INDUSTRY NOTE

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Jefferies

EQUITY RESEARCH EUROPE

Building & Construction
The Truth About Operational Gearing

Key Takeaway

With more believers than doubters in the UK residential sector recovery, attention has turned from *'Do I need exposure to the sector?'* to *'Where should I be exposed?'* We believe that the answer to that question lies in the land purchase decisions being made today and that traditional ROCE measures are, irrelevant. Land purchased today will tell us more about the returns of tomorrow than the current capital employed.

Treadmill or Travelator? We do not believe that listed housebuilders lend themselves to traditional ROCE analysis. Our stumbling block is that much of the Capital Employed (the 'CE' in ROCE) is actually Capital Un-Employed (CUE). In any one year, a housebuilder with say a 5 year landbank will have 4 years unemployed. Is it fair to judge the returns of any one year on all of the capital, surely we should consider the returns over the life of the landbank? In a rising market a long landbank acts as a travelator, enhancing returns, whilst a short one a treadmill as you need to run to stand still.

ROCE or ROIC – Whose Capital Employed is it anyway? Another problem we have with ROCE is what is the appropriate way to think about the Capital Employed. Is it the physical capital employed as captured by the Balance Sheet or the purchase price of the shares at the time an investor became a shareholder? In our view, investment decisions should be based on a two stage process; firstly comparing the share price today with the NPV of the returns attaching to that share and secondly how the land purchase decisions made today may impact that NPV trajectory, which will lead to either a re-rating or a de-rating of the shares.

When is book value not book value? Our preferred, mainstream valuation metric is P/B (price to tangible net asset value), because it is less volatile than PER, but P/B is not without its challenges. Try as we might we have not been able to untangle all the movements across the sector within NRV provisions, its as if a piece of the jigsaw is missing. Our NPV approach focuses on the returns generated by the assets rather than the accounting value of those assets, which, in our view levels the playing field

The truth about operational gearing. During the last cycle the link between land buying theory and practice broke and returns suffered. In practice house price inflation exceeded profit growth, in theory the reverse is true. Housebuilders tell us today that they have learnt the error of their ways. There is a risk however that this link breaks again. One warning sign is that as the market improves, UK housebuilders are choosing to disclose less information. We would find it hard to trust that the theory of operational gearing will hold in practice this time around if housebuilders do not disclose plot costs and ASPs on land purchased. If there is nothing to hide, why hide it?

When you have seen one housebuilder, you haven't seen them all. The returns across the sector vary enormously. £100 invested in a single UK housebuilder on 1 Jan 2001 was, on 30 Nov 2013, worth £114 if you chose badly and £981 if you chose well. Our top picks based on valuation grounds today for the coming year are Barratt and Bellway.

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Company Name	Ticker	Mkt. Cap (MM)	Rating	Price	Price Target	Cons. Next FY	Current EPS Estimates 2013	2014	2015	Previous Est. 2014	2015
Barratt Developments	BDEV LN	£3,169.4	BUY	324.70p	474.00p▲	--	14.60p	26.80p	36.40p	23.80p	33.80p
Bellway	BWY LN	£1,696.1	BUY	1,396.00p	1,954.00p▲	--	89.30p	130.00p	161.40p	121.30p	136.40p
Berkeley	BKG LN	£2,996.3	HOLD	2,282.00p	2,398.00p▲	--	160.00p	191.80p	233.30p	174.30p	190.00p
Bovis	BVS LN+	£1,008.1	BUY	754.00p	987.00p▼	--	44.90p	65.20p	80.00p	65.20p	80.00p
Crest Nicholson	CRST LN	£855.8	HOLD	340.40p	387.00p▲	--	26.00p	34.60p	41.80p	31.00p	38.60p
Galliford Try	GFRD LN+	£897.6	BUY	1,096.00p	1,303.00p▲	--	71.30p	79.00p	96.40p	79.00p	96.40p
Persimmon	PSN LN	£3,493.2	HOLD	1,154.00p	1,275.00p▲	--	78.30p	97.00p	115.30p	85.50p	98.90p
Redrow	RDW LN	£1,021.0	BUY	276.10p	344.00p▲	--	15.70p	23.00p	31.00p	18.30p	24.30p
Taylor Wimpey	TW/ LN+	£3,418.4	BUY	106.00p	132.00p▲	--	6.10p	8.70p	10.50p	8.00p	9.50p

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Executive Summary

A year of outperformance

UK Housebuilders have significantly outperformed the market year to date. In the 11 months ended 30 November 2013, Redrow's total return was 70.3%, the sector average was 53.2%. Over the same period the total return on the FTSE 100 and FTSE 250 was 16.9% and 28.4% respectively.

If you've seen one housebuilder, you haven't seen them all

We have analysed the total returns generated from investing in the UK housebuilders over the last 13 years. Over this period, £100 invested in the FTSE 100 would now be worth £170, an average return of 4% p.a. If you had invested in the FTSE 250, £100 is now worth £350 from a 10% annual return. Over the same period a £100 investment in a single UK Housebuilder would be worth £114 at the low end and £981 at the high end. If you re-invested each year into the worst performing share, your £100 investment is now worth £4. However if you had picked the outperformer each year, £100 would have now grown to £33,000.

Picking the winners in the year ahead

Unfortunately we cannot guarantee to select the best performing share for the coming year. However we do provide our take on a new way to consider ROCE and we try to estimate the value embedded in each housebuilder's landbank, from which we derive the Net Present Value (NPV) of the Capital Employed, a measure we call NPV ROCE. The details of the derivation of NPV ROCE can be found in the body of this note. We estimate that the NPV ROCE ranges from 30% at Bellway to more than 50% at Berkeley, Crest and Taylor Wimpey. On the more traditional valuation metrics of PER and P/B our top picks are Barratt and Bellway.

Estimates and price targets upgraded

Following the November IMS season and having reflected on the statements themselves and current market date, we have updated our estimates and price targets. We have now built in 2% underlying house price inflation and tweaked our volume estimates in the light of 'Help to Buy'. We summarise our current ratings, percentage changes to EPS estimates and the current upside to our price targets in Table 1 below.

Table 1: Ratings, EPS upgrades (%) and Price Targets

	Rating	2013	2014	2015	PT (p)	Upside (%)
Barratt	Buy	n/a	12.6	7.7	474	45.8
Bellway	Buy	n/a	7.2	18.3	1954	40.0
Berkeley	Hold	n/a	10.0	22.8	2398	5.1
Bovis	Buy	0	0	0	987	30.9
Crest Nicholson	Hold	0	11.6	8.3	387	13.8
Galliford Try	Buy	n/a	0	0	1303	18.9
Persimmon	Hold	10.7	13.5	16.6	1275	10.5
Redrow	Buy	n/a	0	0	344	24.6
Taylor Wimpey	Buy	0	8.75	10.5	132	24.5

Source: Jefferies estimates

The truth about operational gearing

In the body of this note we try and assess the scale of operational gearing both on the upside and downside. Using actual market data we have built an operational gearing model, which we compare to the actual performance of UK Housebuilders. The conclusion is that investors should keep a close watch on the price of land purchased and be fearful if the current trend of reducing disclosures (we have noted that as the UK housing market recovers there has been a reduction in the length of RNS statements) prevents them making an assessment of the anticipated return associated with land entering the landbank. We view the price of land entering the landbank as the key determinant of future returns.

Valuation Summary

Our valuation methodology is based on Price to Book (share price divided by the tangible net book value per share) and traditional PER.

Stage 1 - We apply a recovery multiple to our CY2014 estimates (1.6x P/B, 16x PER) and steady state multiples to our CY2016 estimates (1.1x P/B and 10x PER) and give a 25% weighting to each output.

Stage 2 - We repeat stage 1 for our Upside and Downside cases. Our Upside case models additional house price inflation of 2% p.a and additional volume growth of 2% p.a. We increase land and build costs in-line with the additional house price inflation. Our Downside case sees volume declines of 2% and all costs remaining at their Base case level.

Stage 3 - We weight the outputs of stages 1 and 2 according to our view of the likelihood of each outcome to arrive at our price target. We assume a 50% likelihood for our Base case, 40% for our Upside case and 10% for our Downside scenario.

Table 2: Valuation Summary

	Barratt	**Bellway**	**Berkeley**	**Bovis**	**Crest**	**Galliford Try**	**Persimmon**	**Redrow**	**Taylor Wimpey**
Bloomberg code	**BDEV LN**	**BWY LN**	**BKG LN**	**BVS LN**	**CRST LN**	**GFRD LN**	**PSN LN**	**RDW LN**	**TW/ LN**
Rating	**Buy**	**Buy**	**Hold**	**Buy**	**Hold**	**Buy**	**Hold**	**Buy**	**Buy**
Current Price (p)	325	1396	2282	754	340	1096	1154	276	106
Current Mkt Cap (£m)	3158	1684	2955	1010	876	904	3498	1013	3378
Net Debt (£m)	19	41	58	-19	0	20	-202	14	59
EV (£m)	3177	1725	3013	991	876	884	3296	1027	3437
Price to Book									
Current P/B	1.25	1.23	2.14	1.15	1.43	2.04	1.55	1.47	1.39
PER									
Current PER	10.3	9.8	10.4	11.6	9.5	12.5	11.8	10.2	12.2
Scenario weightings									
Bull (40%)	218	861	1031	427	171	561	549	158	63
Base (50%)	217	983	1253	488	191	652	632	176	60
Bear (10%)	39	110	113	72	25	90	93	11	8
PT	**474**	**1954**	**2398**	**987**	**387**	**1303**	**1275**	**344**	**132**
Upside/(downside)	**46**	**40**	**5**	**31**	**14**	**19**	**10**	**25**	**24**
PT									
Base Case	474	1966	2507	976	382	1303	1265	351	121
% upside/(downside)	34	41	10	29	12	19	10	27	14
Upside Case	544	2154	2578	1067	427	1605	1373	394	157
% upside/(downside)	67	54	13	41	26	28	19	43	48
Downside Case	393	1098	1134	723	253	898	933	109	83
% upside/(downside)	21	-21	-50	-4	-26	-32	-19	-61	-22
2x price to book	521	2269	2131	1306	476	1549	1494	376	152
% upside/(downside)	60	63	-7	73	40	41	29	36	44

Source: Bloomberg, Jefferies estimates

The Autumn Statement

Overview

In our view, whilst the Autumn Statement did not bring any surprises with respect to the UK residential market it should have settled the nerves of those concerned about the curtailment of 'Help to Buy' and near term increases in UK Bank Rate. No changes to 'Help to Buy' were hinted at, rather the Chancellor spoke of how successful the scheme has been so far.

Unemployment and Bank Rate

The OBR does not expect unemployment to fall below 7% until 2016. We reiterate the forward guidance given by the Monetary Policy Committee that Bank Rate will be maintained at 50bp until the unemployment rate has fallen below 7%, subject to there being no risks to price or financial stability. In our view, Bank Rate will not be moving away from its current level for some time.

'Help to Buy' 1

So far, over 18,000 reservations for new homes have been made under the equity loan scheme since it was launched in April 2013. So far more than 900 developers have registered to deliver homes via 'Help to Buy' 1, the UK Government baked equity loan scheme.

'Help to Buy' 2

In the month since 'Help to Buy' 2 was launched, more than 2,000 people have put in applications to lenders totalling £365 million of new mortgage lending and more than 65% of the mortgage market have committed to participate in 'Help to Buy' 2, the UK Government backed mortgage guarantee scheme. So far, more than three quarters of the applications are coming from outside London and the South East. On average, households have asked to borrow around £155,000 for houses worth about £163,000, which is below the Treasuries view of UK average house price at £245,000.

Housing bubbles

The Autumn Statement commented that to a large extent, the recent increase in national house price indices is driven by movements in London, where prices grew 9.4% in the year to September. But the market nationwide remains more subdued, and outside London and the South East, prices grew by an average of 1.4% over the same period. Real house prices are 16.7% below their pre-crisis peak, and by 2018-19 the OBR forecast house prices will still be around 3.5% below their pre-crisis peak in real terms.

Housing affordability

A combination of low interest rates and some improvement in house price affordability means that mortgage costs are close to historic lows. Mortgage repayments average 27% of household disposable income, compared with almost 50% in 2007 and a long-term average of 36%. Mortgage interest rates would need to rise by almost 4 percentage points for interest payments to reach the same proportion of income as in 2007, according to the Council of Mortgage Lenders.

UK Government committed to 'Help to Buy'

The Autumn Statement reported that although household lending and the housing market are recovering, the lack of availability of higher LTV mortgages remains a significant barrier to first time buyers and those without a large deposit. 'Help to Buy' is a targeted, temporary measure designed to address the shortage of higher LTV mortgages and will continue to perform this vital function until the scheme ends in 3 years' time. The median first time buyer LTV ratio was around 95% for most of the 1980s and 1990s, and only dropped below 90% during 2 of the years over the quarter of a century before 2007. Currently, the median first time buyer LTV is around 80%.

Please see important disclosure information on pages 57 - 60 of this report.

Enough of demand what about supply?

It is fair to say that 'Help to Buy' has led to a supply response. Output in the construction sector grew by 1.7% in the third quarter of 2013, driven by public and private housing. Total housing starts increased 16% year on year in the third quarter of 2013. In the second quarter of 2013, more than 8 out of 10 of all major residential planning applications were approved. The number of residential units approved in England was 35% higher in the year to September 2013 compared with the previous year. The government's 'Help to Buy' package will help generate new supply, with over 18,000 reservations for new homes since the launch of the 'Help to Buy' equity loan in April 2013. However, it is clear that continued strong growth in housebuilding will be needed in the years to come to meet housing needs and ensure market stability. The OBR EFO notes *"the weakness of housing supply"* and the *"slow response of supply to price signals – which many researchers argue is related to rigidities in the planning system".*

The government is taking action to address these supply side constraints, addressing delays at every stage of the planning process, incentivising improved performance and reducing costs for developers. In addition the Autumn Statement announced that the government will also issue £1 billion in loans to unblock large housing developments and give local authorities additional flexibility through the Housing Revenue Account (HRA) to support new affordable housing.

The government will take steps to address delays at every stage of the planning process, incentivise improved performance and reduce costs for developers, including:

- Consulting on measures to improve plan making, including introducing a statutory requirement to put a Local Plan in place.
- Legislating to treat planning conditions as approved where a planning authority has failed to discharge a condition on time, and using legislative measures to strengthen the requirement for planning authorities to justify conditions that must be discharged before building can start.
- Consulting on proposals to reduce the number of applications where unnecessary statutory consultations occur and piloting a single point of contact for cases where conflicting advice is provided.
- Allowing developers to apply directly to the Department for Communities and Local Government (DCLG) where a planning authority makes fewer than 40% of its decisions on time.
- Carrying out an evaluation of the New Homes Bonus, which will complete at Easter 2014. The government will consult on measures to further improve the incentive provided by the New Homes Bonus, in particular through mechanisms to withhold payments where planning approvals are made on appeal.

Residential related taxes

Two changes to the property tax system were announced. From April 2015, capital gains tax will be introduced on future gains made by non-residents disposing of UK property. The details have yet to be decided and a consultation on how best to introduce this tax will be published in early 2014.

The Autumn Statement also commented that the Government will reduce the capital gains tax private residence relief final period exemption from 36 months to 18 months to reduce the incentive for those with multiple homes to exploit the tax rules

FLS Changes Re-Cap

On 28th November, the Bank of England too the decision that, with the recovery of the UK housing market established, the Funding for Lending Scheme (FLS) will no longer be available for residential mortgages from 1 February 2014.

Why the change? The Bank of England believes that activity in the housing market is picking up and house price inflation appears to be gaining momentum, and therefore does not need the support of FLS.

Is 'Help to Buy' impacted? The changes have no implications for HM Government's 'Help to Buy' scheme, which is designed to address the specific issue of access to mortgages for borrowers without large deposits, unlike the FLS, which was designed to boost lending more generally.

Was FLS a big deal anyway? Cumulative net lending since June 2012 by FLS participants was £3.6bn at the end of Q3 2013. This lending is split between households and to small and medium sized businesses – private non-financial corporations (PNFCs). If all the £3.6bn related to residential mortgages, we believe it would equate to around 27,700 mortgages (assuming an average mortgage advance of £130,000). Since June 2012 there have been 878,400 mortgage approvals for house purchase, at most therefore FLS linked mortgages account for 3.2% of this total.

Will this mortgage supply disappear? This is unlikely, in our view. FLS reduced mortgage rates on average by c.0.6% for a 75% LTV floating rate mortgage and by c.1.0% for 75% LTV fixed rate mortgages and 90% LTV fixed rate.

Will the change hit First Time Buyers? No, the issue with the mortgage market has been the lack of supply of 95% LTV mortgages, which FLS didn't help. 'Help to Buy' is unchanged and we noted in last week's FF/RW & Focus that Chelsea Building Society has launched 36, 95% LTV mortgage products outside the scope of 'Help to Buy'. In addition, empirically, First Time Buyer mortgage approvals are not correlated to mortgage rates.

What should I do now? We would remain invested in the sector and would view any 'FLS linked' weakness in the shares to act as a buying opportunity. In our view the changes to FLS which are effective from 1 February 2014 will not significantly impact the UK housebuilders, a view which has been confirmed by all the UK housebuilders we have spoken to since the FLS announcement. They would be more interested in seeing mortgage rates fall on 'Help to Buy' mortgage products, although they appreciate that rates will, in part, impact the level of underlying house price inflation and that generally lower house price inflation is preferable to higher rates.

Risk Factors

We divide risk factors into three main categories: market, regulatory and operational. We discuss below what are, in our view, the key risks to our estimates at a sector level and those risks which equally apply to all UK housebuilders. We do not attempt to discuss all the risks facing the sector, but rather to provide a framework on which investors should carry out their own risk assessment. Specific risks relating to individual companies are discussed in the company sections of this report.

Market Risks

Our estimates are based on our assumption of a stable underlying UK housing market. We expect to see stability in underlying house prices, mortgage approvals for house purchase, mortgage rates, housing transactions and household income.

Falling house prices would negatively impact the sector. UK Housebuilders are price takers, land purchased today reflects current house prices. If house prices fall, a housebuilder's average selling price will fall, reducing earnings and, if the falls are significant, would lead to an impairment of the value of the land held on the balance sheet, this would reduce the Tangible Net Asset Value (TNAV). In our view, the key valuation metric for housebuilders is Price to TNAV, falling house prices could therefore lead to a de-rating of the sector.

Consortium sites. Whilst we often talk about the national housing market, we believe that the 'market' itself is a collection of many local markets, for instance house prices in one street may be 25% higher than a similar adjacent street due to school catchment areas. On large sites, housebuilders often either sell part of the site to other housebuilders or enter into joint venture agreements. There is a risk that should local market conditions deteriorate, one or more of the housebuilders may reduce their selling prices to gain market share, which may lead to a downward spiral of house prices in that specific local market and a reduction in profits generated from that site.

Falling mortgage approvals would negatively impact the sector. The majority of homes sold by the UK housebuilding sector are sold to homebuyers who require mortgage finance to secure their purchase. A reduction in mortgage supply, could therefore lead to a reduction in the number of homes sold in the sector, which would reduce earnings estimates and could lead to a de-rating of the sector.

Rising mortgage rates. Residential mortgage rates are currently at an all-time low, the current average mortgage rate is 3.28%, significantly below what, in our opinion, is a more normalised rate of 6.0%-8.0%. Mortgage rates are a proxy for the cost of finance and if rates were to increase, mortgage costs rise, which may reduce the pool of potential homebuyers on affordability grounds. In this scenario housing transaction volumes would reduce and homebuilders would sell fewer homes, which is likely to reduce earnings estimates.

