Directors' Report: Business Review

Group Financial Review

Chris Rickard
Group Finance Director

Cash generation remains an important focus for the Group, but our primary focus will increasingly move towards returning to normal levels of profitability as quickly as market conditions allow.

Financial summary

Adjusted loss per share

(4.3)p
for 2009
(7.2p loss for 2008)

Tangible net assets per share

47p
at 31/12/2009
(120p at 31/12/2008)

Net debt

£750.9m
at 31/12/2009
(£1,529.3m at 31/12/2008)

Group summary

The Group's financial position strengthened significantly during 2009. As outlined in the 2008 Annual Report we reached agreement with all of our debt providers on a revised financing package in April 2009. We subsequently launched a Placing and Open Offer in May 2009, raising £510 million net of expenses which was used to pay down debt and reduce facilities. In addition, we have maintained our tight control on work in progress and investment in land and, as a result, end the year with a significantly reduced net debt.

Market conditions in both the UK and North America were better than those experienced in the second half of 2008, although they still remained challenging.

Group results

Group revenue from continuing operations in 2009 was £2.6 billion (2008: £3.5 billion). Group completions were 15,166 (2008: 19,029), with reduced levels of legal completions recorded in both of our main markets. Whilst mortgage availability and mortgage valuations continue to adversely affect our business, the strong cash generation in 2009 compared with 2008 allowed us to focus on price improvement rather than volumes.

Group operating profit* was £43.3 million (2008: £96.3 million), producing an operating margin* of 1.5% (2008: 2.6%). Of this operating profit* £14.3 million was generated by our UK business (2008: £53.0 million) and £48.1 million by our North American business (2008: £59.9 million). We recorded an operating loss* of £1.4 million in our Spain & Gibraltar business (2008 loss: £2.4 million) and an operating loss* of £17.7 million in our Corporate segment (2008 loss: £14.2 million). £2.8 million of the Group's operating profit* was earned in the first half of the year and £40.5 million in the second half. The second half result included a net credit of £15.6 million relating to utilisation of inventory net realisable value write downs taken in the first half, where the selling prices have exceeded our market assumptions (2008: nil).

The Group's pre-exceptional net finance charges were £139.4 million (2008: £168.6 million) and the Group incurred a loss before tax and exceptional items from continuing operations of £96.1 million for the year to 31 December 2009 (2008 loss: £74.7 million).

* Profit on ordinary activities before finance costs, exceptional items, brand amortisation and tax, after share of results of joint ventures.

Group results

	UK Housing	North America Housing	Spain and Gibraltar Housing	Corporate
Completions	10,186	4,755	225	–
Revenue	1,700.4	824.3	61.0	9.9
Operating profit/(loss)* (£m)	14.3	48.1	(1.4)	(17.7)
Operating margin*	0.8	5.8	(2.3)	–

	Group
Loss before tax and before exceptional items – continuing (£m)	**(96.1)**
Exceptional items (£m)	**(603.8)**
Loss before tax – continuing (£m)	**(699.9)**
Tax including exceptional credit (£m)	**59.3**
Profit for the year from discontinued operations (£m)	**–**
Loss for the year – total Group (£m)	**(640.6)**
Adjusted loss per share – continuing (p)	**(4.3)**
Dividends per share	**nil**

The Group has recorded a total of £603.8 million of pre-tax exceptional items in 2009 (2008: £1,895.0 million). This results in a consolidated loss before tax of £699.9 million (2008 loss: £1,969.7 million). The pre-exceptional tax charge of £14.3 million (2008: £23.4 million) relates mainly to Canada, where the Group continues to be profit making. The exceptional tax credit was £73.6 million, comprising a UK tax credit of £25.4 million relating to the reinstatement of the pension deferred tax asset and a US tax credit of £48.2 million relating to the five year net operating loss carryback (2008 exceptional credit: £100.0 million comprising a net credit of £91.6 million in respect of UK inventory write downs and deferred tax movements and a net credit of £8.4 million relating to US inventory write downs made in the year).

