Additionally we exchanged contracts with MOPAC (Mayor's Office for Policing and Crime) to acquire the former Metropolitan Police Training Centre at Hendon. Following detailed negotiations with the London Borough of Barnet and the GLA and a series of public consultations, the site which extends to 50 acres is expected to gain a mixed-use planning permission in 2015 for c.2,600 new homes.

In addition to our ten London division sites, we have increased our presence in the outskirts of the Capital. We now have five sites managed by our South East and Southern Counties divisions within the M25, including a joint venture in Croydon where we are currently underway on the first phase of a large-scale regeneration project.

We have also made good progress on the site for up to 950 homes we have under contract in Ebbsfleet which will become part of the Government's flagship new Garden City. Outline planning permission was granted by Dartford Borough Council earlier in the year and we anticipate making a start on site in 2015. Similarly, Harrow Estates are moving forward positively with Stockport Council on the large site we own outright at Woodford Aerodrome south of Manchester where we have a resolution to grant planning permission for c.920 plots and again expect to be on site sometime in 2015.

Putting the Customer First

Our customers are at the centre of our business through the communities we create, the homes we build and the service we provide: we are determined to give our customers the experience they expect from a renowned premium home builder.

Our developments are designed to create great places to live that will stand the test of time. Places in which people are proud to own a home, keen to protect the quality of the local environment and feel encouraged to be part of the community.

The Heritage Collection has been critical to our success and the turnaround we have delivered over the past five years. We continue to develop and improve the range in response to our customers' feedback and to incorporate changing trends in lifestyle, technology and interior design. In 2014 the Heritage Collection accounted for 80% of private completions.

Whilst the Heritage Collection will remain our dominant 'brand' we expect to see it reduce as a proportion of our overall business as we bring on-stream more bespoke developments and new brands of product. We recognise there is a place for alternative designs that either reach out to a wider customer base or respond to particular site constraints and market demands. Over the past year we have seen the number of bespoke apartments we build increase and we have introduced and completed the first homes from two new brands.

The Regent Collection has many of the characteristics of the Heritage Collection: it has attractive traditional elevations complemented with modern spacious interiors. It appeals to a market where there is demand for more densely plotted well-designed homes generally in urban locations. On sites such as Wilton in Wiltshire, we are able to combine the Regent Collection alongside the Heritage Collection to broaden our target markets.

Our brand new range Abode is conceptually different to the Heritage and Regent Collections. Abode has contemporary elevations and extensive open plan living space with high ceilings and bedrooms with walk-in wet rooms. Underfloor heating as standard on the ground floor gives more flexibility for furnishing and built-in storage cabinets and workstations help to make the best use of space. A high quality kitchen area is at the centre of the open plan design. The branding and marketing of Abode is also very different. Strong fresh colours accentuate the contemporary designs and sales hubs make use of handheld technology: Abode appeals to customers looking for a different style of living. Our first Abode site is selling well and we expect to roll-out new sites in 2015.

We know our customers appreciate our award winning homes and we are determined to also provide them with an award winning level of service. Last year 93% of our customers when surveyed independently said they would recommend us to a friend and for the fourth year running we were awarded a maximum five stars in the HBF Annual Customer Satisfaction Survey. But we want and have targeted ourselves to do better.

Last year we announced the launch of My Redrow which allows our customers to manage their buying journey with us: from booking appointments with Sales Consultants to making choices and buying options online. Last year more and more of our customers chose to buy extras online and we continue to extend the list of options available. Eventually My Redrow will become the personal one-stop facility for our customers giving them online access to manage and monitor their buying and aftersales service. As part of this process we have embarked upon a complete review of how we currently communicate with our customers and expect to roll-out a friendlier, more responsive and engaging service in 2015.

Building Efficiently, Responsibly and Sustainably

Responding to a stronger market has been challenging for us and the industry. Last year excluding our London sites where we outsource construction, we built 3,394 units of output, a 400 units and 13% increase on the previous year. Early in the financial year trade and material shortages emerged. Brick and block producers were overwhelmed with demand and unable to increase capacity in the short term. As a result lead-times became extended across a number of products. Our long-standing partnerships with our brick and block suppliers gave us a degree of protection and we managed to avoid serious delays to our build programmes and were able to deliver a more even spread of completions throughout the year. Trades were also in short supply, particularly but not limited to bricklayers where we have seen significant increases in rates. As more production capacity comes on-stream we expect to see material shortages easing over the coming months, we do however anticipate trade shortages will continue until the industry is able to address the underlying failure to attract more young people into the industry to grow and replace the ageing workforce. Material and trade shortages have impacted costs from their benign base and we have seen like-for-like build costs increase on average by around 5% over the past year.

Our customers expect us to build their new home to a high standard and our key external measure of quality is the number of Reportable Items per NHBC inspection. In 2014 the average number of Reportable Items per inspection was 0.21 (2013: 0.21) and remained below the industry average of 0.25.

Fourteen of our site managers recently won NHBC Pride in the Job Awards, an increase of two on the previous year. Two of our site managers also won NHBC Health and Safety Awards.

We are committed to ensuring our sites are a safe place to work. It is therefore with much regret and sadness that I have to report there was a fatal accident involving one of our subcontractors on site last year. We are fully co-operating with the investigation that is being undertaken by the Health and Safety Executive and our condolences and support have been offered to the subcontractor’s family.