Falling housing transactions. Whilst in our view there is no causal link between consumer confidence and the UK housebuilding sector, there is a risk that the general macro-economic malaise and the continuing euro crisis may lead to home movers and homebuyers deciding to delay their purchase decision. Our volume estimates are calculated by taking the number of active sites (the number of developments the housebuilder is actively marketing) and applying a sales rate (the number of homes sold per site, per week) to the number of active sites. If housing transactions were falling, we may have to reduce our sales rate estimates and this in turn may lead to a reduction in earnings estimates across the sector.

Falling household income. Household income, has, in our view, remained relatively stable since the onset of the credit crunch. The level of a homebuyer's post-tax income is a key input into the CAFI (our housing affordability index). If household incomes were to fall significantly, the current high levels of affordability would not be maintained.

A significant reduction in housing affordability would, in our view, lead to a fall in the level of housing transactions and in the longer term would put downward pressure on house prices. Neither outcome is welcome news for a housebuilder and may lead to downgrades across the sector.

Illiquidity of the underlying assets. Land and residential properties can be relatively illiquid assets. Such illiquidity may affect a housebuilder's ability to value, or sell its assets (either homes or land) in a timely fashion. It may therefore have to accept a lower price than anticipated in response to changes in either local or national housing market conditions. In this scenario the balance sheet value of land, work in progress and finished goods held for resale may be higher than the market value and our profit and net asset estimates may need to be reduced.

Regulatory Risks

National Planning Policy Framework. The UK housing market is currently coming to terms with this new planning regime. We welcomed the NPPF, especially the *'presumption in favour of sustainable development'*, which should, in theory, lead to a reduction in planning delays (land is required to have residential planning permission attached before a developer can build and ultimately sell a home). The NPPF came into force in March 2012 however, in terms of legislation and policy it is still early days and for us, the jury remains out as to whether the theory of the NPPF is borne out in practice. The risk to our estimates of planning delays is that we may have to reduce our volume assumptions, by reducing our estimates of the number of active sites from which the housebuilder operates, which would in turn negatively impact our estimates and therefore our view of fair value.

Changes to UK Government backed stimulus packages. On 28 November 2013 the Bank of England announced that FLS funding will no longer be available for residential mortgages from 1 February 2014. In our view, the impact on the UK housing market of this decision will be minimal, at the margin, mortgage rates for some may tick up 60-100bp. However, more importantly, the change in FLS highlighted the risk that UK Government backed stimulus packages may be changed. If 'Help to Buy' were to be scaled back, we believe that there shares in the sector would experience a significant de-rating.

Changes in the regulatory environment. There is a risk that changes in legislation could result in housebuilders having to increase the level of social housing on developments, or pay increased levels of 'planning taxes' such as Section 106 contribution. Local authorities across England and Wales are currently developing their approach to the Community Infrastructure Levy (CIL), which may lead to delays in planning and increase the costs of bringing sites into the development phase. The impact of changes in the regulatory environment is, in our view, likely to reduce the expected rate of return on developments and put downward pressure on our estimates across the sector.

There may also be changes in regulation between the time when initial consents are given and the time when construction begins, which may cause delays, increase costs and therefore reduce shareholder returns. These changes may relate to building regulations, additional planning requirements, employment laws, health and safety regulations and environmental and sustainability requirements.

Changes to residential property taxes. Tax rules, including stamp duty land tax and capital gains tax and their interpretation may change. With the current pressure on the Treasury to raise UK tax receipts, there is a risk that property related taxes may increase. In this scenario, our view is that the number of housing transactions would reduce and this would negatively impact our earnings estimates across the sector.

Operating Risks

Land purchasing and availability. Land is the major raw material for the sector and in our view the limited availability of good quality land at an attractive price may lead to significant price competition. Purchasing land on attractive terms enhances the sector's ability to grow earnings should the housing market recover. Similarly purchasing poor quality or mis-priced land will have a detrimental impact on profitability and returns. Not purchasing enough land reduces the flexibility of a housebuilder's landbank and its ability to actively manage the land to create value for shareholders. If availability of land for sale reduces, our volume estimates may have to be trimmed back and if land price competition becomes a feature of the land market we may have to reduce our operating margin estimates.

Land quality assessments. Cost estimates made in advance of commencing a development are dependent upon assumptions, estimates and judgements, which may prove to be inaccurate. For instance planning may be delayed due to complications of rare species of wildlife being found on site, or technical issues under the ground, which were not apparent or visible during the initial site assessment, for instance costs of removal, investigation or remediation of hazardous or toxic substances. There are also risks that such substances do not come to light until the completion of the development which could lead, potentially, to significant unanticipated costs. The impact of such unanticipated costs or delays is to reduce the profits generated from the development.

Building the wrong product. A housebuilder may misjudge local market conditions and supply a product that is not in demand. A recent example would be the effective over-supply of apartments in city centres such as Leeds. Developers misjudged the appetite for city centre apartments and this was exacerbated by tightening mortgage supply following the onset of the credit crunch. As a result, these developments took longer to complete and realised lower selling prices than anticipated when the original investment into the land was made. Shareholder returns derived from such sites were therefore lower than originally planned.

Rising building material costs. We currently assume gently rising building material costs (cement, timber, bricks etc), however due to the structure of the industry UK housebuilders are generally price takers of their significantly larger building materials suppliers. In our view, these gentle rises are currently mitigated by continuing build efficiency programmes across the sector and our assessment that the low industry wide housebuilding volumes are helping to keep a check on input price inflation. Were build costs to increase ahead of our expectations, the housebuilder's operating margins would reduce and earnings estimates would need to be scaled back.

Labour shortages. The challenging market conditions witnessed by the UK housebuilding sector since the start of the credit crunch has led to a significant reduction in the skilled labour base employed by the housebuilders and not all have found alternative positions using their sector specific skills. As a result, the pool of skilled labour has reduced across the industry. Should market volumes start to recover, there is a risk that labour costs may increase more quickly than we anticipated and we may have to reduce our operating margin assumptions.

Viability of sub-contractor networks. The UK housebuilding industry makes heavy use of the sub-contractor market.. There is a risk that certain sub-contractor's businesses may fail and this may result in increased costs across the sector.

Construction defects. There can be no assurances that new homes built will be free from defects once completed. Construction defects may occur on developments and may arise sometime after the completion of the development. Housebuilders typically obtain warranty, guarantee or indemnity protection on developments, but these may not cover all eventualities and significant liabilities may only come to light after the expiry of the warranty or indemnity period.

Share Price Past

Thirteen year view

In the following three tables we look at the total returns made across the UK Housebuilders we cover since 1st January 2001. Table 3 illustrates the total annual returns for each stock. Table 4 illustrates the total returns since 2000 for each share. We hope that this dispels the myth that investment is purely a sector rather than a stock specific call. Depending on which horse you backed in 2000, your £100 at the end of November 2013 could be worth between £114 and £981, quite a spread.

For those keen to develop their hindsight Table 5 shows the returns you would have made by investing equally across the sector, the accumulators of picking and re-investing the best or worst share, a basket of the top 3 and bottom 3 overall and for completeness, the returns for the FTSE 100 and FT250.

Top marks to those of you who matched the best performance accumulator, which turned £100 on new year's eve 2000 into £33,000. Commiserations to those who did the opposite, turning £100 into £4. Choosing a basket of the three best performers overall would have netted an average return of 20% p.a, a basket of the bottom 3 would have returned 9% p.a against the FTSE 100 at 4% p.a and the FTSE 250 at 10% p.a.

Table 3: Annual Total Return, %

	BDEV	BWY	BKG	BVS	CRST	GFRD	PSN	RDW	TW	Average	FTSE 100	Sector FTSE 250
2001	50.3	34.2	-4.5	12.5		66.3	63.9	11.1	-1.6	29.0	-13.4	-6.3
2002	-5.7	5.4	-13.8	-3.3		-34.7	14.2	3.8	3.1	-3.9	-22.1	-25.0
2003	44.1	58.6	52.2	37.4		74.0	31.0	45.5	63.1	50.7	17.9	38.9
2004	13.9	21.1	57.7	25.6		27.6	32.8	17.1	5.6	25.2	11.4	23.1
2005	72.5	43.2	37.3	42.0		79.4	89.3	43.0	45.5	56.5	21.0	30.4
2006	29.1	40.4	54.0	40.0		87.6	24.4	36.6	16.6	41.1	15.1	30.8
2007	-61.4	-43.7	-10.7	-40.6		-35.6	-45.5	-52.9	-50.3	-42.6	7.5	-2.1
2008	-84.1	-25.2	-23.2	-32.3		-67.2	-69.6	-48.4	-92.7	-55.3	-28.2	-37.8
2009	170.1	38.1	-5.9	8.6		38.9	104.4	7.0	279.6	80.1	27.4	50.7
2010	-28.5	-16.8	8.5	-4.8		0.1	-10.4	2.0	-19.0	-8.6	12.7	27.6
2011	4.8	8.2	43.4	7.2		65.6	14.7	-16.4	19.0	18.3	-3.8	-9.9
2012	123.5	48.4	37.7	32.6		63.6	72.0	46.4	77.5	62.7	10.2	26.2
2013*	59.7	40.4	38.8	37.2	62.3	51.9	55.3	70.3	62.8	53.2	16.9	28.4

Source: Bloomberg *1 January 2013 – 30 November 2013

Table 4: Total return with respect to £100 invested 1 January 2001

Year ended	BDEV	BWY	BKG	BVS	CRST	GFRD	PSN	RDW	TW
2000	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
2001	150.3	134.2	95.5	112.5	100.0	166.3	163.9	111.1	98.4
2002	141.7	141.4	82.3	108.8	100.0	108.7	187.2	115.3	101.5
2003	204.2	224.2	125.3	149.4	100.0	189.0	245.2	167.9	165.6
2004	232.6	271.6	197.7	187.7	100.0	241.2	325.6	196.5	174.9
2005	401.3	388.8	271.5	266.6	100.0	432.7	616.3	281.1	254.6
2006	517.9	545.9	418.1	373.2	100.0	811.7	766.7	384.1	296.8
2007	200.1	307.2	373.4	221.7	100.0	522.5	418.1	181.1	147.4
2008	31.9	229.7	286.8	150.1	100.0	171.4	127.2	93.5	10.8
2009	86.2	317.2	269.9	163.1	100.0	238.1	260.0	100.0	40.8
2010	61.6	263.9	292.9	155.2	100.0	238.5	232.8	101.9	33.1
2011	64.5	285.6	419.9	166.5	100.0	394.8	267.1	85.2	39.3
2012	144.2	424.0	578.2	220.8	100.0	645.8	459.5	124.7	69.8
2013*	**230.4**	**595.3**	**802.7**	**303.0**	**162.3**	**981.1**	**713.7**	**212.4**	**113.7**
Growth (%)	130.4	495.3	702.7	203.0	62.3	881.1	613.7	112.4	13.7
Growth pa (%)	6.6	14.7	17.4	8.9	3.8	19.2	16.3	6.0	1.0
Rank	6	4	2	5		1	3	7	8

Source: Bloomberg *1 January 2013 – 30 November 2013

Table 5: Winners losers and baskets

Year ended	Average across all housebuilders	Biggest riser	Biggest faller	FTSE100	FTSE250	Top 3	Bottom 3
2000	100.0	100.0	100.0	100.0	100.0	100.0	100.0
2001	129.0	166.3	95.5	86.6	93.7	141.9	119.9
2002	124.0	189.9	62.4	67.4	70.3	125.7	120.4
2003	187.0	330.4	81.7	79.5	97.6	191.6	181.8
2004	234.1	521.2	86.3	88.6	120.2	267.0	204.0
2005	366.4	986.4	118.5	107.3	156.7	450.3	313.4
2006	516.9	1850.7	138.2	123.5	204.9	699.6	399.4
2007	296.8	1653.0	53.4	132.8	200.7	485.5	180.4
2008	132.6	1269.6	3.9	95.3	124.8	226.6	45.0
2009	238.8	4819.3	3.7	121.4	188.1	330.4	113.5
2010	218.2	5230.7	2.6	136.8	240.1	328.5	96.3
2011	258.2	8660.8	2.2	131.7	216.3	463.9	98.6
2012	420.1	19354.0	2.9	145.1	273.1	731.9	180.0
2013*	643.7	32967.6	4.0	169.6	350.6	1088.1	295.7
Growth (%)	320.1	19254.0	-97.1	45.1	173.1	631.9	195.7
Growth rate pa (%)	15.4	56.2	-22.0	4.1	10.1	20.2	8.7

Source: Jefferies estimates, company data *1 January 2013 – 30 November 2013

Share Price Present

Twelve month view

In the year to 30 November 2013, our UK Housebuilder's total return on average was 53.2% ranging from Bovis and Berkeley at 37.2% and 38.8% respectively to Redrow and Taylor Wimpey at 70.3% and 62.8%. The total return of the FTSE 100 over the same period was 16.9%.

Table 6: Share Price Performance 2013

	BDEV	BWY	BKG	BVS	CRST	GFRD	PSN	RDW	TW	Average	FTSE 100	FTSE 250
2013 *	59.7	40.4	38.8	37.2	62.3	51.9	55.3	70.3	62.8	53.2	16.9	28.4

Source: Bloomberg *1 January 2013 – 30 November 2013

Please see important disclosure information on pages 57 - 60 of this report.

Share Prices Yet to Come

Valuing Housebuilders PER, and P/B and ROCE

Essentially we believe that valuation comes down to one thing, how much are you willing to pay for the expected returns attached to each share. The most common measure across the whole market is the Price Earnings Ratio (PER), which allows cross sector comparisons to be easily, if not wholly accurately, made. No discussion about housebuilders valuation is complete without consideration of Price to Book (P/B) and ROCE continues to gain share of voice.

There are however complications, PERs can be rather fickle and the common or garden P/B measure has become rather distorted by Net Realisable Value provisions. Discussions centred around traditional ROCE are increasingly common, but in our view also misplaced. We believe that the best approach is to look at the returns of the future, rather than to try to untangle the accounting policies and practices of the past, a path that we believe will lead to nowhere other than frustration. We also believe that the first question to answer with respect to any equity investment is 'Would I invest in the shares today?' Our focus is to look at tomorrow's value in today's landbank.

Turn assets fast or maximise return on assets?

Treadmill or Travelator?

We do not believe that listed housebuilders lend themselves to traditional ROCE analysis. Our stumbling block is that much of the Capital Employed (the 'CE' in ROCE) is actually Capital Un-Employed (CUE). In any one year, a housebuilder with say a 5 year landbank will have 4 years unemployed, therefore is it fair to judge the returns of any one year on all of the capital, surely we should consider the returns over the life of the landbank?

We provide a simple illustration below. Treadmill Builders focuses on a quick asset turn to maximise ROCE, buying land as it needs it. Travelator Builders seeks to maximise returns rather than ROCE. We illustrate a rather extreme and overly simplified two year model in Table 7 below. In Year 1, Treadmill Builders buys one plot of land and builds and sells one house, whereas Travelator Builders buys two plots of land and builds and sells one house. Both make a gross profit of £25,000. However Treadmill has a ROCE of 100% but Travelator just 50%.

In Year 2 house prices have doubled and land prices and build costs have followed suit. Treadmill continues to deliver a ROCE of 100%, whereas Travelator has made a ROCE of 300% as its returns have been assisted by the market. Over the two years, Treadmill has delivered gross profit of £75,000 and a ROCE of 100% and Travelator a gross profit of £100,000 and a ROCE of 200%. Had we based our investment decision on a one year view rather than over the horizon of the landbank we would have missed returns of £25,000 or 33%. We have not added finance costs into our model, but in our view they are unlikely to change the overall result. Returning to the real UK economy, we also believe that finance costs are unlikely to outweigh the impact of underlying house price inflation over the medium term.

Table 7: Treadmill vs Travelator, a ROCE tale of two housebuilders

	Treadmill Builders: Year 1	Year 2	Total	Travelator builders: Year 1	Year 2	Total
House price (£'000)	100	200		100	200	
Land cost (£'000)	25	50		25	25	
Build cost (£'000)	50	100		50	100	
Gross profit (£'000)	25	50	75	25	75	100
Gross margin (%)	25	25		25	37.5	
Capital employed (£'000)	25	50	75	50	25	50
ROCE (%)	100	100	100	50	300	200

Source: Jefferies estimates

Working smarter or working harder

In our example above Treadmill Builders would have to run very fast with respect to operational efficiency to catch up with Travelator Builders. One way to equalise the returns would be to increase volumes by 50% in year two. This however brings its own challenges. Is there sufficient supply of land, labour and building materials and will the higher demand increase prices (and therefore reduce returns)?

We appreciate that Travelator Builders is a bull market story, and should the market turn in year two it would be left with land at the wrong price, whereas Treadmill is always buying land at marked to market prices. However, it is the longer landbank housebuilders (Berkeley, Persimmon) which deliver the highest long run returns.

ROCE or ROIC – Whose Capital Employed is it anyway?

Another problem we have with ROCE is, what is the appropriate way to think about the Capital Employed. Is it the physical capital employed as captured by the Balance Sheet or the purchase price of the shares at the time an investor became a shareholder? One could argue that to a large extent the historic Balance Sheet is irrelevant. Making an investment in the shares today is more about the returns on the shares purchased than the capital employed. Suppose Treadmill Builders generates twice the ROCE of Layzee Builders, if the returns are reflected in the price of shares is it that important? If Treadmill generates returns of 100p per share and Layzee 50p per share, but Layzee's share price is half that of Treadmill, all others things being equal, an investor should be indifferent.

We believe it is important to look forward not back. The key is how we believe future operations and investment decisions will impact current returns, to ascertain if the shares are mis-priced. If Layzee hires a few employees from Treadmill, future returns may increase. Whereas if Treadmill hires workers from Layzee, returns may reduce.

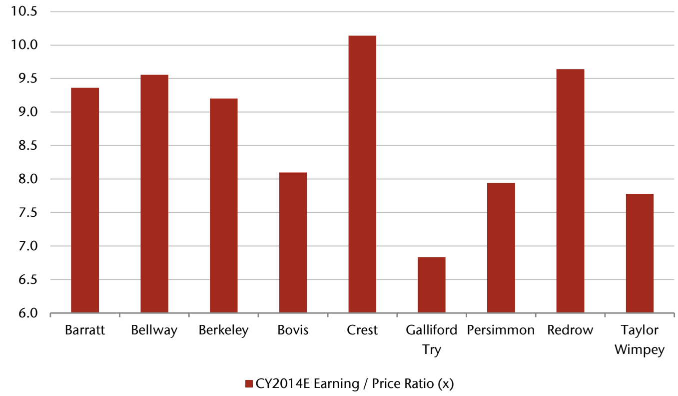
Whilst not disclosing as much as they used to in the bad old days, housebuilders still generally do disclose details of their land spend including their hurdle rates and whether these hurdle rates are being achieved. Whilst not an exact science, we can analyse the land spend data to ascertain the direction of operating margins and therefore future ROCE. In our view, investors should be more focused on the land purchasing decisions being made today than the returns being made on land purchased in the past. If the current reductionist disclosure trends continue and prevent these calculations being made, we would suggest that in this case 'no news' is probably 'bad' rather than 'good'.

ROCE from an investors' point of view

We would suggest that one way to consider ROCE is to compare EPS to the price of the share at the time of purchase. From the investors' point of view the returns are the 'earnings' attached to the share and the capital employed the actual capital invested, or to put it another way the reciprocal of the PER at the time of purchase (the EPR). We would caution against any one valuation metric being considered in isolation. We believe that PER, EPR should all be considered in with respect to the growth trajectory of the underlying earnings.