The results of the now disposed of Construction business in Ghana are incorporated into the Corporate reporting segment.

Dividends

The Board did not propose an interim dividend and is not proposing a final dividend for 2009 (2008 full year dividend: nil). We will continue to review the appropriateness of reinstituting dividend payments in the light of prevailing market conditions in the future.

UK Housing

Revenue was £1,700.4 million (2008: £2,390.1 million) from 10,186 completions (2008: 13,394), reflecting the ongoing weakness in market conditions and our decision to accept lower volumes in order to preserve pricing. Average selling prices were lower year on year at £160k (2008: £171k), but showed an increase from the £153k recorded in the first half of 2009. Operating profit* was £14.3 million (2008: £53.0 million), with an operating margin* of 0.8% (2008: 2.2%).

North America Housing

In Sterling terms, revenue was £824.3 million (2008: £981.6 million). Our Canadian business continues to perform strongly, fully vindicating our decision not to divest it during our debt rescheduling negotiations. Completions were 4,755 (2008: 5,421), whilst average selling prices were broadly flat at £171k (2008: £175k) reflecting the more stable market environment. Operating profit* was £48.1 million (2008: £59.9 million). The operating margin* was 5.8% (2008: 6.1%).

Spain and Gibraltar Housing

Revenue from our operations in Spain and Gibraltar was £61.0 million (2008: £59.8 million), with completions of 225 homes (2008: 214). Markets in mainland Spain remained extremely challenging. However, average selling prices were relatively stable at £260k (2008: £270k), reflecting a continuing impact of completions from our Gibraltar business and the ongoing weakness of Sterling against the Euro.

Operating loss* was £1.4 million (2008 loss: £2.4 million).

Construction

Following the sale of the Group's UK Construction business in September 2008, we completed our exit from construction activities with the sale of our construction businesses in Ghana on 21 April 2009. The business was sold to existing management for £1 in cash, giving rise to a profit on sale of £0.2m. The results of the Ghana operations have been presented within continuing operations within the Corporate business segment.

The reported profit after tax from discontinued operations in 2008 was £53.1 million.

Exceptional items

The majority of the 2009 exceptional items relate to the Group undertaking further reviews of the carrying value of its land and work in progress assets at the half year. Given the continuing possibility of further increases in unemployment, continuing scarcity of mortgage finance and the prospect of interest rates rising from their current historic lows, we eliminated future sales price increases from our assumptions at the half year review. We also, inter alia, reviewed in detail and revised, where appropriate, our previous assumptions for costs and other risks at the half year.

A total of £445.0 million was written off against the carrying value of land assets in the UK during 2009 (2008: £904.4 million). A write down of £78.7 million was recorded against land and work in progress assets in North America during 2009 (2008: £71.1 million). A write down of £3.3 million was recorded in Spain and Gibraltar (2008: £37.4 million). All of these write downs were recorded in the first half of the year and no further write down was required as a result of the carrying value review undertaken at the year end.

There were no impairments to goodwill or other intangible assets during the year (2008: £816.1 million).

Other exceptional items charged to profit before finance costs and tax in 2009 amounted to £53.7 million (2008: £55.6 million) and consisted of refinancing costs of £44.8 million (2008: £20.5 million) and restructuring costs of £8.9 million (2008: £35.1 million). Further details of these exceptional charges are set out in Note 5 to the consolidated financial statements.

* Profit on ordinary activities before finance costs, exceptional items, brand amortisation and tax, after share of results of joint ventures.

Net finance costs

Total finance costs for 2009, net of interest receivable of £10.6 million (2008: £8.5 million), were £162.5 million (2008: £179.1 million).

Within finance costs, interest on borrowings from financial institutions totalled £109.1 million (2008: £127.9 million). This decrease was due to the lower average net debt levels the Group carried in 2009 of £1,245.2 million (2008: £1,821.9 million) reflecting the cash generation of the business and the Placing and Open Offer. Other items included in finance costs are a net pension interest charge of £34.3 million (2008: £11.7 million), a mark to market gain on interest rate derivatives of £11.8 million (2008 loss: £10.8 million), a total of £18.4 million (2008: £26.7 million) charged for imputed interest on land creditors and exceptional finance charges relating to bank and debenture loans of £23.1 million (2008: £10.5 million).

