

Directors' Report: Business Review

Principal Risks and Uncertainties

<p>Compliance with financial and operational covenants</p> <p>→</p>	<p>Description of risk</p> <p>The agreement to amend our debt facilities reached in April 2009 includes a number of financial and operational covenants. Breach of these covenants could, in certain circumstances, lead to a requirement to repay debt funding in its entirety.</p>	<p>Relevance to strategy</p> <p>Our covenants include limits on the level of new land spend during 2010, 2011 and 2012 and also specify the amount of cash to be generated from the business at each quarterly test date. These requirements will be a consideration in business decisions, including new land acquisitions and new outlet openings.</p>	<p>Impact</p> <p>As the landbank is a long term asset, any requirement to pay back debt at short notice could lead to a requirement to sell assets on unfavourable terms, or potentially cause the business to fail if sufficient funds cannot be raised.</p>	<p>Mitigation</p> <p>We monitor the cash position closely through weekly and monthly forecasts. New land acquisitions are only approved where forecasts show sufficient headroom against the covenant. The covenant levels were set in negotiation with our debt holders in early 2009 on the basis of the forecasts at that time.</p>
<p>Economic and market environment</p> <p>→</p>	<p>Description of risk</p> <p>Demand for our homes can be adversely affected by weakness in the wider economy. This includes factors such as unemployment levels, interest rates and the availability of credit, which are outside of the Group's control.</p>	<p>Relevance to strategy</p> <p>The majority of the homes that we build are sold to individual purchasers who take on significant mortgages to finance their purchase. As such, customer demand is extremely sensitive to economic conditions.</p>	<p>Impact</p> <p>The global economy has shown greater stability during 2009. However, credit availability and consumer confidence remain below normal levels. As a result, the level of demand for new housing continues to be significantly reduced, impacting both profitability and cash generation.</p>	<p>Mitigation</p> <p>Our local teams select the locations and home designs that best meet customer demand. We continue to evaluate new outlet openings on the basis of local market conditions and regularly review the pricing and incentives that we offer. We also minimise the level of speculative build that we undertake.</p>
<p>Government regulations and planning policy</p> <p>→</p>	<p>Description of risk</p> <p>Governments issue a wide variety of requirements for new housing, particularly in the UK, covering areas such as design, quality, sustainability and product mix. The UK General Election in 2010 could lead to a change of Government and potentially changes to these regulations.</p>	<p>Relevance to strategy</p> <p>In addition to our short term landbank, we have a strategic landbank of 84,865 potential plots in the UK. Our ability to obtain the planning permission required to build homes on this land is dependent on our ability to meet the relevant regulatory and planning requirements.</p>	<p>Impact</p> <p>Inability to obtain suitable consents could impact on the number or type of homes that we are able to build. We could also be required to fund higher than anticipated levels of planning obligations, or incur additional costs to meet increased regulatory requirements. All of these would have a detrimental impact on the contribution per plot.</p>	<p>Mitigation</p> <p>We consult with the UK Government on upcoming legislation, both directly and as a member of industry groups, to highlight potential issues. At a local level our land specialists work closely with the relevant planning authorities and structure land purchase agreements to mitigate such risk.</p>
<p>Land purchasing</p> <p>→</p>	<p>Description of risk</p> <p>Purchasing land that is poor quality or mis-priced or purchasing land in insufficient quantity.</p>	<p>Relevance to strategy</p> <p>Land is the major 'raw material' for the Group, but the availability of good quality land at an attractive price is currently scarce. Purchasing land of the appropriate quality on attractive terms will enhance the Group's ability to deliver strong profit growth as housing markets recover.</p>	<p>Impact</p> <p>Purchasing poor quality or mis-priced land would have a detrimental impact on our profitability. Purchasing insufficient land would prevent the Group from delivering budgeted future home completions and lead to a shortfall in anticipated performance.</p>	<p>Mitigation</p> <p>We operate an investment appraisal process for land purchases, which ensures that such projects are subject to appropriate review and authorisation dependent on the proposed scale of expenditure.</p>

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<p>Availability of sub-contractors</p> <p>→</p>	<p>Description of risk</p> <p>The difficult operating environment over the last two years has resulted in the failure of some sub-contractors' businesses. In addition, reduced levels of homebuilding have led to some skilled tradesmen leaving the industry to take jobs in other sectors.</p>	<p>Relevance to strategy</p> <p>In order to optimise our build cost efficiency, whilst retaining the flexibility to commence work on new sites as market conditions allow, the vast majority of work carried out on site is performed by sub-contractors.</p>	<p>Impact</p> <p>If our sub-contractors are not able to recruit sufficient numbers of skilled employees, our developments may suffer from delays or quality issues, leading to reduced levels of customer satisfaction. Lack of skilled sub-contractors could also result in higher levels of waste being produced from our sites.</p>	<p>Mitigation</p> <p>We vet all suppliers prior to working with them to ensure that they meet our requirements for environmental impact, health and safety, quality and financial stability. We also work to address the skills shortage in the industry through apprenticeship schemes and the Construction Industry Training Board.</p>
<p>Site safety</p> <p>→</p>	<p>Description of risk</p> <p>Building sites are inherently dangerous places and our management of health and safety issues is of paramount importance to us.</p>	<p>Relevance to strategy</p> <p>Our operations require a large number of people, ranging from employees and sub-contractors to customers and their families, to visit our sites each day. We want all of these people to go home at the end of the day safe and uninjured.</p>	<p>Impact</p> <p>In addition to the potentially tragic personal impact of an accident on site, there is potential for legal proceedings, financial penalties, reputational damage and delay to the site's progress.</p>	<p>Mitigation</p> <p>We have a comprehensive HSE management system, which is integral to our business. This is supported by policies and procedures to ensure that we live up to our intention of providing a safe and healthy working environment.</p>
<p>Construction and cost management</p> <p>→</p>	<p>Description of risk</p> <p>Construction work can be subject to delays and additional cost for a variety of reasons. These include adverse ground conditions, environmental considerations and adverse weather conditions.</p>	<p>Relevance to strategy</p> <p>We build homes in the UK, US, Canada, Spain and Gibraltar on a wide variety of different sites. Potential issues range from hurricanes in Florida to extreme cold in Ontario and from ground contamination to the presence of protected wildlife species.</p>	<p>Impact</p> <p>Construction delays can result in additional costs to get the build programme back on schedule, lead to quality issues and have an adverse impact on customer satisfaction. Additional costs arising from the construction process may have an adverse impact on profit.</p>	<p>Mitigation</p> <p>We monitor both cost and risk closely throughout the life of a project from initial viability assessment to post completion review. This is achieved through the use of detailed risk registers and regular site valuations, which are reviewed and approved at the appropriate level.</p>
<p>Ability to attract and retain high calibre employees</p> <p>→</p>	<p>Description of risk</p> <p>Recruiting employees with inadequate skills or in insufficient numbers, or not being able to retain key staff.</p>	<p>Relevance to strategy</p> <p>The housebuilding process, from land and planning through construction to sales and customer care, requires significant input from skilled people to deliver quality homes to our customers.</p> <p>The challenging market conditions have meant that we have had to reduce our number of employees across the Group.</p>	<p>Impact</p> <p>Not having the right teams in place could lead to delays, quality issues, reduced sales levels, poor customer care and reduced profitability.</p>	<p>Mitigation</p> <p>We monitor employee turnover levels on a monthly basis and conduct exit interviews, as appropriate, to identify any areas for improvement. We benchmark our remuneration levels against the industry, have succession plans in place for key roles within the Group and hold regular development reviews to identify training requirements.</p>