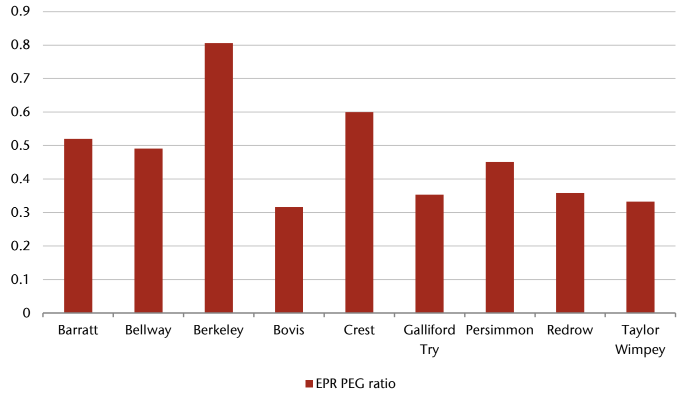
Chart 1 shows the EPR based on CY2014E EPS and on this basis the returns appear highest at Crest, Redrow and Barratt. However when earnings growth is factored in, see Chart 2 (which shows the EPR PEG ratio based on EPS growth for the two years ending 31 December 2016), Bovis and Taylor Wimpey appear to have the most value attractions. Later in this note we develop this idea further looking at the NPV per share of each housebuilder compared to the share price to derive a Returns expected on Capital employed today.

Chart 1: Earnings / Price ratio - Investor ROCE proxy, %



Source: Jefferies estimates

Chart 2: EPR PEG ratio (x)



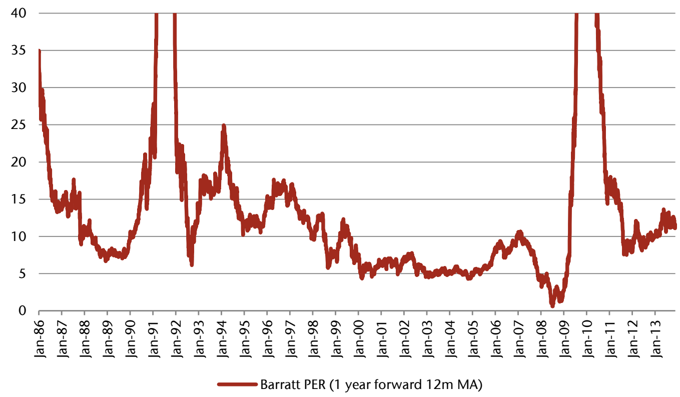
Source: Jefferies estimates

The Fickle and Volatile World of PER

In a cyclical industry, earnings are by definition somewhat volatile. One's view of the appropriate PER multiples therefore has to adapt to both changing market conditions and unforeseen bumps and dips in the road. Basing investment decisions on 'through the cycle' multiples leads to suboptimal returns, in our view, often leaving too much profit on the table on the upside and not leaving enough of the losses on the downside.

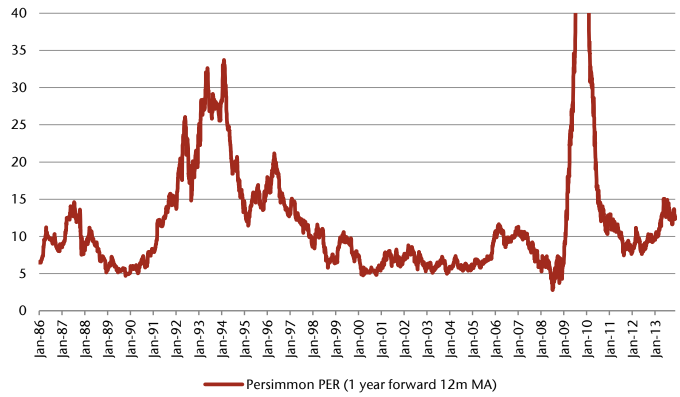
As with any valuation metric, we are most interested in what happened at turning points and for UK housebuilders this is typically when PER has nothing to say (as profits become losses).

Chart 3: Barratt PER since January 1986 (x)



Source: Datastream

Chart 4: Persimmon PER since January 1986 (x)



Source: Datastream

In our view the UK housing recovery which began in 2013 will continue into 2014, 2015 and 2016 and therefore PER will, in our view, be relevant for the next three years. We would wish to anchor PER valuations to EPS growth and in our view PEG ratios appear appropriate given the scale of earnings growth anticipated over the next three years.

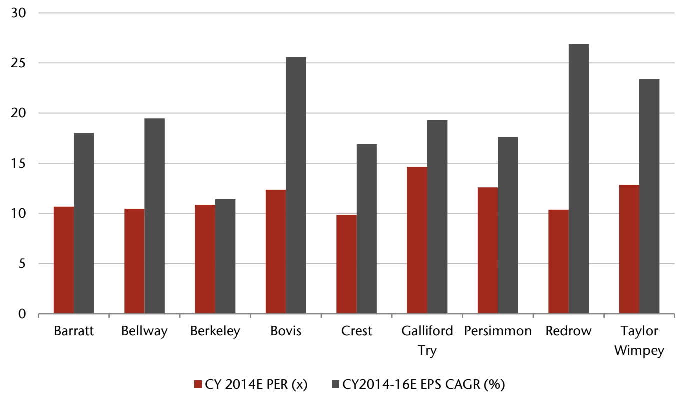
Conventional wisdom suggests that a share is fairly valued on a PEG basis with a PEG of 1.0. In Table 8 we have looked at the implied PEG ratio derived share price based on the CY2013-2016E EPS Compound Average Growth Rate for each of the UK housebuilders we cover.

Table 8: PEG Ratio upside

	Barratt	Bellway	Berkeley	Bovis	Crest	Galliford Try	Persimmon	Redrow	Taylor Wimpey
CY 14E PER (x)	10.7	10.5	10.9	12.4	9.9	14.6	12.6	10.4	12.9
CY 14E EPS (p)	31.6	143.1	219.5	65.2	35.8	75.2	97.5	27.0	8.7
CY14-16E EPS CAGR (%)	18.0	19.5	11.4	25.6	16.9	19.3	17.6	26.9	23.4
CY14-16E PEG (x)	0.6	0.5	1.0	0.5	0.6	0.8	0.7	0.4	0.5
Implied share price if PEG = 1	569	2785	2506	1669	606	1453	1719	726	203
Upside to current price (%)	69	86	5	107	71	32	40	159	82

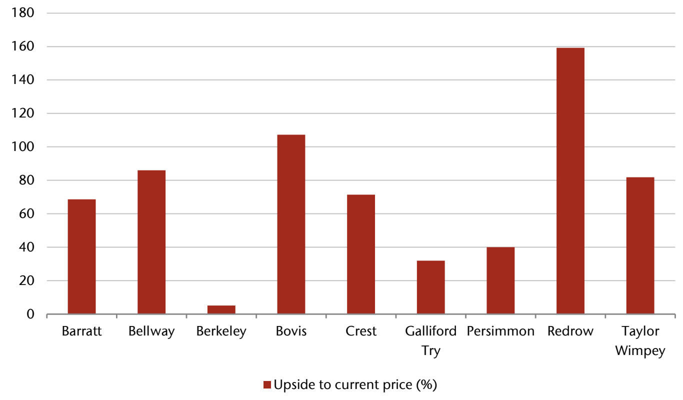
Source: Jefferies estimates

Chart 5: CY 2014E PER



Source: Jefferies estimates

Chart 6: Upside to current share price if PEG =1, %

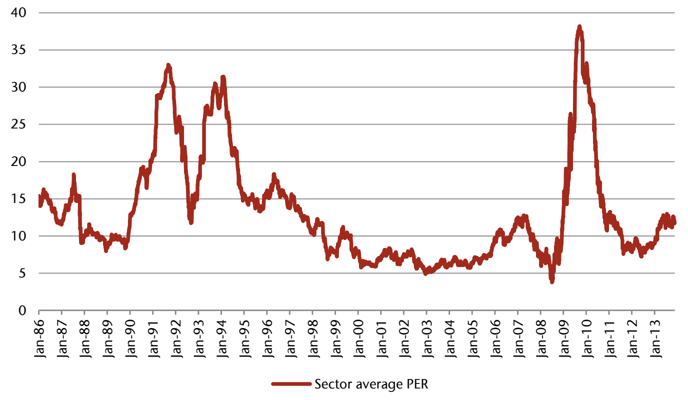


Source: Jefferies estimates

The Stability of Price to Book

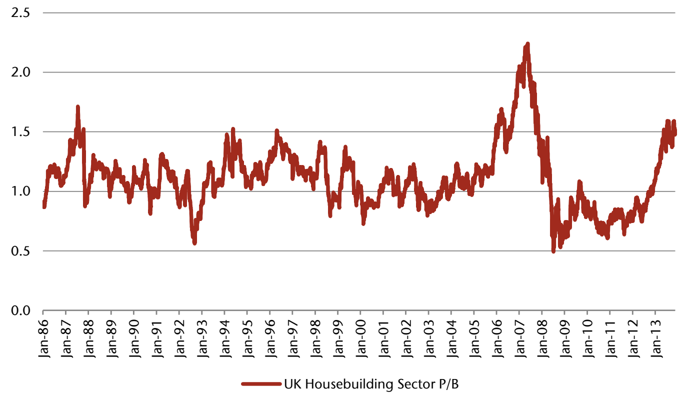
In normal markets the book value of a UK housebuilder is less volatile than its earnings, which in our view, makes book value based valuation methods more helpful.

Chart 7: UK Housebuilding sector PER (x)



Source: Datastream

Chart 8: UK Housebuilding sector P/B (x)



Source: Datastream

Does the past point to the future?

On a one year forward P/B basis the sector appears to trough at around 0.5x P/B and peak above 2.0x. The sector currently trades at around 1.5x CY2014E P/B, so at the highest of top down views the upside for the sector is in the range of 33%-66%, based on previous cycles.

Table 9: Price to Book highs and lows

	Barratt	Bellway	Berkeley	Bovis	Crest	Galliford Try	Persimmon	Redrow	Taylor Wimpey	Sector average
1990-92 low	0.4	0.6	0.3	n/a		n/a	1	n/a	0.3	0.5
1994 peak	2.4	2.2	0.9	n/a		n/a	2.1	n/a	1.4	1.8
2007 peak	2.2	1.9	3	2.1		3.5	2.5	2.4	2.2	2.5
2008 low	0.1	0.5	1	0.5		0.6	0.4	0.5	0.1	0.5
Current CY2014E P/B	1.3	1.3	2.3	1.2	1.5	1.4	1.7	1.5	1.5	1.5

Source: Jefferies estimates, Datastream

However, whilst the high level top down acts as a useful screening mechanism for value, we need to dig a little deeper to assess the different approaches the housebuilders have taken to dividends and Net Realisable Value (NRV) provisions, both of which we discuss in detail below.

But what about dividends

There are a range of dividend policies across the UK housebuilding sector including, multi-year scheduled cash payments (Berkeley, Persimmon) NBV based distributions (Taylor Wimpey) and a range of progressive and dividend cover ratio led distributions. There is a risk that assessing valuation with respect to book values leads us to compare apples with pears.

To level this particular playing field we have simply assumed that no dividends are paid and therefore the future distributions are rolled up (or rather maintained) in the book value. We appreciate that valuing cash that would have been paid out on a multiple is not wholly logical, however, this cash could be re-invested in land and therefore generate further returns. The land market is current yielding very attractive opportunities and we therefore believe that the cash could be re-invested in the current UK land market.

Table 10: Net Book Value per share + cumulative dividend estimates

	Barratt	Bellway	Berkeley	Bovis	Crest	Galliford Try	Persimmon	Redrow	Taylor Wimpey
CY2013E	238	1075	1144	615	224	535	659	173	69
CY2014E	270	1218	1363	680	252	626	757	195	78
CY2015E	309	1392	1608	760	287	736	872	222	88
CY2016E	353	1566	1803	849	322	826	1001	254	99

Source: Jefferies estimates

Table 11: Price to (book+dividend) ratio

	Barratt	Bellway	Berkeley	Bovis	Crest	Galliford Try	Persimmon	Redrow	Taylor Wimpey
CY2013E	1.4	1.4	2.1	1.3	1.6	2.1	1.9	1.6	1.6
CY2014E	1.2	1.2	1.7	1.2	1.4	1.8	1.6	1.4	1.4
CY2015E	1.1	1.1	1.5	1.1	1.2	1.5	1.4	1.3	1.3
CY2016E	1.0	1.0	1.3	0.9	1.1	1.3	1.2	1.1	1.1

Source: Jefferies estimates

When is book value not book value?

There are however drawbacks to the Price to Book valuation method, in our view.

The majority of a housebuilder's book value is to be found in its land holdings which are valued at the lower of purchase cost or net realisable value. Unfortunately it is at turning points where once again the waters get muddied and cross sector comparisons become more difficult. As house prices fell, housebuilders made Net Realisable Value (NRV) provisions. In theory, an NRV provision is made when the current and foreseeable market conditions would lead to homes being sold at a loss. In these circumstances, an NRV provision is made against the land to counter the loss. NRV provisions cannot create a profit, but can move a plot to a 'break even' position. To the extent that a provision turns out to have been either too low or too high, further exceptional provisions are made or exceptional write backs are processed.

This is where the fun begins, across the UK housebuilders the size and the scale of NRV provisions differed enormously. At one end Berkeley Group did not make any NRV provisions at the other end Redrow's provision was around one third of its entire landbank. To add to the confusion, we have been unable to accurately track the movement in these provisions (where provisions were made) and the scarcity of exceptional write backs suggests to us that the average UK housebuilding CFO has much higher forecasting abilities than the average UK housebuilding equity analyst.

We therefore have to question whether the current landscape of book values provides a level playing field on which to hang our valuation. In truth, we suspect not. We, along with many other analysts, no doubt have asked housebuilders for more disclosure in this area, but the answers provided usually focus on the commercial sensitivity of that information rather than the information itself. This is a shame, as in our view this is likely to lead to some valuations being flattered, whilst others are penalised.

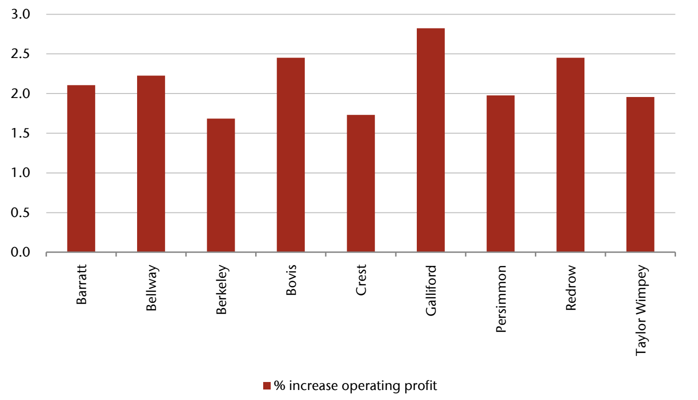
Rather than trying to retrospectively level the playing field, (a level of ground engineering skills we do not possess) we have analysed the current state of each landbank, the expected returns, how the market is currently valuing those returns, in order to try and assess if valuations suggest that there are buying and selling opportunities.

Table 12 analyses each housebuilder's landbank in order to derive our view of the EBIT potential within each landbank. The analysis is based on the last reported data from each housebuilder and current selling prices and build costs.

Table 13 shows the sensitivities for a 1% increase in both house prices and build costs, land costs remain fixed, the land already having been purchased.

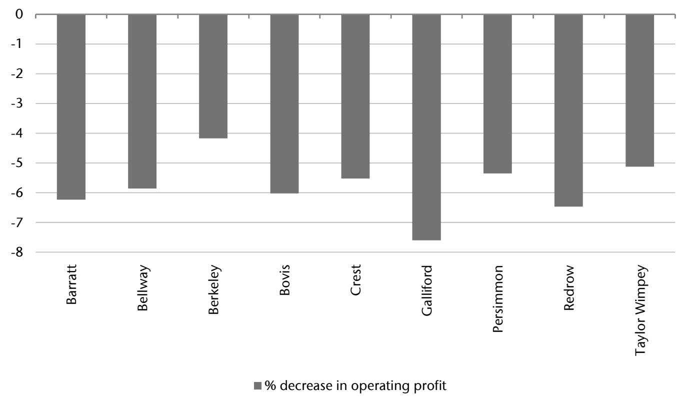
Table 14 shows the sensitivity for a 1% decrease in house prices. We assume that build costs would not fall. Once again land costs remain fixed, the land already having been purchased.

Chart 9: Increase in EBIT from a 1% increase in house prices and build costs, %



Source: Jefferies estimates

Chart 10: Decrease in EBIT from a 1% fall in house prices, %



Source: Jefferies estimates

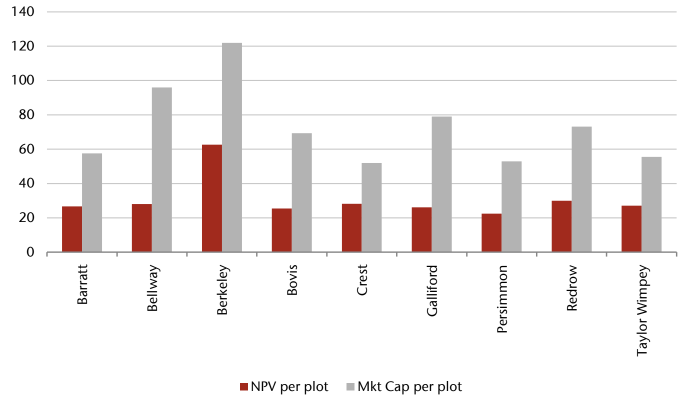
We also have to consider the time value of money. The length of landbank varies across the sector and therefore the timing of generating or extracting that EBIT from the landbank will also vary. Galliford with a landbank of 3.5 years will generate its EBIT quicker than Berkeley Group with a 7 year landbank.

In order to reflect these timing differences we have modelled EBIT over time based on CY2014E volumes for each housebuilder and applied a discount rate of 10% p.a. This allows us to calculate what we believe is a more useful measure of Return on Capital for Investors.

In Table 15 we show our view of the NPV per plot for each housebuilder. We compare the NPV per plot to the Market Cap per plot. Our proxy for ROCE is NPV per plot divided by the market cap per plot, which in our view is the ROCE an investor should focus on with respect to making an investment today. On the basis of this analysis, Crest Nicholson offers the highest returns followed by Berkeley, Taylor Wimpey and Barratt.

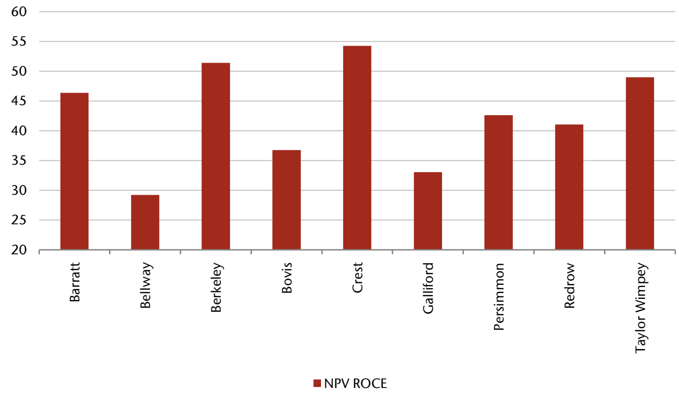
One of the limitations of our approach is that it assumes no changes in operational efficiency across the housebuilders. Barratt, Bovis and Taylor Wimpey in our view are all currently primed for operational gearing gains whereas Berkeley Group and Crest are already widely perceived as efficient operators with little in the way of slack to trim. Barratt, Bovis and Taylor Wimpey also benefit more from movements in selling prices and build costs because build costs take a larger share of the overall costs in the south of the country than they do in the north.