Tax

The pre-exceptional Group tax rate for 2009 was 14.9% (2008: 31.3%), resulting in a tax charge of £14.3 million (2008: £23.4 million). During the year, the Group has also recorded a significant exceptional tax credit of £73.6 million, comprising a UK tax credit of £25.4 million relating to the reinstatement of the pension deferred tax asset and a US tax credit of £48.2 million relating to the five year net operating loss carryback introduced in November 2009 as part of an economic stimulus package. In 2008, an exceptional tax credit of £100.0 million was reported, comprising a net credit of £91.6 million in respect of UK inventory write downs and deferred tax movements and a net credit of £8.4 million relating to US inventory write downs made in the year.

During 2009, we have recognised £112.9 million of deferred tax asset on the balance sheet, which relates almost entirely to the UK pension deficit. As a result of the revised financing arrangements and the successful equity raise concluded during 2009, we now consider it appropriate to recognise this asset. The remaining deferred tax assets of £663.5 million, which relate predominantly to trading losses incurred by the Group during the economic downturn, will be recognised on the balance sheet once there is a greater certainty regarding the timing of the Group's return to normal levels of profitability.

In total, the Group has unrecognised potential deferred tax assets as at 31 December 2009 in the UK of £375.1 million (2008: £248.3 million), in the US of £267.0 million (2008: £303.6 million) and £21.4 million in other jurisdictions (2008: £17.3 million), providing a significant buffer against future tax charges.

Our highlights for 2009

- Significantly improved second half performance:
  - Group operating profit of £40.5 million
  - No operating exceptional charges
- Net debt reduced by £778.4 million
- Placing and Open Offer raising £510 million (net)

Earnings per share

The pre-exceptional basic loss per share from continuing operations was 4.3 pence (2008 loss per share: 7.2 pence). The basic loss per share after exceptional items is 25.1 pence (2008: loss of 136.5 pence).

Balance sheet and cash flow

Net assets at 31 December 2009 were £1.5 billion (2008: £1.7 billion) equivalent to a tangible net asset value of 47 pence per share (2008 restated: 120 pence per share). Gearing at 31 December 2009 stood at 50.0% (2008: 91.4%).

The Group's cash inflow from operating activities was £206.3 million (2008: £153.6 million). Year-end net debt levels reduced from £1,529.3 million in 2008 to £750.9 million in 2009, a decrease of £778.4 million. A decrease of £44.8 million is attributable to favourable movements in the exchange rates.

Debt refinancing and Placing and Open Offer

As detailed in the 2008 Annual Report, we reached agreement with all of our debt providers regarding a revised covenant and financing package in April 2009, which was appropriate for both the prevailing adverse market conditions at the time and robust against downside scenarios.

Whilst the agreement to amend our debt facilities did not require the Group to raise new equity capital, it did allow for significant advantages in the event that the Group met its planned £150 million reduction in facilities by the end of 2009 and raised a minimum of £350 million of new equity by the end of 2010.

It was therefore pleasing to be able to conclude a Placing and Open Offer to raise £510 million net of expenses shortly after the agreement to amend our debt facilities, with the new shares starting to trade on the London Stock Exchange on 1 June 2009.

This equity raise satisfied both of the conditions outlined above and as a result:

- The cash margin and coupon payable on the debt, which is based on a ratchet mechanism related to gearing, was reduced by 2.5%;
- The Initial PIK of 1.5% ceased to accrue and no additional PIKs became payable; and
- The level of operating restrictions were reduced.

Treasury management and funding

The Group operates within policies and procedures approved by the Board. These are set out in detail in Note 21 to the consolidated financial statements.