Last year we published our first major report on sustainability and set ourselves a number of targets to achieve by 2018. Aspirations 2018 set targets across five key parts of our business: Design, Customers, Community, People and Environment. We have made good progress against many of these targets. We managed to divert 94% of waste from landfill and virtually all of our timber was responsibly sourced. We recently passed our first independent environmental audit and achieved level 2 of the British Standard (8555) Environmental Management System.

Our developments continue to be more environmentally sustainable and make wider contributions to local communities. Last year 1,364 (2013: 720) of our homes were built to Level 3 or above of the Code for Sustainable Homes. We also installed renewable heat or electricity generation technologies into 23% (2013: 16%) of our homes.

Our People

As we grow we want our people to grow with us. Our extensive training and development programmes allow our people to fulfil their career aspirations and it is gratifying to see so many of our existing staff stepping-up into more senior roles. During the year our staff completed 2,952 days of training, an increase of 10% on the previous year. We have introduced e-learning which allows our people to train online at their pace and at times to suit them.

But the rapid growth of the business does mean that we need to expand our workforce and last year we created over 230 directly employed new jobs and many more in our supply chain. It is pleasing to report that many of these new positions were filled with people that had previously worked for us.

The industry has a skills shortage. For far too long we have failed to attract young people into our industry and tradesmen, technicians and managers are now in short supply. Over recent years we have introduced recruitment and training programmes to address this: 15% of our workforce are on structured training and development programmes. We have an annual intake of apprentices and now employ 84 across the divisions with plans in place to increase this further. Once they have mastered their trade we are finding many of our apprentices have an appetite to progress further and are taking up Trainee Site Assistant positions. We have now also launched a Commercial Apprenticeship scheme that allows young people seeking a career in quantity surveying to combine work with academic study and we have plans to launch a similar scheme for those looking for a career in design and engineering. Our graduate programme has also expanded: this year we have increased our intake to 26 including our placement programme offering undergraduates the opportunity to gain work experience. Addressing the undersupply of skills in the industry will take some time to correct but we are determined to do our share and in the process develop the people and range of skills our business needs for the future.

A shortage of skilled people means that talent is in demand. Last year overall staff turnover was 12% and broadly unchanged from the previous year with a significantly lower level amongst our senior managers. Creating a work environment where our people can prosper, feel valued and be rewarded for doing a job well is essential to retaining talented people and during the course of the year we undertook a detailed survey of our staff to assess what we do well and where we could do better. Overall the feedback was constructive and positive and is now helping us to shape and improve the way we recruit, manage and communicate.

Strategy

It is widely accepted that there is a chronic shortage of new homes being built and the main political parties are all in agreement this must be addressed. This underlying demand for new homes, combined with a steadily improving economy and the Government's decision to extend Help to Buy until 2020, gives us the confidence we should continue with our strategy to invest to grow the business.

Over the past five years our strong growth has been driven by a combination of volume growth and increasing our average selling price. Volume growth has been achieved by increased sales rates from more active outlets. The average selling price has risen sharply due to mix changes mainly as a result of the introduction of the Heritage Collection, a shift into higher priced locations and over the past year, a modest level of house price inflation. The growth in turnover from new sites as a result of this strategy has meant that operating margins have recovered towards more normal levels despite significant investment in expanding our divisional structure.

Moving forward top-line growth will rely upon operating from more outlets and in the shorter term a continuing but slowing increase in the average selling price. During the past three years our turnover has increased by c.80%: over the next three years we anticipate growth to moderate and we are targeting turnover of £1.3bn in financial year 2017. We forecast margins will continue to rise as we work out the remaining impaired land and we achieve more efficient recovery of operating expenses: we are targeting operating margins of 18% in 2017. As our profitability improves and we bring on-stream more outlets our Return on Capital Employed will also improve and we are targeting a minimum of 20% in 2017.

We have increased our geographical coverage over the past year with the opening of new divisions in the south. There remains scope for further geographical concentration of our divisions particularly in and around London and the south east where we currently operate from just three business units. We recently restructured our senior management team to focus on the opportunity to grow in these areas. Away from the south and south east all of our divisions retain capacity to grow.

The repositioning of our land bank reflects our strategy to grow in the south and south east and we now have a range of standard product to address our target markets in these areas. We also have the expertise and skills required to develop medium-rise apartment schemes that we expect to become an increasing proportion of our product as we expand into more densely populated urban areas.

40th Anniversary Year

It is approaching forty years since Steve founded the business in November 1974. Much has been achieved over that time but perhaps the last five years since Steve's return to the business stands out. During that time we have increased our turnover by 186% and turned large losses into record profits. We have doubled the workforce and regained our reputation as a 'premium' homebuilder with a range of award winning homes delivering high standards of customer service. We have encouraged more young people to take up a career in the industry and developed the careers of those that work for us.

Our people have responded magnificently to the widespread changes we have introduced over the past five years or so and it should not come as a surprise that in our 40th Anniversary year they are prepared to go the extra mile and do their bit for those that are less well off. The Redrow Charity Challenge has seen our people generously and enthusiastically help and raise money for those in need: I very much thank them for their wonderful work.

Outlook

With an improving economy, growing but well-regulated mortgage availability and the extension of Help to Buy, the prospect for a continuing and sustainable recovery in the new homes' market is favourable. We have a strong order book and a healthy pipeline of outlets to bring on-stream in 2015 and beyond. We have expanded our divisional structure and strengthened our management teams. We have a broad range of product and a reputation for quality and service. We are very well placed to continue with our successful strategy to grow the business.

John Tutte
Group Chief Executive