Chart 11: NPV per plot, £'000



Source: Jefferies estimates

Chart 12: NPV ROCE %



Source: Jefferies estimates

Table 12: EBIT potential in the current Landbank

	Barratt	Bellway	Berkeley	Bovis	Crest	Galliford	Persimmon	Redrow	Taylor Wimpey
No of plots (x)	57,654	18,991	25,684	15,579	17,094	11,400	70,716	14,162	65,084
CY 2014E volumes (x)	14,738	6,771	3,600	3,350	2,533	3,250	12,000	3,550	12,250
Land bank years (x)	3.9	2.8	7.1	4.7	6.7	3.5	5.9	4.0	5.3
ASP in landbank (£'000)	208.0	197.0	378.0	199.9	221.1	246.0	165.1	245.0	186.5
Average plot cost (£'000)	36.9	41.2	62.0	48.2	29.3	59.0	30.2	55.0	34.7
Average plot cost ratio (%)	17.7	20.9	16.4	24.1	13.3	24.0	18.3	22.4	18.6
Current build costs (£'000)	130.0	113.1	206.8	102.0	135.0	134.3	96.0	138.0	105.9
Build cost ratio (%)	62.5	57.4	54.7	51.0	61.1	54.6	58.1	56.3	56.8
Implied gross margin (£'000)	41.1	42.7	109.2	49.7	56.8	52.7	38.9	52.0	45.8
Implied gross margin (%)	19.8	21.7	28.9	24.9	25.7	21.4	23.6	21.2	24.6
Admin costs per home(£'000)	7.7	9.0	18.6	16.5	16.8	20.3	8.1	14.1	9.5
Admin costs per home(% of ASP)	4.0	4.7	9.5	7.5	7.5	8.0	4.8	6.3	4.91
Operating profit (£'000)	33.4	33.6	90.7	33.2	40.0	32.4	30.9	37.7	36.4
Operating margin (%)	16.1	17.1	24.0	16.6	18.1	13.2	18.7	15.4	19.5
Cumulative EBIT (£m)	1,925	639	2,329	517	684	369	2,182	534	2,367

Source: Jefferies estimates, company data

Table 13: Cumulative EBIT sensitivities: impact of a1% increase in ASP and build costs

	Barratt	Bellway	Berkeley	Bovis	Crest	Galliford	Persimmon	Redrow	Taylor Wimpey
ASP in landbank (£'000)	210.1	199.0	381.8	201.9	223.3	248.5	166.8	247.5	188.3
Average plot cost (£'000)	36.9	41.2	62.0	48.2	29.3	59.0	30.2	55.0	34.7
Average plot cost ratio (%)	17.6	20.7	16.2	23.9	13.1	23.7	18.1	22.2	18.4
Current build costs (£'000)	131.3	114.3	208.8	103.0	136.4	135.6	97.0	139.4	106.9
Build cost ratio (%)	62.5	57.4	54.7	51.0	61.1	54.6	58.1	56.3	56.8
Implied gross margin (£'000)	41.9	43.5	111.0	50.6	57.7	53.8	39.6	53.1	46.6
Implied gross margin (%)	19.9	21.9	29.1	25.1	25.8	21.7	23.8	21.4	24.8
Admin costs per home(£'000)	7.8	9.1	18.7	16.7	17.0	20.5	8.2	14.2	9.6
Admin costs per home(% of ASP)	3.7	4.6	4.9	8.3	7.6	8.3	4.9	5.8	5.1
Operating profit (£'000)	34.1	34.4	92.2	34.0	40.7	33.3	31.5	38.8	37.1
Operating margin (%)	16.2	17.3	24.2	16.8	18.2	13.4	18.9	15.7	19.7
Change in operating profit (%)	2.1	2.2	1.7	2.5	1.7	2.8	2.0	2.5	2.0
Change in operating margin (%)	1.1	1.2	0.7	1.4	0.7	1.8	1.0	1.4	0.9

Source: Jefferies estimates

Table 14: Cumulative EBIT sensitivities: impact of a1% decrease in ASP and build costs

	Barratt	Bellway	Berkeley	Bovis	Crest	Galliford	Persimmon	Redrow	Taylor Wimpey
ASP in landbank (£'000)	205.9	195.0	374.2	197.9	218.9	243.5	163.5	242.6	184.6
Average plot cost (£'000)	36.9	41.2	62.0	48.2	29.3	59.0	30.2	55.0	34.7
Average plot cost ratio (%)	17.9	21.1	16.6	24.4	13.4	24.2	18.5	22.7	18.8
Current build costs (£'000)	130.0	113.1	206.8	102.0	135.0	134.3	96.0	138.0	105.9
Build cost ratio (%)	63.1	58.0	55.3	51.5	61.7	55.1	58.7	56.9	57.4
Implied gross margin (£'000)	39.0	40.7	105.5	47.7	54.6	50.2	37.3	49.6	44.0
Implied gross margin (%)	19.0	20.9	28.2	24.1	24.9	20.6	22.8	20.4	23.8
Admin costs per home(£'000)	7.7	9.0	18.6	16.5	16.8	20.3	8.1	14.1	9.5
Admin costs per home(% of ASP)	3.7	4.6	5.0	8.3	7.7	8.4	4.9	5.8	5.1
Operating profit (£'000)	31.3	31.7	86.9	31.2	37.8	29.9	29.2	35.4	34.5
Operating margin (%)	15.2	16.2	23.2	15.8	17.3	12.3	17.9	14.6	18.7
Change in operating profit (%)	-6.2	-5.9	-4.2	-6.0	-5.5	-7.6	-5.4	-6.5	-5.1
Change in operating margin (%)	-5.3	-4.9	-3.2	-5.1	-4.6	-6.7	-4.4	-5.5	-4.2

Source: Jefferies estimates

Table 15: NPV per plot and NPV ROCE

	Barratt	Bellway	Berkeley	Bovis	Crest	Galliford	Persimmon	Redrow	Taylor Wimpey
NPV per plot	26.70	28.06	62.68	25.49	28.19	26.14	22.51	30.03	27.16
Mkt Cap per plot	57.6	96.0	121.9	69.3	52.0	79.1	52.9	73.1	55.5
NPV ROCE	46.36	29.23	51.42	36.78	54.23	33.05	42.60	41.07	48.96

Source: Jefferies estimates

The Truth About Operational Gearing

The Theory

The theory of housebuilder operational gearing is two-fold. Firstly as house prices rise, profits should increase. Land costs are fixed and build costs are around 60% of the average selling prices. Therefore if house prices and build costs rise by 1%, in theory, gross profit should increase by 2%.

Table 16: Gross profit operational gearing theory

House Price Inflation	Base	1.0%	2.0%	3.0%	4.0%	5.0%	-1.0%	-2.0%	-3.0%	-4.0%	-5.0%
ASP	100	101	102	103	104	105	99	98	97	96	95
Build cost	60	60.6	61.2	61.8	62.4	63	59.4	58.8	58.2	57.6	57
Land	20	20	20	20	20	20	20	20	20	20	20
Gross profit	20	20.4	20.8	21.2	21.6	22	19.6	19.2	18.8	18.4	18
Gross margin (%)	20	20.2	20.4	20.6	20.8	21.0	19.8	19.6	19.4	19.2	18.9
Change in gross profit from Base Case (%)		2.0	4.0	6.0	8.0	10.0	-2.0	-4.0	-6.0	-8.0	-10.0

Source: Jefferies estimates

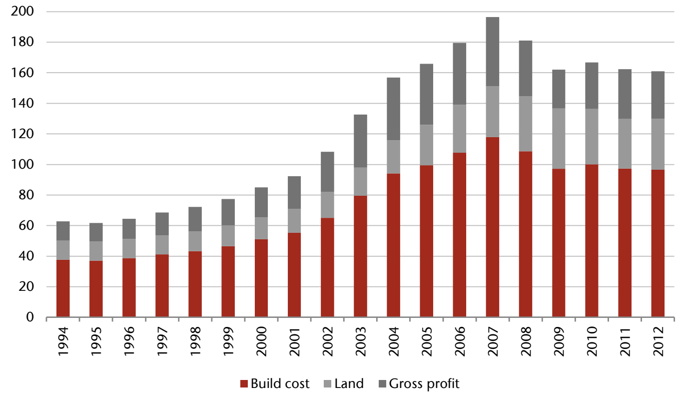
In theory housebuilders are price takers, they do not set house prices. On average, around 90% of UK housing transactions are completed in the secondary market, we therefore assume that a housebuilder's Average Selling Price (ASP) will closely track that of underlying UK house prices.

Our theoretical model assumes that build costs will track house prices, for example, a 1% increase in house prices leads to a 1% increase in build costs. We also assume that house price inflation leads to land price inflation and that the impact on the P&L will see a three year lag. Our model uses actual house price date from 1994 to 2012.

Build costs are assumed to be 60% of ASP and land cost 20% of ASP at the time of purchase, suggesting a base case gross margin of 20%.

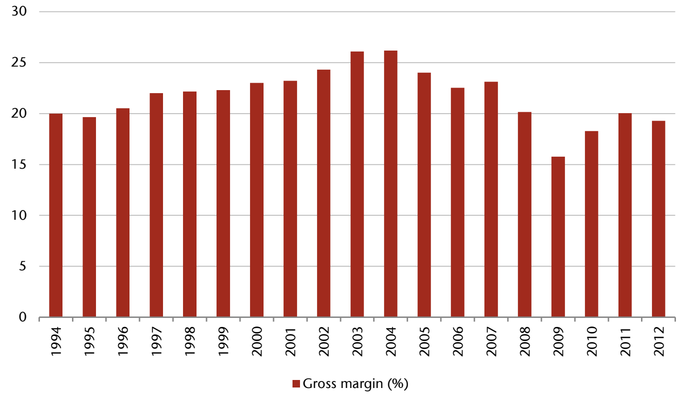
In our theoretical model Gross Margin reaches a peak of 26.1% in 2004 and falls to 15.8% in 2009 and there is a 90% correlation between changes in house prices and changes in gross profits. These relationships would not hold in practice if our build cost and land cost assumptions are incorrect. Our build cost assumption is that they move in-line with house prices, it is difficult to increase prices in a falling market whereas everyone is keen to benefit from a rising one. Our analysis of build costs in our Build Cost Deep Dive, in the 15th November 2013 edition of FF/RW & Focus found that between January 2009 and September 2013, a 1.00% increase in house prices was matched by a 1.05% increase in build costs. Our land cost assumption is that land prices are a residual of house prices and therefore land purchased today should reflect current house prices.

Chart 13: Theoretical ASP split



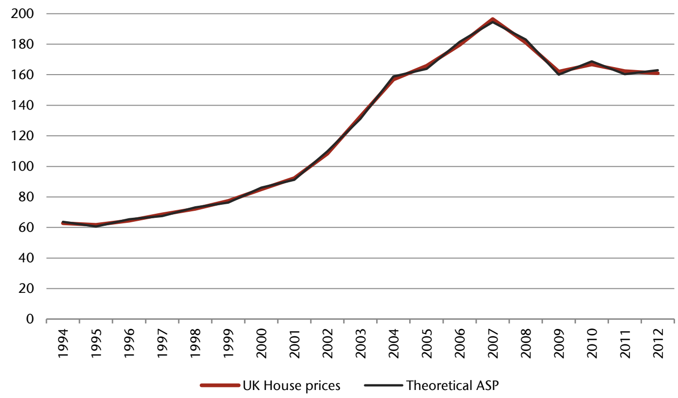
Source: LBG, Jefferies estimates

Chart 14: Theoretical Gross Margin %



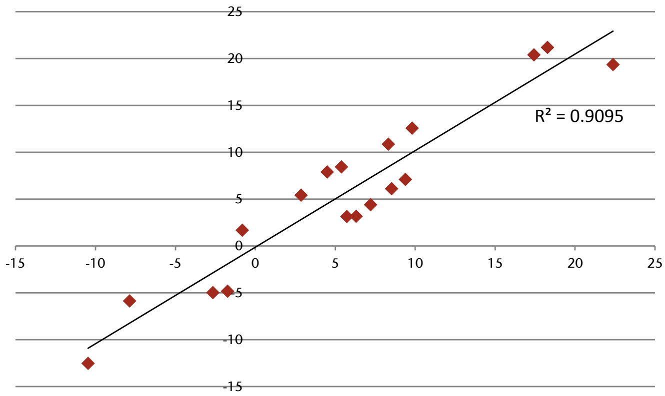
Source: Jefferies estimates

Chart 15: UK House prices and theoretical ASP, £'000



Source: LBG, Jefferies estimates

Chart 16: Theoretical correlation between actual house prices and theoretical gross profit



Source: Jefferies estimates

Secondly the administration and head office costs should not, in our view, be fully variable with respect to volumes we would therefore expect as volumes rise that administration and operating costs would reduce as a percentage of sales revenue, leading to positive operational gearing.

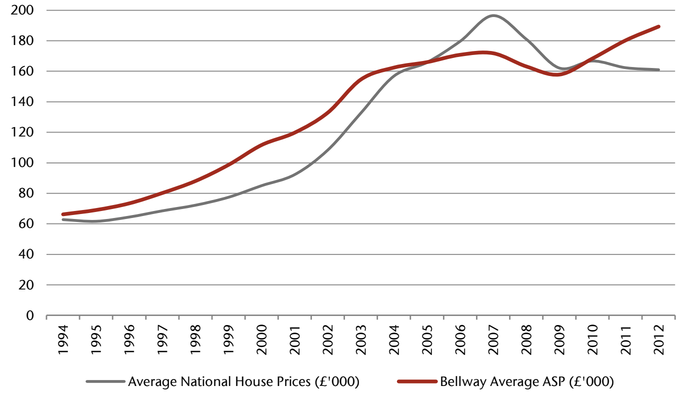
What Happens in Practice

Gross Margin operational gearing

We have analysed actual operating data from Bellway and Persimmon, which in our view are the two UK listed housebuilders with the longest history as pure play UK housebuilders and whose strategy and operations have changed the least over the period of our review.

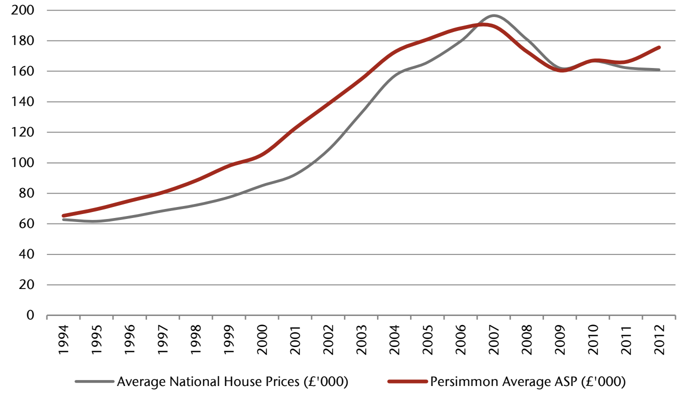
Stage 1 of the theory works well, housebuilder's ASPs are highly correlated with underlying UK house prices. Between 1994 and 2012 the correlation was 91% at Bellway and 95% at Persimmon as shown in Charts 17 to 20.

Chart 17: Bellway ASP and UK average house prices, £'000



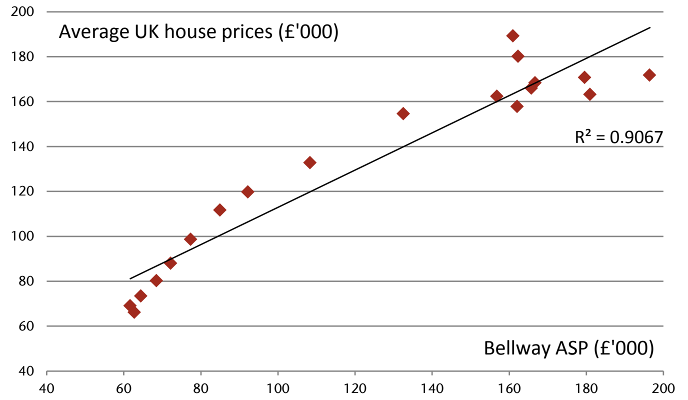
Source: Bellway, LBG

Chart 18: Persimmon ASP and UK average house prices, £'000



Source: Persimmon, LBG

Chart 19: Bellway ASP and UK house price correlation



Source: Bellway, LBG

Chart 20: Persimmon ASP and UK house price correlation

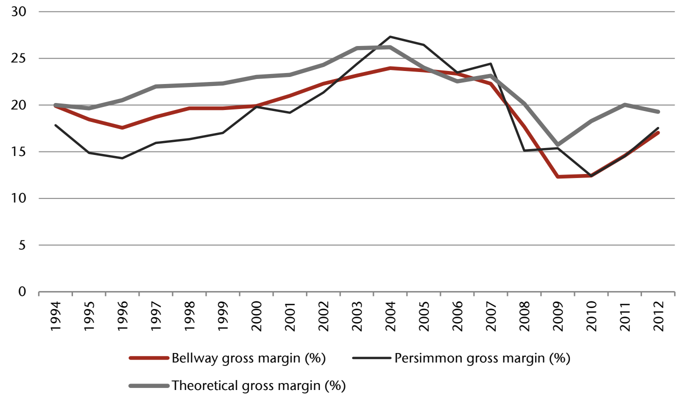
Source: Persimmon, LBG

Stage 2 is to test whether movements in gross profit match movements in ASPs. Here the evidence is less compelling. The theory suggests that a 1% increase in house prices leads to a 2% increase in gross profit. In practice over the period between 1994-2012, 1% increase in ASP lead to 0.9% increase in gross profit at Bellway and a 0.6% increase at Persimmon.

Chart 21 compares the theoretical and actual gross margins. Between 2004 and 2007 Persimmon delivered a gross margin above our theoretical model, which in our view reflects the combination of a longer landbank than our model so therefore greater holding gains and contribution from strategic land, a land type not included in our basic model.

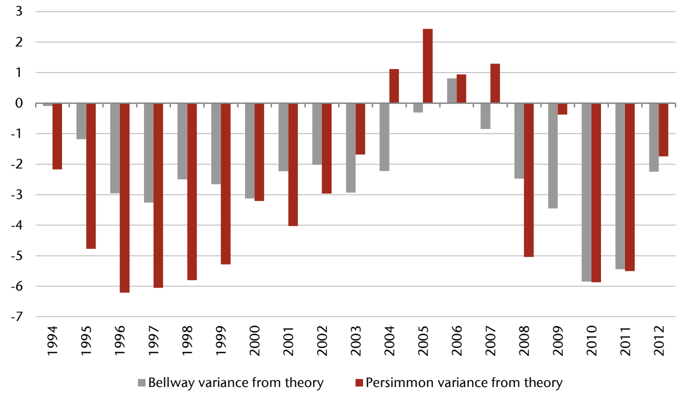
Chart 22 shows that outside of the 2004-2007 period, both Bellway and Persimmon deliver margins below that of our theoretical model.