The Group has three sources of borrowings: bank; US$ Private Placements; and public Sterling Eurobonds, which due to the revised financing package, successfully concluded in April 2009, now have common terms and effectively become repayable on 3 July 2012.

The Group's preference is to manage market risks without the use of derivatives but derivatives will be used where necessary and appropriate to reduce the levels of volatility to both income and equity. The use of such derivatives is strictly controlled and they are not permitted to be used for speculative or trading purposes. However, under the revised financing package we are currently restricted from entering into new derivatives.

Derivatives and foreign currency borrowings are used to selectively hedge our foreign investments in order to protect their Sterling value. Interest rate derivatives, while not satisfying the strict requirements for hedge accounting, continue to hedge interest cost volatility.

Taking into account term borrowings and committed facilities, the Group has access to funding in excess of £1.9 billion (2008: £2.5 billion), which is committed until July 2012. At the year-end, £1.1 billion (2008: £411 million) was committed but undrawn.

The Group is operating well within its revised financial covenants and limits of available funding. The Group does not require any additional funding in the near future.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Group Chief Executive's Review on pages 6 to 10. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in this Group Financial Review. In addition, Note 21 to the financial statements includes details of the Group's financial instruments, hedging activities and its exposure to and management of credit risk and liquidity risk.

The Directors remain of the view that, whilst the economic and market conditions continue to be challenging and not without risk, the Group's financing package is sufficiently robust as to the adequacy of both facility and covenant headroom to enable the Group to operate within its terms for at least the next 12 months. Accordingly, the consolidated financial statements are prepared on a going concern basis.

Further information is contained within the Corporate Governance Report and Note 1 to the consolidated financial statements.

Pensions

Actuarial valuations of both of the Company's main pension schemes, the Taylor Woodrow Group Pension & Life Assurance Fund (TWGP&LAF) and the George Wimpey Staff Pension Scheme (GWSPS), were completed during the first half of 2008. The results of these valuations are a deficit of £162.5 million relating to the TWGP&LAF (previous deficit £64.6 million) and a deficit of £215.0 million relating to the GWSPS (previous deficit £148.0 million). The IAS 19 valuation, which appears on the Group's balance sheet, is £406.4 million at 31 December 2009 (2008: £277.2 million). The increase in the deficit was largely due to the strengthening of the inflation expectation assumption and the reducing discount rate due to the lower iBoxx corporate bond rate as a result of the current economic environment. The balance sheet also includes £2.9 million of post-retirement healthcare benefit obligations (2008: £2.6 million).

The Group's deficit reduction payments in respect of the TWGP&LAF remain unchanged at £20 million per annum. The deficit reduction payments to the GWSPS also remain unchanged at £25 million per annum. No one-off deficit reduction payments were made during 2009 (2008: £5 million in respect of the GWSPS). The terms of the debt refinancing secures the deficit repair payments during the term of the refinancing.

We are undertaking a review of the GWSPS benefits and are in consultation regarding the cessation of the defined benefit accrual in this scheme, replacing the pension provision with defined contribution arrangements. We are also reviewing a package of other proposals, including: changes to scheme investment strategy; implementation of an Enhanced Transfer Value exercise; consideration of a buy-in/buy-out/longevity solution; updating mortality assumptions based on a mortality investigation; offering non-statutory pension increase exchange to pensioners; and enhancing scheme investment governance. Once we have developed this package of proposals further, we will enter consultation with the relevant scheme members.

Further details relating to the pension schemes of the Group are presented in the financial statements in Note 22.

Accounting standards

The consolidated financial statements have been produced in accordance with International Financial Reporting Standards (IFRS) as endorsed and adopted for use in the EU. The financial statements are also in compliance with IFRS as issued by the International Accounting Standards Board. There have been no changes to International Accounting Standards this year that have a material impact on the Group results.

Chris Rickard
Group Finance Director

Our priorities for 2010

- Continued focus on cash management
- Implementation of initiatives to appropriately manage the risk of the pension deficit
- Review scope and timing of refinancing opportunities
- Increased focus on margin improvement