Chart 21: Gross margins theory and practice, %



Source: Jefferies estimates, company data

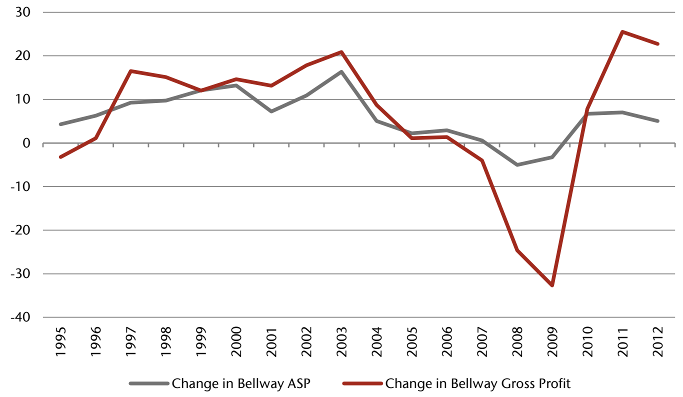
Chart 22: Gross margin how practice differs from theory, %



Source: Jefferies estimates

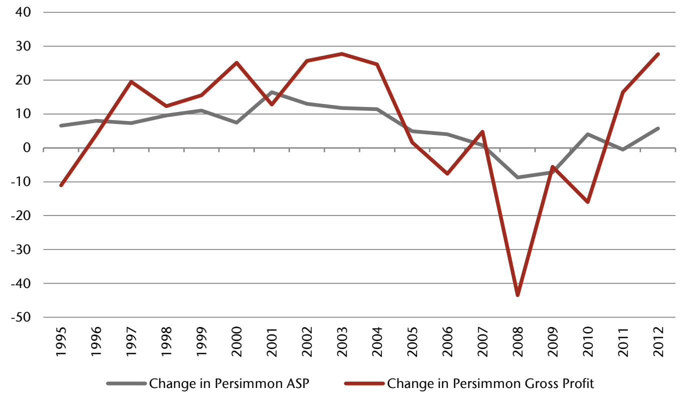
We show in the charts below the empirical change in ASP and Gross Profit for Bellway and Persimmon between 1994 and 2012. From 1997 to 2004, increases in gross profit are greater than increases in selling prices (directionally the theory is borne out in practice, if not the quantum). However, perhaps the more interesting period is 2005-2010 where the theory breaks down. We know that build costs moved in-line with ASPs during this period, so one conclusion is that land purchases factored in a level of theoretical house price inflation which was not achieved in practice.

Chart 23: Bellway change in ASP and Gross Profit, %



Source: Company Data

Chart 24: Persimmon change in ASP and Gross Profit, %

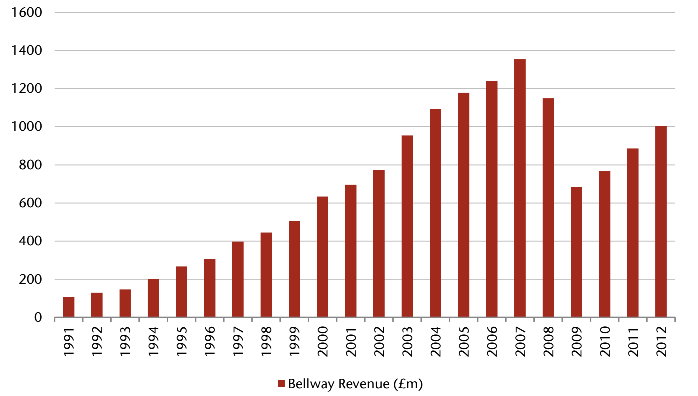


Source: Company Data

Operating cost operational gearing

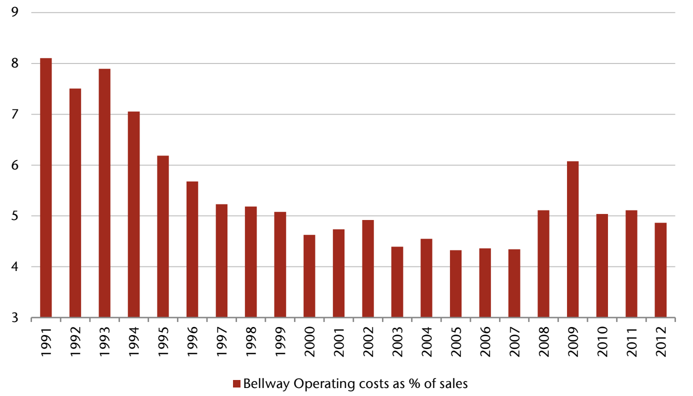
We are pleased to report that both in theory and in practice, operating costs as a percentage of revenues fall as revenues rise. We show the actual data from Bellway and Persimmon between 1991 and 2012 below, although to us it appears that Bellway holds the purse strings slightly tighter than Persimmon.

Chart 25: Bellway Revenue, £m



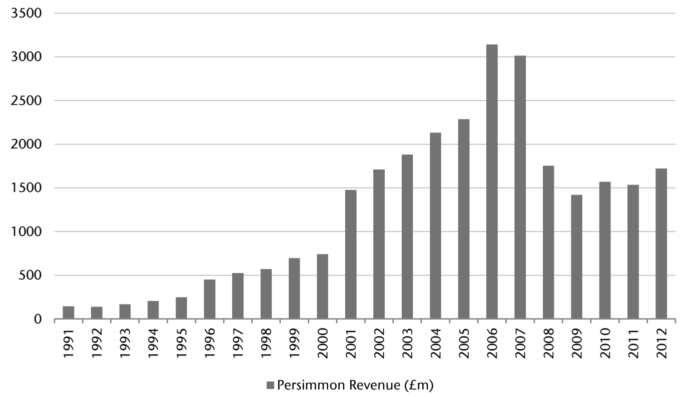
Source: Bloomberg

Chart 26: Bellway operating costs as % of sales, %



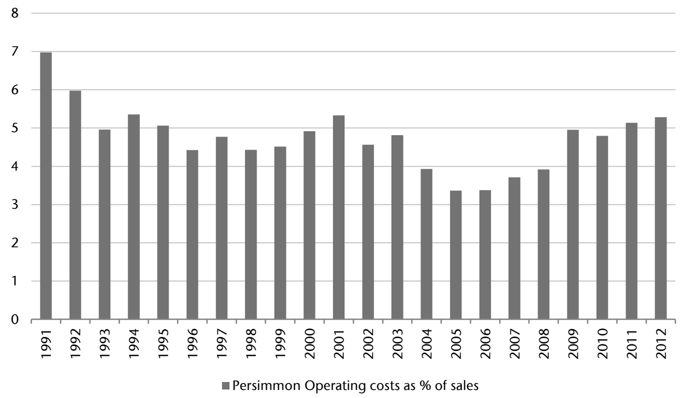
Source: Bloomberg

Chart 27: Persimmon Revenue, £m



Source: Bloomberg

Chart 28: Persimmon operating costs as % of sales, %



Source: Bloomberg

Operational Gearing meets ROCE

Selling prices, build costs and operating costs have a direct impact on 'returns', the 'RO' of ROCE. Build costs and operating costs can be adjusted to adapt to changes in selling prices and volumes, as demonstrated by every housebuilder we cover between 2007 and 2012. Build costs and operating costs are short lived assets/liabilities and are not part of Capital Employed 'CE', whereas land purchases impact both RO and CE because they impact both numerator and denominator of ROCE.

We cannot change the past, but we can alter the future

The UK Housebuilders have, on average, a 5 year landbank. On average therefore a plot of land will remain in CE for 5 years, and once purchased management cannot, in the main, alter its contribution to CE. The only way, in the main, to alter a plot of land's RO is to alter build costs, which we know are linked to house prices, and house prices themselves are determined by the market not the housebuilder.

In our view therefore the biggest determinant of ROCE that management can influence (and therefore should be judged on) is land purchases.

In deciding whether to invest in shares today, one should not, in our view, look at current ROCE or the current landbank, this and management's track record should, in theory, already be reflected in the current price of the shares. In our view, there is little management can do to alter the performance of these assets (yes tweaks can be made, but it is rare that operations can reverse the impact of land purchase decisions which were sub-optimal in the first place). We should consider how, from here, we think management can alter ROCE from its current trajectory. If we look at what is within management's control it comes down to land. If they buy land well today, ROCE will rise and if they buy land badly, ROCE will fall. Rather than focusing on Group ROCE we believe investors should look in detail at current and committed land purchases. If land is being purchased with reference to current house prices and build costs (which we know), then taking the cost of the land and the number of plots we can estimate the gross margin and therefore the ROCE.

If management do not provide this information we should ask why? It is not commercially sensitive because all housebuilders have disclosed their hurdle rates, they should therefore be willing to provide investors with the information to demonstrate how these land purchases clear the hurdle.

Company Summaries

Barratt Developments

BDEV LN, 325p, Buy, PT 474p, Mkt. Cap: £3158m

The largest housebuilder in the UK
Barratt Developments (Barratt) is a UK national housebuilder, operating under two national brands, Barratt Homes and David Wilson Homes. We estimate that, by volume of homes built, Barratt is currently the largest homebuilder in the UK.

Strategy: reduce debt, build volume
The main priority, to reduce debt, has been achieved by a combination of an equity placing in FY 2010 and by pulling the key operational levers: optimising selling prices, improving operational efficiency and carefully targeting land spend. The group aims to be debt free by June 2015.

Value has been pursued by a combination of changing product mix and design, and operational efficiency. The product mix has shifted away from apartments: in FY2009 non-London apartments accounted for 45% of completions; by FY2011 this had almost halved to 23%. New standardised product ranges have been introduced and centralised procurement is now the norm rather than the exception. In addition, operating costs in FY2012 were around £30m below their FY2008 level. We expect significant earnings growth in the medium term as the value strategy gains momentum.

Overall, we expect the group to target one of the shorter landbanks (in terms of landbank years) in the sector. This, in our view, reflects the group's desire to drive profits more from construction than from development gains.

Once a volume builder always a volume builder
'Help to Buy' appears to have acted as a starting pistol for Barratt with respect to volumes. The group's medium/longer-term volume target of 16,000 units has become a short/medium-term target, which we expect it to reach in FY2016. Once the group has reached 16,000 units, it will need to decide whether or not to invest in new divisions. Comments made by the group at their full year 2013 results presentation make us believe that they are likely to wait and see how the housing market is operating once 'Help to Buy' has run its course before deciding to invest in growth outside of its current operating structure.

Volume/margin trade-off
In our view, Barratt has taken the strategic decision to use 'Help to Buy' to accelerate the volumes from its impaired land, in order to generate cash more quickly to re-invest in higher-margin land at what we expect will prove to be close to the cyclical lows of the market. We believe the strategy makes sense and this was the strategy successfully deployed by Galliford Try in 2008/09. High volume, high beta: in our view, Barratt's strategy will lead to the value of its shares being the most geared into 'Help to Buy' and the shorter-term nuances of the underlying UK housing market. We are happy with our Buy rating, but suspect the ride to be more rock 'n' roll than easy listening.

Valuation remains attractive
We estimate that Barratt currently trades on a CY2014E P/B of 1.25x, and the upside potential is more than 45% based on our 474p price target, derived by applying recovery multiples to our CY2014 estimates and steady state multiples to our CY2016 estimates across our Base case and Upside and Downside scenarios, weighted according to our view of the likelihood of each scenario. We reiterate our high conviction Buy on the shares.

Table 17: Barratt P&L Summary, £m

	2013A	2014E	2015E	2016E
Volume (x)	13663.0	14275.0	15200.0	16000.0
Volume growth (%)	8.1	4.5	6.5	5.3
ASP (£'000)	194.8	205.0	210.0	215.0
ASP growth (%)	7.9	5.2	2.4	2.4
Continuing Turnover	2606.6	2820.0	3110.0	3350.0
Gross Profit	359.2	486.1	602.0	686.0
Gross Margin (%)	13.8	17.2	19.4	20.5
EBITA	252.7	372.3	474.6	548.7
EBITA margin (%)	9.7	13.2	15.3	16.4
Net Interest	(68.0)	(60.0)	(56.4)	(50.0)
JV	7.6	25.0	30.0	32.5
Normalised PBT	192.3	337.3	448.2	531.2
Tax rate (%)	24.0	24.0	24.0	0.0
Normalised EPS (p)	14.6	26.8	36.4	41.5
EPS Growth (%)	80.4	84.3	35.4	14.0
Dividend (p)	2.0	4.5	8.1	13.8

Source: Jefferies estimates, company data

Table 18: Barratt Cashflow Summary, £m

	2013A	2014E	2015E	2016E
Net Income	75.0	256.3	340.6	403.7
Depreciation	1.6	4.0	4.0	4.0
Other Non-Cash	10.0	10.0	10.0	10.0
Working Capital	197.7	(75.0)	(72.4)	(74.1)
Cash From Operations	284.3	195.3	282.2	343.6
Interest paid	(80.8)	(60.0)	(56.4)	(50.0)
Interest received	12.8	0.0	0.0	0.0
Tax received/(paid)	(50.5)	(75.9)	(94.1)	(127.5)
Net Cashflow	165.8	59.4	131.7	166.1
Investing activities	(0.7)	(9.2)	0.0	0.0
Dividend paid	(19.5)	(43.8)	(78.7)	(134.6)
Net financing	(3.8)	0.0	0.0	0.0
Movement in Cash	141.8	6.4	53.0	31.6
Net Cash /(Debt) b/f	(167.7)	(25.9)	(19.4)	33.6
Net Cash /(Debt) c/f	(25.9)	(19.4)	33.6	65.1

Source: Jefferies estimates, company data

Table 19: Barratt Balance Sheet Summary

	2013A	2014E	2015E	2016E
Non-current assets	1248.1	1258.1	1268.1	1278.1
Land	2127.0	2420.3	2473.5	2521.5
WIP	1082.8	1238.1	1339.5	1477.2
Trade and other debtors	76.1	91.2	98.7	108.8
Trade and other creditors	(1014.2)	(1094.8)	(1184.4)	(1306.2)
Working Capital	2271.7	2654.9	2727.3	2801.4
Other Assets/(Liabilities)	(420.7)	(602.8)	(462.8)	(309.4)
Net Cash/(Debt)	(25.9)	(19.4)	33.6	65.1
Tangible Net Assets	2181.0	2398.6	2673.9	2943.1
Plot cost (£'000)	36.0	37.4	38.2	38.9
NAV per share (p)	315.6	338.0	366.2	393.9
TNAV per share (p)	224.0	246.3	274.6	302.3

Source: Jefferies estimates, company data

Bellway

BWY LN, 1396p, Buy, PT 1954p, Mkt. Cap: £1684m

Bellway, a national housebuilder

Bellway is a UK national housebuilder, employing around 1400 people with operations in England, Scotland and Wales. The Group designs and offers for sale a range of homes from one bedroom apartments to five and six bedroom detached homes.

Position in the market

Bellway is the UK's fourth largest homebuilder by volume, completing 5,226 homes in FY2012 and we anticipate volumes of 5652 in FY2013. Volumes peaked at 7,638 in FY2007 and troughed at 4,380 in FY2009. Average selling prices past the FY2007 peak of £173,300 in FY2011 when they reached £175,600. We expect average selling prices of around £200,000 for FY2014, the increase largely as a result of mix changes. The group's sales mix is around 70:30 in favour of houses and we estimate that around half of its apartments are sold in Greater London.

The consistent housebuilder

Bellway has been the most consistent of the UK national housebulders we follow. The total shareholder return has averaged 10% p.a each year since the turn of the century. This is an enviable and rather long lived record, is impressive as the period includes the impact of the long lived 2007 credit crunch.

Bellway's London

On a regional basis we prefer housebuilders with no exposure to London rather than those with exposure to London. On the whole, we believe the most important driver of the UK housing market is 'Help to Buy' and we are strongly of the view that, in general, 'Help to Buy' will have a bigger impact outside of London than within it. Bellway's London exposure is mainly to be found in the lower priced boroughs, it has developments in four of the five lowest average house price boroughs. The average price of a Bellway home in London in FY2013 was £240,539, some 38% below the average house price in London of £389,066. Bellway may therefore be one of the few housebuilders with exposure to London which may benefit from 'Help to Buy'.

Strategy

The group intends to continue to increase both volumes (by opening more sites) and selling prices (by on-going changes in the product mix) and thereby increase operating margins. The group takes a more pragmatic view regarding apartments than some of its peers who, in part, shy away from them. Bellway believes that the old adage of location, location, location, continues to ring true and that appropriately priced apartments in the right location continue to sell well and deliver a good operating margin and ROCE.

Investing in growth

Since the start of FY2014, Bellway has opened two new divisions, one in Manchester, the other in the Thames Valley, which in theory, over time, will add around 1,000-1,200 units p.a capacity once both divisions have reached maturity and the UK housing market normalised. Bellway is the first housebuilder to open two new divisions after the announcement of 'Help to Buy' (Redrow has also expanded with the opening of a 'Southern Counties' division). Neither group's openings however were a reaction to 'Help to Buy', although the Government stimulus package should, in our view, help the divisions to get established more quickly than they would have done unaided.

Valuation

Our price target of 1954p suggests upside of around 40%. We reiterate our Buy rating on the shares. Our price target is derived by applying recovery multiples to our CY2014 estimates and steady state multiples to our CY2016 estimates.

Please see important disclosure information on pages 57 - 60 of this report.

Table 20: Bellway P&L Summary, £m

	2013A	2014E	2015E	2016E
Volume (x)	5652.0	6500.0	7150.0	7500.0
Volume growth (%)	8.2	15.0	10.0	4.9
ASP (£'000)	193.0	200.0	206.0	212.0
ASP growth (%)	3.4	3.6	3.0	2.9
Continuing Turnover	1110.7	1320.0	1485.9	1607.8
Gross Profit	203.3	272.6	326.2	377.8
Gross Margin (%)	18.3	20.7	22.0	23.5
EBITA	151.1	211.5	258.4	306.3
EBITA margin (%)	13.6	16.0	17.4	19.0
Net Interest	(10.1)	(11.5)	(10.0)	(10.0)
Normalised PBT	140.9	200.0	248.4	296.3
Tax rate (%)	23.0	21.0	21.0	21.0
Normalised EPS (p)	89.3	130.0	161.4	192.5
EPS Growth (%)	36.4	45.5	24.2	19.3
Dividend (p)	30.0	43.3	53.8	64.2

Source: Jefferies estimates, company data

Table 21: Bellway Cashflow Summary, £m

	2013A	2014E	2015E	2016E
Net Income	108.6	158.0	196.2	234.0
Depreciation	2.5	2.0	2.0	2.0
Other Non-Cash	42.1	20.0	20.0	20.0
Working Capital	(60.1)	(120.2)	(88.8)	(76.5)
Cash From Operations	93.1	59.8	129.4	179.5
Interest paid	(5.9)	(11.5)	(10.0)	(10.0)
Interest received	0.7	0.0	0.0	0.0
Tax received/(paid)	(28.8)	(42.0)	(52.2)	(62.2)
Net Cashflow	59.1	6.3	67.2	107.3
Investing activities	1.2	0.0	0.0	0.0
Dividend paid	(28.0)	(52.7)	(65.4)	(78.0)
Net financing	2.4	0.0	0.0	0.0
Movement in Cash	34.8	(46.4)	1.8	29.3
Net Cash /(Debt) b/f	(40.6)	(5.8)	(52.3)	(50.4)
Net Cash /(Debt) c/f	(5.8)	(52.3)	(50.4)	(21.1)

Source: Jefferies estimates, company data

Table 22: Bellway Balance Sheet Summary, £m

	2013A	2014E	2015E	2016E
Non-current assets	56.7	58.7	60.7	62.7
Land	907.3	939.8	975.6	1013.1
WIP	606.2	739.2	832.1	900.4
Trade and other debtors	57.2	79.2	89.2	96.5
Trade and other creditors	(328.7)	(396.0)	(445.8)	(482.3)
Working Capital	1242.0	1362.2	1451.0	1527.5
Other Assets/(Liabilities)	(74.0)	(44.5)	(6.4)	41.9
Net Cash/(Debt)	(5.8)	(52.3)	(50.4)	(21.1)
Tangible Net Assets	1218.8	1324.2	1455.0	1611.0
Plot cost (£'000)	40.2	41.9	43.8	45.8
NAV per share (p)	1003.2	1089.9	1197.5	1325.9
TNAV per share (p)	1003.2	1089.9	1197.5	1325.9

Source: Jefferies estimates, company data

Berkeley Group

BKG LN, 2282p, Hold, PT 2398p, Mkt. Cap: £3013m

A unique opportunity….
Berkeley Group clearly offers a very different proposition from that of the UK national housebuilders that we follow. It differs with respect to both its business model and its risk profile. It is easy to see the attractions of Berkeley Group, with a heavy exposure to London, a world class city, in Europe, yet not in the Eurozone, and one with an under supply of housing. Aside from the London exposure, the Board has the intention to return £13 per share to each shareholder between now and 30 September 2021 and the five most senior members of the executive management team have been highly incentivised to turn this intention into reality.

A unique price
Berkeley Group currently trades on a CY2013 P/B of 2.23x, against a sector (excluding Berkeley) on 1.53x, a 46% premium. We believe that there is more value elsewhere in the sector and our price target of 2398p suggests to us that the shares are at fair value.

Unlikely to benefit from 'Help to Buy'
In our view, the 'Help to Buy' stimulus package announced in March 2013 and launched in April 2013 has been the main driver of share prices in the UK housebuilding sector. However, in our view, Berkeley is unlikely to benefit, firstly because it is not a volume housebuilder and targets volumes of around 3000 p.a and secondly because the majority of Berkeley Group's customers are unlikely to need or to use 'Help to Buy'. Latest commentary from the national housebuilders suggests that they are achieving around 35%-40% of completions from 'Help to Buy' since its launch in April 2013, whereas at the time of its full year results announcement, Berkeley had completed five, all of which are outside of London.

Mortgage Market Review may increase reliance on the cash rich
'Help to Buy' is largely seen as increasing the supply of mortgages to enable cash strapped First Time Buyers and the so called second steppers to realise their housing aspirations. However the Mortgage Market Review, which comes into force in April 2014, includes a number of affordability tests, which essentially link mortgage capacity to earnings. In our note Upgrades and Affordability we looked at every Berkeley Group development and assessed affordability. Our analysis suggested that, on average, in the postcode areas where Berkeley Group currently has properties for sale, based on mortgage capacity a homebuyer in London (earning London wages) needs a deposit of £87,000 to purchase a one-bedroom home rising to £213,000 for a two-bed and £410,000 for a three- bed. In our view this highlights that often in London even with access to a 95% LTV mortgage many potential buyers may not have the mortgage capacity to purchase a home. As we move away from London and the South East the these mortgage capacity constraints reduce as the main barrier to homeownership has been access to high loan to value mortgages.

Investors vs owner occupiers
Investors account for around 45% of group sales and we believe that investors make up the bulk of the forward orderbook c.85%, owner occupiers, who typically require their home within a six month window the remaining 15%. In our view, there are pros and cons of such exposure to investors. The pros relate to cash flow and higher price points; the cons are that should investor demand start to reduce and we estimate that overseas investors make up around 50% of the forward orderbook, we doubt domestic owner occupier demand could make up the shortfall. We do not believe that the provisions in the 2013 Autumn Statement will have a material impact on Berkeley Group. However we do suspect that strong cash generation will see Berkeley's shares perform positively on the day of the results.

Table 23: Berkeley P&L Summary, £m

	2013A	2014E	2015E	2016E
Volume (x)	3712.0	3600.0	3600.0	3600.0
Volume growth (%)	*4.1*	*(3.0)*	*0.0*	*0.0*
ASP (£'000)	354.0	400.0	430.0	450.0
ASP growth (%)	*26.4*	*13.0*	*7.5*	*4.7*
Continuing Turnover	1372.6	1500.0	1600.0	1650.0
Gross Profit	403.4	464.4	539.1	570.0
Gross Margin (%)	*29.4*	*31.0*	*33.7*	*34.5*
EBITA	278.8	337.6	407.0	431.1
EBITA margin (%)	*20.3*	*22.5*	*25.4*	*26.1*
Net Interest	(8.1)	(7.6)	(7.0)	(6.0)
Normalised PBT	270.7	330.0	400.0	425.1
Tax rate (%)	*22.5*	*23.0*	*21.0*	*21.0*
Normalised EPS (p)	160.0	191.8	233.3	242.5
EPS Growth (%)	*64.1*	*19.8*	*21.7*	*3.9*
Dividend (p)	74.0	100.0	260.0	75.0

Source: Jefferies estimates, company data

Table 24: Berkeley Cashflow Summary, £m

	2013A	2014E	2015E	2016E
Net Income	209.7	254.1	316.0	335.8
Depreciation	1.0	1.0	1.0	1.0
Other Non-Cash	20.0	20.0	20.0	20.0
Working Capital	-102.8	-50.0	150.0	-50.0
Cash From Operations	127.9	225.1	487.0	306.8
Interest paid	-5.9	-9.6	-9.0	-8.0
Interest received	1.2	2.0	2.0	2.0
Tax received/(paid)	-69.2	-75.9	-84.0	-89.3
Net Cashflow	54.0	141.6	396.0	211.6
Investing activities	68.3	0.0	0.0	0.0
Dividend paid	-19.7	-132.5	-352.1	-103.9
Net financing	0.0	0.0	0.0	0.0
Movement in Cash	102.6	9.1	43.9	107.7
Net Cash /(Debt) b/f	-57.9	44.7	53.8	97.7
Net Cash /(Debt) c/f	44.7	53.8	97.7	205.4

Source: Jefferies estimates, company data

Table 25: Berkeley Balance Sheet Summary, £m

	2013A	2014E	2015E	2016E
Non-current assets	160.8	170.8	180.8	190.8
Land	310.0	382.0	454.0	526.0
WIP	1756.7	2340.0	2496.0	2574.0
Trade and other debtors	126.8	150.0	160.0	165.0
Trade and other creditors	-1009.0	-1425.0	-1520.0	-1567.5
Working Capital	1184.5	1447.0	1590.0	1697.5
Other Assets/(Liabilities)	-67.7	-227.7	-460.7	-453.9
Net Cash/(Debt)	44.7	53.8	97.7	205.4
Tangible Net Assets	1305.2	1426.8	1390.6	1622.6
Plot cost (£'000)	69.9	91.0	98.7	103.8
NAV per share (p)	1004.3	1096.7	1069.2	1245.4
TNAV per share (p)	991.3	1083.6	1056.2	1232.4

Source: Jefferies estimates, company data

Please see important disclosure information on pages 57 - 60 of this report.

Bovis

BVS LN, 754p, Buy, PT 987p, Mkt. Cap: £1010m

Bovis Homes is a southern UK focused housebuilder,
The group's product portfolio ranges from one and two bedrooms apartments to five and six bedroom detached family homes. The portfolio includes coach houses, town houses, homes for first time buyers and for the retired. The group also works in partnership with a wide range of housing associations, council and other public sector agencies to provide social housing.

Position in the market
We estimate that by volume of homes built, Bovis is currently the seventh largest homebuilder in the UK. Volumes peaked in FY2006 at 3123 and troughed at 1803 in FY2009. We expect it to sell 2400 homes in FY2012 and for volumes to be in the region of 3000 in FY2014. We expect Bovis to deliver the highest relative volume growth of all the pure play UK housebuilders we follow between now and the end of FY2015.

Strategy
The strategy at Bovis is very clearly communicated, to rebuild volumes, to rebuild margins and to rebuild ROCE. It is rebuilding volumes by increasing the number of active sales outlets across the country, with a focus on increasing its exposure to the South of England where its sales rates are currently higher than in the Northern regions.

The Group has a four point strategy to deliver operating margin growth. Firstly it is improving the product mix on existing sites, by adjusting both the mix and design of homes for sale. Secondly the Group has a very strong focus on cost control, reflecting the fact that in the current market house price inflation cannot be relied upon to deliver margin growth. Thirdly, it is bringing sites which were acquired after the house price falls of 2007-2009 in to production, land prices are a residual of house prices and therefore these newer sites deliver higher operating margins. Fourthly house designs are evolving all the time reflecting changes in market conditions and customer preferences, by reacting to market conditions Bovis is able to secure higher average selling prices of its homes.

Return on Capital will improve as a result of the improved profits delivered by volume and margin growth; however the Group also seeking to improve ROCE by careful control of the Capital Employed itself, with a particular focus on WIP and working capital efficiency and the structure of its landbank. With respect to landbank structure, Bovis is steadily increasing its exposure to smaller consented land sites, where the build out and sales time horizons are shorter than for larger and strategic sites. This in management's view increases both the predictability of consented land supply and a leads to a more effective asset turn, and therefore all other things being equal should assist ROCE growth.

Valuation
At 754p Bovis trades on a CY2014E P/B of 1.15x a 24% discount to the sector. Our price target of 987p suggests upside of around 28%. We reiterate our Buy rating on the shares. Our price target is derived by applying recovery multiples to our CY2014 estimates and steady state multiples to our CY2016 estimates across our Base case and Upside and Downside scenarios, weighted according to our view of the likelihood of each scenario.

Please see important disclosure information on pages 57 - 60 of this report.

Table 26: Bovis P&L Summary, £m

	2012A	2013E	2014E	2015E
Volume (x)	2,355.0	2,785.0	3,350.0	3,550.0
Volume growth (%)	15.2	18.3	20.3	6.0
ASP (£'000)	170.7	188.0	193.0	197.0
ASP growth (%)	5.1	10.1	2.7	2.1
Continuing Turnover	425.5	553.6	676.6	729.4
Gross Profit	96.9	131.1	170.5	200.0
Gross Margin (%)	22.8	23.7	25.2	27.4
EBITA	56.8	82.6	115.2	140.3
EBITA margin (%)	13.3	14.9	17.0	19.2
Net Interest	(2.9)	(4.9)	(5.2)	(5.3)
Normalised PBT	54.1	77.7	110.0	135.0
Tax rate (%)	26.9	23.0	21.0	21.0
Normalised EPS (p)	30.6	44.9	65.2	80.0
EPS Growth (%)	74.7	46.6	45.2	22.7
Dividend (p)	9.0	12.0	15.0	18.0

Source: Jefferies estimates, company data

Table 27: Bovis Cashflow Summary, £m

	2012A	2013E	2014E	2015E
Net Income	40.8	59.9	86.9	106.6
Depreciation	1.8	2.0	2.0	2.0
Other Non-Cash	12.0	15.0	15.0	15.0
Working Capital	(68.3)	(150.7)	(54.7)	(44.3)
Cash From Operations	(13.7)	(73.9)	49.2	79.3
Interest paid	(1.7)	(4.9)	(5.2)	(5.3)
Interest received	0.8	0.0	0.0	0.0
Tax received/(paid)	(9.9)	(17.9)	(23.1)	(28.3)
Net Cashflow	(24.6)	(96.6)	20.9	45.7
Investing activities	0.7	0.0	0.0	0.0
Dividend paid	(8.7)	(16.0)	(20.0)	(24.0)
Net financing	0.6	0.0	0.0	0.0
Movement in Cash	(32.0)	(112.6)	0.9	21.7
Net Cash /(Debt) b/f	50.8	18.8	(93.8)	(92.9)
Net Cash /(Debt) c/f	18.8	(93.8)	(92.9)	(71.2)

Source: Jefferies estimates, company data

Table 28: Bovis Balance Sheet Summary, £m

	2012A	2013E	2014E	2015E
Non current assets	67.6	73.6	79.6	85.6
Land	666.1	769.7	799.9	833.6
WIP	197.4	249.1	304.4	328.2
Trade and other debtors	64.8	55.4	67.7	72.9
Trade and other creditors	(198.6)	(193.8)	(236.8)	(255.3)
Working Capital	729.7	880.4	935.2	979.5
Other Assets/(Liabilities)	(57.3)	(57.6)	(52.3)	(41.6)
Net Cash/(Debt)	18.8	(93.8)	(92.9)	(71.2)
Tangible Net Assets	758.8	802.7	869.7	952.3
Plot cost (£'000)	48.4	49.7	51.6	53.8
NAV per share (p)	570.0	602.9	653.2	715.3
TNAV per share (p)	570.0	602.9	653.2	715.3

Source: Jefferies estimates, company data

Crest Nicholson

CRST LN, 340p, Hold, PT 387p, Mkt. Cap: £876m

Focused on the southern regions of the UK

Crest is a UK housebuilder focused on the southern regions of the UK. The group was founded 50 years ago and listed on the London Stock Exchange, for the second time, in February 2013. In our view, the key strength and weakness of the group is its landbank. On the one hand, we believe it to be the most attractively valued landbank in the sector and the southern UK housing markets are currently the UK housing sweet spot. However, they have recovered faster and further than the midlands and the northern regions and, in our view, are likely to underperform these regions on a three- year view. Crest's southern bias closes off the possibility of the group benefiting from those markets that have yet to set out on the path to recovery.

Landbank derisked.

In our view, Crest has the most attractively priced landbank in the UK housebuilding sector due to the Fair Value (FV) exercise carried out when the group was in private hands (an option not available to its listed peers).

Landbank hidden value.

The FV exercise was carried out in 2009. We have tracked the house prices in the postcode area around each site and, on average, house prices have increased by 8.2% in these areas. We estimate that 22 of the group's current sites were part of the FV exercise and therefore these sites have hidden value embedded within.

Landbank length.

Not only has the group the most attractively valued landbank, it has one of the longest at 6.8 years of target volumes and therefore has a high visibility of earnings.

Landbank's Achilles' heel.

The landbank is derisked, long and has hidden value within; however, virtually all of it is in the south of England. The southern housing markets have moved the fastest and furthest from their troughs and, in our view, offer the least upside from here, although they currently remain the most attractive markets. We also believe that new regulations in the UK residential mortgage market may temper house price growth in the south from 2014. In our view, Crest has limited exposure to those regional markets with the greatest potential. However, we believe that the solution to the affordability issue in the south is Build to Rent and the Private Rented Sector (PRS) sector, and although this has, for at least the last 20 years, proved to be a tricky nut to crack, should a solution be found before the end of 'Help to Buy', Crest's Achilles' heel may not be exposed.

Valuation

At 352p, Crest trades on a CY2014 FVA P/B of 1.43x. Our 387p PT is based on applying a recovery multiple of 1.6x to our CY2014 FVA net book value and a PER of 10x to our CY2014E EPS Base case, Bull and Bear case estimates, and steady state FVA P/B multiples of 1.1x and PER of 10x to our CY2016E Base case, Bull and Bear case estimates. Our PT is a blend of the three cases, weighted in-line with our view of the likelihood of each scenario. We use steady state PER multiples for CY2014 and CY2016 EPS because, due to the FVA, we judge the earnings to be derived from steady state conditions.

Please see important disclosure information on pages 57 - 60 of this report.

Table 29: Crest Nicholson P&L, £m

	2012A	2013E	2014E	2015E
Volume (x)	1882.0	2000.0	2500.0	2700.0
Volume growth (%)	23.8	6.3	25.0	8.0
ASP (£'000)	203.0	218.8	226.9	235.0
ASP growth (%)	6.9	7.8	3.7	3.6
Continuing Turnover	408.0	486.1	630.2	705.0
Gross Profit	111.8	131.2	159.2	182.3
Gross Margin (%)	27.4	27.0	25.3	25.9
EBITA	70.5	94.0	116.7	137.9
EBITA margin (%)	17.3	19.3	18.5	19.6
Net Interest	(9.4)	(8.0)	(5.0)	(5.0)
Normalised PBT	61.1	86.0	111.7	132.9
Tax rate (%)	(2.9)	24.0	22.0	21.0
Normalised EPS (p)	25.0	26.0	34.6	41.8
EPS Growth (%)	(41.3)	3.9	33.3	20.5
Dividend (p)	0.0	5.0	8.0	10.0

Source: Jefferies estimates, company data

Table 30: Crest Nicholson Cashflow, £m

	2012A	2013E	2014E	2015E
Net Income	62.9	65.4	86.0	105.0
Depreciation	1.2	1.2	1.2	1.2
Other Non-Cash	(7.6)	20.0	20.0	20.0
Working Capital	(45.7)	(97.2)	(91.0)	(24.6)
Cash From Operations	10.8	(10.6)	16.2	101.6
Interest paid	(11.8)	(8.0)	(5.0)	(5.0)
Interest received	1.2	0.0	0.0	0.0
Tax received/(paid)	0.6	0.0	0.0	(18.8)
Net Cashflow	0.9	(18.6)	11.2	77.9
Investing activities	(5.1)	0.0	0.0	0.0
Dividend paid	0.0	0.0	(12.6)	(20.1)
Net financing	15.7	50.0	0.0	0.0
Movement in Cash	11.5	31.4	(1.4)	57.7
Net Cash /(Debt) b/f	(42.8)	(31.3)	0.0	(1.3)
Net Cash /(Debt) c/f	(31.3)	0.0	(1.3)	56.4

Source: Jefferies estimates, company data

Table 31: Crest Nicholson Balance Sheet, £m

	2012A	2013E	2014E	2015E
Non-current assets	140.1	142.1	144.1	146.1
Land	0.0	0.0	0.0	0.0
WIP	469.4	583.3	724.7	775.5
Trade and other debtors	41.5	48.6	63.0	70.5
Trade and other creditors	(194.9)	(218.8)	(283.6)	(317.3)
Working Capital	316.0	413.2	504.2	528.8
Other Assets/(Liabilities)	(79.0)	(105.4)	(130.0)	(134.5)
Net Cash/(Debt)	(30.0)	0.0	(1.3)	56.4
Tangible Net Assets	318.1	420.9	487.9	567.7
Plot cost (£'000)	0.0	0.0	0.0	0.0
NAV per share (p)	138.1	179.0	205.6	237.4
TNAV per share (p)	126.5	167.4	194.1	225.8

Source: Jefferies estimates, company data

Please see important disclosure information on pages 57 - 60 of this report.

Galliford Try

GFRD LN, 1096p, Buy, PT 1303p, Mkt. Cap: £904m

In our view, Galliford Try is the largest housebuilder in the UK not to be classified as a housebuilder. Housebuilding is the driver of profits and therefore earnings. Many perceive that the presence of its construction arm dilutes its exposure to the housing market, we disagree. In our view the Group's offering is enhanced by its construction arm, which allows Galliford to reach parts of the housing market other housebuilders cannot reach.

Now we are a housebuilder.
Following an expansionary Rights Issue the Group has, in our view transformed itself from a complex hybrid to a straight forward housebuilder. It is our assessment that investors prefer simple investment cases to complex ones and in Galliford we have just that.

What next?
One could be forgiven for thinking that Galliford had arrived at its destination, not so. Now it is a housebuilder, there is much it still wishes to achieve. Operating margin growth is the top priority and all managers, not just the tops ones, have been incentivised to make this happen and with their track record of delivery, we expect operating margins to press on from here.

Reaching the parts other housebuilders cannot reach.
In our view, Galliford Try's construction arm brings three main benefits: it has a broader range of skills and capabilities than many of its peers, allowing it to take on complicated sites that many shy away from, sites where the competition is muted and margins therefore higher. It can be a one stop shop for the affordable housing market, a market we believe to be increasingly attractive due to changes in public sector funding arrangements. Finally the construction arm is cash generative and last time we checked, cash was still king.

Construction, the hidden gem
During the credit crunch the focus at Galliford has been to enhance the housebuilding operations, meanwhile its construction business has been quietly getting on with business and not seeing its margins decline as much as it originally guided. We note that other contractors are starting to suggest that the UK construction market is stabilising and that activity levels are starting to tick upwards. When 'Help to Buy' has run its course we must remember that Galliford Try has several strings to its bow.

Another take on capital returns.
There are already a number of capital return models in the UK housebuilding sector and today Galliford has added another, to move its 2.0x dividend cover to 1.7x by the end of 2015. Its approach is transparent, does not seek to call the cycle and does not disconnect the promised returns from the underlying performance of the business. Such a policy we believe is made possible, in part, by the cash generative construction arm.

Valuation

Our price target for Galliford Try is 1303p. We value the Group using the same methodology as we do the other UK housebuilders we follow, a blend of P/B (Price to tangible net book value) and PER (Price Earnings Ratio). We value the contribution of the construction arm using UK construction sector multiples of EV/EBITDA and PER.

Please see important disclosure information on pages 57 - 60 of this report.

Table 32: Galliford Try P&L Summary, £m

	2013A	2014E	2015E	2016E
Volume (x)	2932.0	3250.0	3250.0	3375.0
Volume growth (%)	-3.5	10.8	0.0	3.8
ASP (£'000)	228.2	249.6	232.5	232.5
ASP growth (%)	7.1	9.4	-6.9	0.0
Housebuilding turnover	562.8	764.4	716.6	764.5
Construction turnover	902.1	912.2	949.6	976.4
Group revenue	1470.9	1682.7	1672.2	1746.9
Operating profit: Housing	74.3	88.5	105.7	130.4
Operating margin: Housing (%)	13.1	12.4	14.7	16.8
Operating profit: Construction	14.9	13.0	13.6	14.0
Operating margin: Construction (%)	1.6	1.3	1.3	1.3
Central costs/JV/PPP	-7.8	-12.9	-12.8	-13.4
EBITA	81.4	88.6	106.4	131.0
Amortisation	-1.0	-1.0	-1.0	-1.0
EBIT	80.4	87.6	105.4	130.0
Net Interest	-6.3	-5.6	-5.4	-5.3
Normalised PBT	74.1	82.0	100.0	124.7
Tax rate (%)	21.5	22.0	22.0	22.0
Underlying PAT	58.2	64.0	78.0	97.2
Normalised EPS (p)	71.7	78.8	96.1	119.8
EPS Growth (%)	17.7	9.9	22.0	24.7
Dividend (p)	37.0	43.8	56.5	70.5

Source: Jefferies estimates, company data

Table 33: Galliford Try Cashflow Summary, £m

	2013A	2014E	2015E	2016E
EBITDA	84.2	91.4	109.2	133.8
Other non-cash	-6.4	6.3	6.3	6.3
	77.8	97.7	115.5	140.1
Pension Funding	-7.3	-7.3	-7.3	-7.3
Net cash from operations	70.5	90.4	108.2	132.8
Decrease/(increase) inventories	0.0	0.0	0.0	0.0
Decrease/(increase) in developments	-28.4	-109.6	5.4	-38.1
Decrease/(increase) in receivables	-28.3	-35.9	2.1	-15.0
Increase/(decrease) in creditors	-3.8	93.4	-4.6	33.0
Net cash (used)/generated from operations	10.0	38.3	111.0	112.7
Interest received	4.0	0.0	0.0	0.0
Interest paid	-8.6	-5.6	-5.4	-5.3
Tax (paid)/received	-9.2	-18.0	-22.0	-27.4
Net cash used in operating activities	-3.8	14.7	83.6	79.9
Dividends	-26.9	-31.9	-39.0	-49.7
Capex	-5.8	-5.8	-5.8	-5.8
Other	-0.4	11.7	0.7	0
Net cash inflow/(outflow)	-36.9	-11.3	39.5	24.5
Opening net cash/(debt)	22.5	-14.4	-25.7	13.8
Closing net cash/(debt)	-14.4	-25.7	13.8	38.3

Source: Jefferies estimates, company data

Table 34: Galliford Try Balance Sheet Summary, £m

	2013A	2014E	2015E	2016E
Non current assets	219.3	222.3	225.3	228.3
Land	441.8	506.4	503.3	525.7
WIP	306.8	351.7	349.6	365.2
Trade and other debtors	300.6	336.5	334.4	349.4
Cash and cash equivalents	57.9	0.0	13.8	38.3
Total Current Assets	1107.1	1194.7	1201.1	1278.6
Total Assets	1326.4	1417.0	1426.4	1506.9
Debt	72.3	25.7	0.0	0.0
Trade and other payables	648.6	742.0	737.4	770.3
Other liabilities	104.1	115.5	119.5	124.9
Net Assets	501.4	533.8	569.5	611.7
Tangible Net Assets	386.4	418.8	454.5	496.7
TNBV per share	476.0	515.8	559.8	611.8

Source: Jefferies estimates, company data

Persimmon

PSN LN, 1154p, Hold, PT 1275p, Mkt. Cap: £3296m

Persimmon is a UK national housebuilder.

The Group operates under three main brands, Persimmon Homes, Charles Church and Westbury Partnerships. Persimmon Homes is the core business of the Group building open market homes across a wide range of property types from detached homes through to apartments. Charles Church is the Group's premium brand and Westbury Partnerships its business which focuses on social housing. The Group is based in York.

Position in the market

Persimmon is one of the three largest housebuilders in the UK and it is regarded, in our view, as the Blue Chip housebuilder. This reputation is manifested in the rating of its shares, which typically trade at a higher premium to TNAV than its peers. It has a strong record of delivery and was one of the most unscathed by the credit crunch and it is currently leading the pack with respect to the race to rebuild operating margins among the UK national housebuilders.

Persimmon has traditionally had a smaller exposure to apartments than its peers and continues to have a focus on traditional family housing, in part this reflects its decision to, in the main, focus on greenfield sites and it has very limited exposure to brownfield and regeneration sites which typically have a higher weighting to apartments.

Strategy

The Group announced details of its Capital Return Plan in February 2012, where the Board proposed to return excess capital to shareholders over the next nine years. The proposed plan is to return £1.9bn (620p per share) to shareholders between June 2013 and June 2021, whilst strengthening the underlying business. However, the dividend plan does not ask the Group to do anything it hasn't already done before. The Group's plans require it to generate £1.9bn over a ten year period, if we look at the previous ten years, which include a rather challenging period, the Group generated £2.2bn.

The strategic priorities underlying the Capital Return Plan are to improve operating margins by: conversion of strategic land at enhanced margins, acquisition of new land (both consented and strategic) in prime locations, optimising existing sites via re-plans where appropriate and to keep tight control of build costs. The Group currently has a balanced landbank across the UK; however, we may see a gentle increase in the exposure to the South of England over time.

The Group is a key player in the strategic land market and has one of the biggest strategic land portfolios in the sector. Strategic land remains a key part of the Group's strategy, it has underpinned operating margins in the past and we expect it to continue to underpin them in the future.

Valuation

At 1154p Persimmon trades on a CY2014E P/B of 1.55x. Our price target of 1275p suggests upside of around 10%. We reiterate our Hold rating on the shares. Our price target is derived by applying recovery multiples to our CY2014 estimates and steady state multiples to our CY2016 estimates across our Base case and Upside and Downside scenarios, weighted according to our view of the likelihood of each scenario.

Please see important disclosure information on pages 57 - 60 of this report.

Table 35: Persimmon P&L Summary, £m

	2012A	2013E	2014E	2015E
Volume (x)	9903	11000	12000	13000
ASP (£'000)	175.6	180.0	185.0	190.0
ASP growth (%)	5.7	2.5	2.8	2.7
Continuing Turnover	1721.4	2000.0	2220.0	2470.0
Gross Profit	301.9	394.0	472.8	548.8
Gross Margin (%)	17.5	19.7	21.3	22.2
EBITA	217.1	308.9	377.3	442.6
EBITA margin (%)	12.6	15.4	17.0	17.9
Net Interest	1.9	-1.0	-1.0	-1.0
Normalised PBT	219.0	307.9	376.3	441.6
Tax rate (%)	23.2	23.0	22.0	21.0
Normalised EPS (p)	55.6	78.3	97.0	115.3
EPS Growth (%)	73.3	41.0	23.8	18.8
Dividend (p)	75.0	0.0	10.0	85.0

Source: Jefferies estimates, company data

Table 36: Persimmon Balance Sheet Summary, £m

	2012A	2013E	2014E	2015E
Net Income	168.1	237.1	293.5	348.9
Depreciation	4.1	7.0	7.0	7.0
Other Non-Cash	59.7	50.0	50.0	50.0
Working Capital	9.0	-60.9	24.4	58.0
Cash From Operations	240.9	233.2	374.9	463.9
Interest paid	-2.5	-9.0	-9.0	-9.0
Interest received	0.7	8.0	8.0	8.0
Tax received/(paid)	-56.6	-70.8	-82.8	-92.7
Net Cashflow	182.5	161.3	291.2	370.1
Investing activities	-3.8	0.0	0.0	0.0
Dividend paid	-18.2	-226.5	-30.3	-257.2
Net financing	0.0	0.0	0.0	0.0
Movement in Cash	160.5	-65.2	260.9	112.9
Net Cash /(Debt) b/f	41.0	201.5	136.4	397.3
Net Cash /(Debt) c/f	201.5	136.4	397.3	510.2

Source: Jefferies estimates, company data

Table 37: Persimmon Cashflow Summary, £m

	2012A	2013E	2014E	2015E
Non-current assets	498.2	508.2	518.2	528.2
Land	1495.7	1429.7	1357.7	1279.7
WIP	555.3	640.0	710.4	790.4
Trade and other debtors	47.3	120.0	133.2	148.2
Trade and other creditors	-599.5	-630.0	-666.0	-741.0
Working Capital	1498.8	1559.7	1535.3	1477.3
Other Assets/(Liabilities)	-204.8	26.5	43.3	70.0
Net Cash/(Debt)	201.5	136.4	397.3	510.2
Tangible Net Assets	1749.2	1986.3	2249.5	2341.2
Plot cost (£'000)	26.9	25.7	24.4	0.0
NAV per share (p)	661.9	740.6	828.0	858.5
TNAV per share (p)	580.7	659.4	746.9	777.3

Source: Jefferies estimates, company data

Redrow

RDW LN, 276p, Buy, PT 344p, Mkt. Cap: £1013m

Redrow is a UK national housebuilder, which was founded by Steve Morgan in 1974. Mr Morgan is currently the Executive Chairman of the Group and in our view the Group retains the entrepreneurial spirit of an owner managed business. The Group operates from ten divisions across the UK, having added a new 'Southern Counties' division during 2013, which serves the M3 and M4 corridors and has plans to open a Western Counties division during the summer of 2014.

Position in the market

We estimate that by volume of homes built Redrow is currently ranked 6th out of the largest 7 pure play UK housebuilders. We expect volumes in FY2014 to be around 3325 homes and for them to grow gradually in the medium term as new sites become active rather than due to an increase in sales rates and is therefore likely to be at the lower of the volume scale of the UK housebuilders we follow.

Strategy

The Group's strategy is to be the premium brand in the sector, which it seeks to achieve by sourcing and purchasing high quality land and by employing exacting build standards and through market sensitive home design.

The Group seeks to source land in the right place for the right price, which will be accomplished through investment in strategic land, medium term land where value can be added by technical site optimisation and the purchase of consented land.

Redrow is keen that the build quality of its products is a clear differentiator along with product design. The key to the Group's design was the launch of the New Heritage Collection, which focuses on traditional detached family housing. In 1H 2013 New Heritage represented 85% of private homes turnover, up from 67% a year earlier.

London calling

Alongside its national operations, Redrow re-entered the London market in the second half of 2010. At 30 June 2013, the Group's London division had a landbank of 728 plots with an estimated GDV of around £500m. In the medium to long term the Group expects London will account for approximately 20% of its operating profit.

But significant exposure in the regions

Of all the midcap UK housebuilders we follow, we estimate that Redrow has the lowest exposure to London and the Southern regions of the UK at around 30% with almost 35% in the Northern regions, c.20% in midlands and the balance c.15% in Wales. House prices and transactions levels have not recovered as quickly outside of London and the South as they have inside, the greatest potential from here may therefore be away from the South.

Valuation

We estimate that Redrow currently trades on a CY2014E P/B of 1.47x, and the upside potential is around 25% based on our 344p price target, which is based on applying recovery multiples to our CY2014 estimates and steady state multiples to our CY2016 estimates. We reiterate our high conviction Buy on the shares.

Please see important disclosure information on pages 57 - 60 of this report.

Table 38: Redrow P&L Summary, £m

	2013A	2014E	2015E	2016E
Volume (x)	2827	3350	3750	4000
Volume growth (%)	15.0	18.5	11.9	6.7
ASP (£'000)	213.9	226.6	235.0	240.0
ASP growth (%)	12.7	5.9	3.7	2.1
Continuing Turnover	604.8	805.7	945.9	1042.6
Gross Proft	113.6	163.5	212.8	247.6
Gross Margin (%)	18.8	20.3	22.5	23.7
EBITA	73.6	112.9	154.2	185.0
EBITA margin (%)	12.2	14.0	16.3	17.7
Net Interest	-5.4	-10.0	-10.0	-10.0
Normalised PBT	71.5	108.7	144.2	175.0
Tax rate (%)	22.8	28.0	28.0	28.0
Normalised EPS (p)	15.7	23.0	31.0	38.0
EPS Growth (%)	45.7	46.3	34.4	22.9
Dividend (p)	1.0	3.0	5.0	8.0

Source: Jefferies estimates, company data

Table 39: Redrow Cashflow Summary, £m

	2013A	2014E	2015E	2016E
Net Income	53.7	78.3	103.8	126.0
Depreciation	1.2	1.5	1.5	1.5
Other Non-Cash	10.7	12.0	12.0	12.0
Working Capital	-144.1	-150.0	-25.0	-20.0
Cash From Operations	-78.5	-58.2	92.3	119.5
Interest paid	-3.2	-10.0	-10.0	-10.0
Interest received	0.0	0.0	0.0	0.0
Tax received/(paid)	0.0	-25.0	-31.7	-36.8
Net Cashflow	-81.7	-93.2	50.6	72.8
Investing activities	6.8	0.0	0.0	0.0
Dividend paid	0.0	-10.9	-18.2	-29.1
Net financing	-2.1	0.0	0.0	0.0
Movement in Cash	-77.0	-104.1	32.4	43.7
Net Cash /(Debt) b/f	-14.0	-91.0	-195.2	-162.7
Net Cash /(Debt) c/f	-91.0	-195.2	-162.7	-119.1

Source: Jefferies estimates, company data

Table 40: Redrow Balance Sheet Summary, £m

	2013A	2014E	2015E	2016E
Non current assets	87.6	97.6	107.6	117.6
Land	622.0	601.9	573.1	537.1
WIP	273.5	275.2	366.6	430.4
Trade and other debtors	24.9	24.2	32.2	37.8
Trade and other creditors	-296.7	-296.4	-394.8	-463.5
Working Capital	623.7	604.9	577.2	541.9
Other Assets/(Liabilities)	-11.1	155.4	207.8	283.7
Net Cash/(Debt)	-91.0	-195.2	-162.7	-119.1
Tangible Net Assets	607.3	660.9	727.9	822.2
Plot cost (£'000)	47.2	45.7	43.5	40.8
NAV per share (p)	164.7	179.2	197.3	222.8
TNAV per share (p)	164.2	178.7	196.8	222.3

Source: Jefferies estimates, company data

Taylor Wimpey

TW/ LN, 106p, Buy, PT 132p, Mkt. Cap: £3378m

The largest housebuilder in the UK
Taylor Wimpey is one of the three largest housebuilders in the UK, operating from 24 regional offices across England, Scotland and Wales. The Group builds a broad range of homes, from one and two bed apartments to five bedroom detached homes. The Group also has a small division in Spain, accounting for less than 2% of group revenue.

Trajectory set for a significant Re-rating
In our view, Taylor Wimpey has all the ingredients in place for a significant re-rating. Having started at the beginning with land strategy and cleaned up its operations with VIM, it has a clear strategy and one which not only has crystallised best practice from within, but also which echoes the strategies successfully employed by others (strategic land – Persimmon, and landbank optimisation – Berkeley Group). In our view, the price of the shares has yet to recognise the potential of the value strategy.

Maximising value not volume
The focus is now to maximise the value from each home completion rather than seeking to maximise the number of completions. We still expect volumes to grow, but that volume growth will come naturally as new sites are opened rather than being driven by volume targets. Taylor Wimpey talks of a soft cap on volumes of c.14,000 completions per annum. What does natural growth look like? In the current market we would expect to see outlet growth in the region of 0-5% p.a and sales rates no higher than 0.7 private sales per site per week. Our current estimates are based on private sales per site per week of around 0.5.

Taking the long view on land
The other key driver of value is the Group's approach to land, which can be subdivided into two initiatives 'Value tracking and Improvement' (VIM) and strategic land.

Value Tracking and Improvement
The aim of VIM is to deliver site margins *'at least in line with initial viability assessments'* and underpins the new focus of quality over quantity. Under VIM, every site both old and new is reviewed quarterly to ensure that expected margins are being delivered and to either register and capture how additional gains have been made or agree actions to get margins back on track if they have fallen behind the target. So far VIM has typically added between 1.0%-1.5% of margin to new land. Typically the improvements have come from re-plans adjust the product mix and build densities, planning negotiations (not rushing the planning process to help drive volumes) and consistently focusing on quality over speed.

After consented land comes strategic land
Consented land provides certainty. A housebuilder needs to know where its land is coming from on a two year view to allow it to manage and plan its business efficiently and to maintain appropriate supply chain relationships. With strategic land (land without a planning consent) the planning horizon can typically be anywhere between 3-10 years. A housebuilder can therefore only really invest heavily in strategic land if its consented landbank allows. Strategic land has done wonders for the operating margins of Persimmon, and we expect that, over time, it will do the same for those of Taylor Wimpey.

Valuation
We estimate that Taylor Wimpey currently trades on a CY2014E P/B of 1.39x, and the upside potential is around 25% based on our 132p price target, which is derived by applying recovery multiples to our CY2014 estimates and steady state multiples to our CY2016 estimates across our Base case and Upside and Downside scenarios, weighted according to our view of the likelihood of each scenario.

Table 41: Taylor Wimpey P&L Summary, £m

	2012A	2013E	2014E	2015E
UK Volume (x)	10886	11500	12250	13000
UK ASP (£'000)	181.0	186.5	191.2	195.9
UK ASP growth (%)	5.8	3.0	2.5	2.5
Continuing Turnover	2019.0	2160.0	2360.0	2570.0
Gross Profit	356.3	415.5	499.6	574.5
Gross Margin (%)	17.6	19.2	21.2	22.4
EBITA	227.7	295.5	383.6	454.5
EBITA margin (%)	11.3	13.7	16.3	17.7
Net Interest	-44.8	-48.0	-29.7	-26.6
Normalised PBT	185.3	250.6	358.0	432.6
Tax rate (%)	n/a	28.3	23.0	23.0
Normalised EPS (p)	4.7	6.1	8.7	10.5
EPS Growth (%)	127.5	29.7	42.8	20.9
Dividend (p)	0.6	0.7	0.8	0.9

Source: Jefferies estimates, company data

Table 42: Taylor Wimpey Cashflow Summary, £m

	2012A	2013E	2014E	2015E
Net Income	174.3	213.9	275.6	333.1
Depreciation	5.0	5.0	5.0	5.0
Other Non-Cash	21.6	20.0	0.1	0.5
Working Capital	-73.3	-172.3	-95.9	-124.0
Cash From Operations	127.6	66.5	184.8	214.7
Interest paid	-33.3	-52.0	-33.7	-30.6
Interest received	1.2	4.0	4.0	4.0
Tax received/(paid)	3.0	0.0	0.0	0.0
Net Cashflow	98.5	18.5	155.2	188.1
Investing activities	-0.2	0.0	0.0	0.0
Dividend paid	-20.1	-21.4	-24.3	-27.4
Net financing	-20.3	0.0	0.0	0.0
Movement in Cash	57.9	-2.9	130.8	160.6
Net Cash /(Debt) b/f	-116.9	-59.0	-61.9	68.9
Net Cash /(Debt) c/f	-59.0	-61.9	68.9	229.6

Source: Jefferies estimates, company data

Table 43: Taylor Wimpey Balance Sheet Summary, £m

	2012A	2013E	2014E	2015E
Non-current assets	465.4	475.4	485.4	495.4
Land	2051.0	2110.8	2213.7	2345.0
WIP	734.9	820.8	896.8	976.6
Trade and other debtors	105.7	97.2	106.2	115.6
Trade and other creditors	-928.7	-993.6	-1085.6	-1182.2
Working Capital	1962.9	2035.2	2131.1	2255.1
Other Assets/(Liabilities)	-381.1	-268.1	-253.6	-242.5
Net Cash/(Debt)	-59.0	-61.9	68.9	229.6
Tangible Net Assets	1982.9	2175.3	2426.6	2732.3
Plot cost (£'000)	30.1	30.5	31.4	32.7
NAV per share (p)	62.2	68.2	76.1	85.6
TNAV per share (p)	62.0	68.0	75.9	85.5

Source: Jefferies estimates, company data

Barratt Developments

Buy: 474p Price Target

Scenarios

Target Investment Thesis

- Volume growth 5.4% pa.
- ASP growth 3.3% pa.
- Sales rates 0.75 (sales per site per week)
- FY2013-16E 15 CAGR EPS growth 42% pa.
- Price Target 474p

Upside Scenario

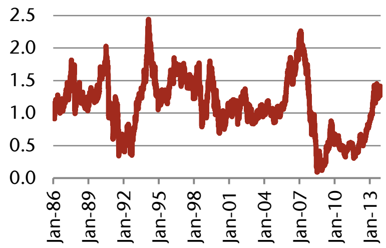
- Volume growth 2% ahead of Base Case.
- Average Selling Price growth 2% ahead of Base Case.
- Build cost inflation in line with house price inflation.
- Land cost inflation in-line with house price inflation
- Price Target 544p

Downside Scenario

- Volume decline of 4% pa
- No house price inflation.
- Build costs in line with Base Case
- Operating costs in line with Base Case
- Price Target 393p

Long Term Analysis

1 Year Forward P/B



Source: Datastream, Jefferies estimates

Long Term Financial Model Drivers

FY2013-16 growth rates	
Volume growth (%pa)	**5.4%**
ASP growth (%pa)	**3.3%**
Operating Margin Expansion	**700bp**

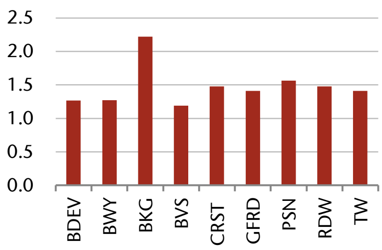
Other Considerations

Barratt has the largest exposure of the UK national housebuilders to the London market.

The group seeks to operate a ROCE focused shorter landbank model, which provides protection against the downside, but may temper returns on the upside.

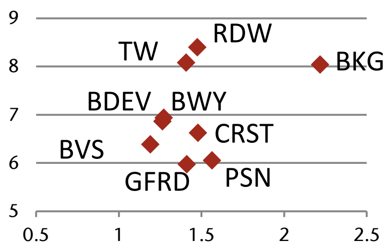
Peer Group

Group P/B CY2014E



Source: Bloomberg, Jefferies estimates

NBV Growth vs P/B



Source: Bloomberg, Jefferies estimates

Recommendation / Price Target

Ticker	Rec.	PT
BDEV	Buy	474
BWY	Buy	1954
BKG	Hold	2398
BVS	Buy	987
CRST	Hold	387
GFRD	Buy	1303
PSN	Hold	1275
RDW	Buy	344
TW/	Buy	132

Catalysts

- Unexpected increase in mortgage supply.
- NPPF presumption in favour of sustainable development perceived to be effective.
- Underlying house price inflation.
- Reduction in property related taxes and regulation.

Company Description

Barratt Developments is a UK national housebuilder, operating under two national brands, Barratt Homes and David Wilson Homes. The Group also has a regional brand, Ward Homes, which operates in Kent and the South East. The Group also has a Commercial Developments business, which specialises in retail, leisure, office, industrial and mixed use schemes. We estimate that the revenue split is 98% housing, 2% commercial developments. The Group operates from 25 divisions across the UK.

Berkeley Group

Hold: 2398p Price Target

Scenarios

Target Investment Thesis

- Volume growth 9.9% pa.
- ASP growth 8.3% pa.
- Sales rates n/a
- FY2013-16E CAGR EPS growth 14.9%
- Price Target 2398p

Upside Scenario

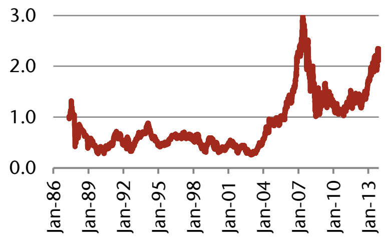
- Volume growth 2% ahead of Base Case.
- Average Selling Price growth 2% ahead of Base Case.
- Build cost inflation in line with house price inflation.
- Land cost inflation in-line with house price inflation
- Price Target 2578p

Downside Scenario

- Volumes fall to 3000 by FY2016
- No house price inflation.
- Build costs in line with Base Case
- Operating costs in line with Base Case
- Price Target 1134p

Long Term Analysis

1 Year Forward P/B



Source: Bloomberg, Jefferies estimates

Long Term Financial Model Drivers

FY2013-16 growth rates	
Volume growth (%pa)	**(1.0)%**
ASP growth (%pa)	**8.3%**
Operating Margin Expansion	**582bp**

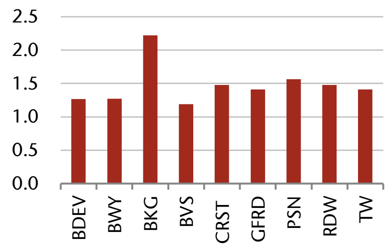
Other Considerations

We estimate that around 450% of Berkeley Group's customers are from overseas. Changes in both the wealth of these purchasers and exchange rates are likely to impact demand.

The group also has a growing rental property portfolio, which could be liquidised. At 30 April 13 the market value was £105m.

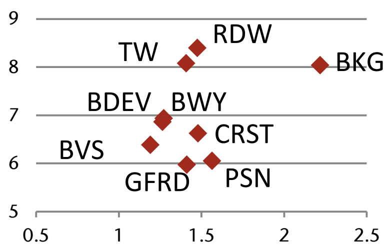
Peer Group

Group P/B CY2014E



Source: Bloomberg, Jefferies estimates

NBVs Growth vs P/B



Source: Bloomberg, Jefferies estimates

Recommendation / Price Target (p)

Ticker	Rec.	PT
BDEV	Buy	474
BWY	Buy	1954
BKG	Hold	2398
BVS	Buy	987
CRST	Hold	387
GFRD	Buy	1303
PSN	Hold	1275
RDW	Buy	344
TW/	Buy	132

Catalysts

- The group expects to invest profits into land and construction until 2014 before generating cash to return to shareholders in 2015. Berkeley has a history of paying 'special dividends' early, if history repeats itself the shares may re-rate as a dividend is announced.
- In our view, most view Berkeley's glass as half full rather than half empty, suggesting that any change in sentiment is likely to be negative rather than positive and such a change may impact the group's premium rating.

Company Description

Berkeley Group is a UK housebuilder with a geographic focus on London and the South East of England. The Group's product focus is on urban regeneration and mixed use developments and it has a target to build more than 95% of its developments on brownfield (previously developed land) rather than green field sites.

Bellway

Buy: 1954p Price Target

THE LONG VIEW

Scenarios

Target Investment Thesis

- Volume growth 9.9% pa.
- ASP growth 3.2% pa.
- Sales rates 0.57 (sales per site per week)
- FY2013-16E CAGR EPS growth 29.2%
- Price Target 1954p

Upside Scenario

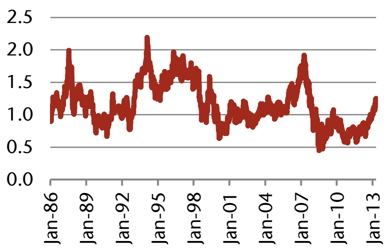
- Volume growth 2% ahead of Base Case.
- Average Selling Price growth 2% ahead of Base Case.
- Build cost inflation in line with house price inflation.
- Land cost inflation in-line with house price inflation
- Price Target 2154p

Downside Scenario

- Volume decline of 2% pa
- No house price inflation.
- Build costs in line with Base Case
- Operating costs in line with Base Case
- Price Target 1098p

Long Term Analysis

1 Year Forward P/B



Source: Bloomberg, Jefferies estimates

Long Term Financial Model Drivers

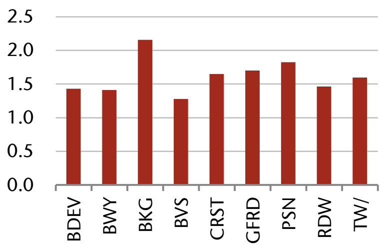
FY2013-16 growth rates	
Volume growth (%pa)	**9.9%**
ASP growth (%pa)	**3.2%**
Operating Margin Expansion	**545bp**

Other Considerations

The group has less of a southern bias to its operations than other housebuilders and may , in our view, therefore benefit more from Help to Buy, which we expect to be more of an assistance to transaction growth in the Northern and Midland regions of the UK.

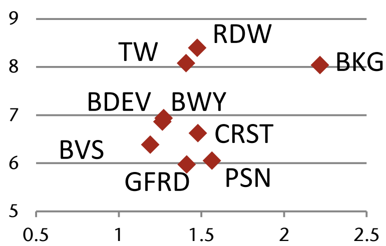
Peer Group

Group CY2014E P/B



Source: Bloomberg, Jefferies estimates

NBV Growth vs P/B



Source: Bloomberg, Jefferies estimates

Recommendation / Price Target (p)

Ticker	Rec.	PT
BDEV	Buy	474
BWY	Buy	1954
BKG	Hold	2398
BVS	Buy	987
CRST	Hold	387
GFRD	Buy	1303
PSN	Hold	1275
RDW	Buy	344
TW/	Buy	132

Catalysts

- Unexpected increase in mortgage supply.
- New management team change strategy.
- NPPF presumption in favour of sustainable development perceived to be effective.
- Underlying house price inflation .
- Reduction in property related taxes and regulation.

Company Description

Bellway is a UK national housebuilder, employing around 1400 people across the UK. The Group designs and offers for sale a range of homes from one bedroom apartments to five and six bedroom family homes.

Please see important disclosure information on pages 57 - 60 of this report.

Bovis Homes

Buy: 987p Price Target

Scenarios

Target Investment Thesis

- Volume growth 10.4% pa.
- ASP growth 2.3% pa.
- Sales rates 0.68 (sales per site per week)
- FY2013-16E CAGR EPS growth 25.6%
- Price Target 987p

Upside Scenario

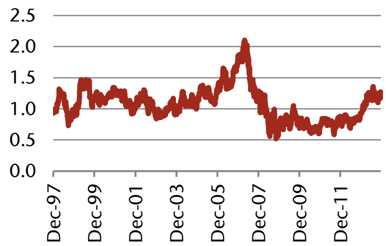
- Volume growth 2% ahead of Base Case.
- Average Selling Price growth 2% ahead of Base Case.
- Build cost inflation in line with house price inflation.
- Land cost inflation in-line with house price inflation
- Price Target 1067p

Downside Scenario

- Volume decline of 2% pa
- No house price inflation.
- Build costs in line with Base Case
- Operating costs in line with Base Case
- Price Target 1098p
- Build costs in line with Base Case.
- Price Target 723p

Long Term Analysis

1 Year Forward P/B



Source: Bloomberg, Jefferies estimates

Long Term Financial Model Drivers

FY2013-16 growth rates	
Volume growth (%pa)	10.4%
ASP growth (%pa)	2.3%
Operating Margin Expansion	469bp

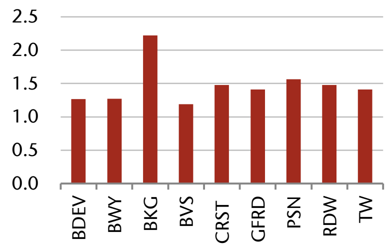
Other Considerations

Bovis is seeking to enhance returns through a combination of volume and margin growth; the strategy and management's 'aspirations' have been very clearly communicated to the market, and any deviation from the plan may cause share price volatility.

Around 70% of the group's landbank is in the south of England, the highest concentration of a national housebuilder.

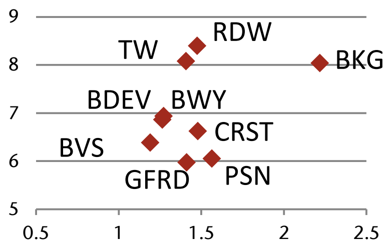
Peer Group

Group CY2014E P/B



Source: Bloomberg, Jefferies estimates

NBV Growth vs P/B



Source: Bloomberg, Jefferies estimates

Recommendation / Price Target (p)

Ticker	Rec.	PT
BDEV	Buy	474
BWY	Buy	1954
BKG	Hold	2398
BVS	Buy	987
CRST	Hold	387
GFRD	Buy	1303
PSN	Hold	1275
RDW	Buy	344
TW	Buy	132

Catalysts

- Unexpected increase in mortgage supply.
- NPPF presumption in favour of sustainable development perceived to be effective.
- Returns delivered ahead of/behind management's 'aspirations'.
- Underlying house price inflation.
- Reduction in property related taxes and regulation.

Company Description

Bovis Homes is a UK national housebuilder, its product portfolio ranges from one and two bedrooms apartments to five and six bedroom detached family homes. The portfolio includes coach houses, town houses, homes for first time buyers and for the retired. The Group also works in partnership with a wide range of housing associations, council and other public sector agencies to provide social housing.

Crest Nicholson

Hold: 387p Price Target

Scenarios

Target Investment Thesis

- Volume growth 10.5% pa.
- ASP growth 3.1% pa.
- Sales rates 1.0 (sales per site per week)
- FY2013-16E CAGR EPS growth 18.9% pa.
- Price Target 387p

Upside Scenario

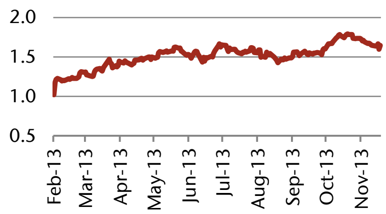
- Volume growth 2% ahead of Base Case.
- Average Selling Price growth 2% ahead of Base Case.
- Build cost inflation in line with house price inflation.
- Land cost inflation in-line with house price inflation
- Price Target 427p

Downside Scenario

- Volume decline of 2% pa
- No house price inflation.
- Build costs in line with Base Case
- Operating costs in line with Base Case
- Price Target 253p

Long Term Analysis

1 Year Forward P/B



Source: Bloomberg, Jefferies estimates

Long Term Financial Model Drivers

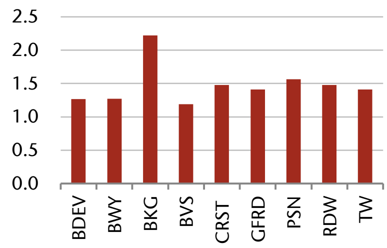
FY2013-16 growth rates	
Volume growth (%pa)	**9.9%**
ASP growth (%pa)	**5.0%**
Operating Margin Expansion	**71bp**

Other Considerations

Crest Nicholson is in the unique position that all of its land has either been purchased since the land market correct or was adjusted to fair value, due to the fair value adjustment whilst a private company its NBV is lower than its peers, and its margin higher. To enable a like for like comparison one has to adjust for the fair value exercise

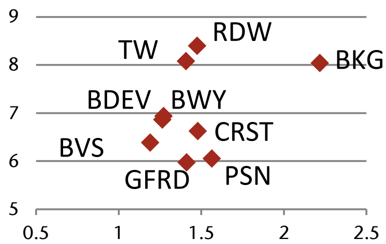
Peer Group

Group P/B CY2014E



Source: Bloomberg, Jefferies estimates

NBV Growth vs P/B



Source: Bloomberg, Jefferies estimates

Recommendation / Price Target (p)

Ticker	Rec.	PT
BDEV	Buy	474
BWY	Buy	1954
BKG	Hold	2398
BVS	Buy	987
CRST	Hold	387
GFRD	Buy	1303
PSN	Hold	1275
RDW	Buy	344
TW/	Buy	132

Catalysts

- Selling shareholder lock-ups expire on 11 August 2013 Varde and Deutsche currently have a combined stake of c.43% of the Group, there is a risk that placement of a large stake may reduce the price of the shares
- Analyst site visit 19 September 2013 may provide positive stimulus for the shares
- NPPF presumption in favour of sustainable development perceived to be effective.
- Returns delivered ahead of/behind management's 'aspirations'.

Company Description

Crest Nicholson ("Crest") is UK Housebuilder operating in the southern half of England, including London. The Group operates on both greenfield and brownfield sites. Crest offers a wide product range from homes for first time buyers through to 5 and 6 bedroom family homes and sites often include a mixture of houses, apartments and supporting commercial premises as part of its larger developments.

Galliford Try

Buy: 1303p Price Target

Scenarios

Target Investment Thesis

- Volume growth 4.8% pa.
- ASP growth 0.6% pa.
- Sales rates 0.6 (sales per site per week)
- FY2013-16E CAGR EPS growth 18.7% pa.
- Price Target 1303p

Upside Scenario

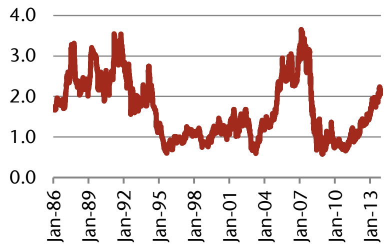
- Volume growth 2% ahead of Base Case.
- Average Selling Price growth 2% ahead of Base Case.
- Build cost inflation in line with house price inflation.
- Land cost inflation in-line with house price inflation
- Price Target 1605p

Downside Scenario

- Volume decline of 2% pa
- No house price inflation.
- Build costs in line with Base Case
- Operating costs in line with Base Case
- Price Target 898p

Long Term Analysis

1 Year Forward P/B



Source: Bloomberg, Jefferies estimates

Long Term Financial Model Drivers

CY2013-16 growth rates	
Volume growth (%pa)	**4.8%**
ASP growth (%pa)	**0.6%**
Housing Operating Margin Expansion	**370bp**

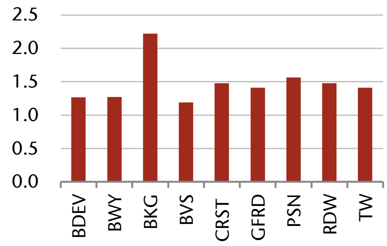
Other Considerations

Galliford Try has a broader range of skills and capabilities than most of its peers due to the support of its construction arm. This allows it to tackle more complicated sites where there is less competition and the potential of higher rewards.

Clear 'tracker dividend' with cover moving from 2.0x in FY2012 to 1.7x by FY2015.

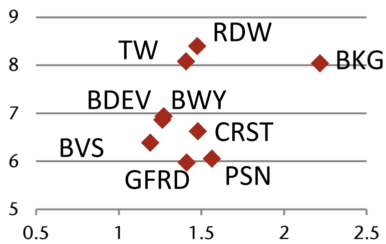
Peer Group

Group P/B CY2014E



Source: Bloomberg, Jefferies estimates

NBV Growth vs P/B



Source: Bloomberg, Jefferies estimates

Recommendation / Price Target (p)

Ticker	Rec.	PT
BDEV	Buy	474
BWY	Buy	1954
BKG	Hold	2398
BVS	Buy	987
CRST	Hold	387
GFRD	Buy	1303
PSN	Hold	1275
RDW	Buy	344
TW/	Buy	132

Catalysts

- Unexpected increase in mortgage supply.
- Large scale of public land releases to Registered Providers.
- NPPF presumption in favour of sustainable development perceived to be effective.
- Underlying house price inflation.
- Reduction in property related taxes and regulation.

Company Description

Galliford Try is the fifth largest national housebuilder in the UK and trades under the Linden Homes brand. It is a developer of both open market and affordable housing, and operates mainly in the South and East of England. The Group's housebuilding business is supported by its cash generative construction arm, which provides construction services throughout the UK.

Persimmon

Hold: 1275p Price Target

Scenarios

Target Investment Thesis

- Volume growth 8.4% pa.
- ASP growth 2.3% pa.
- Sales rates 0.6 (sales per site per week)
- FY2013-16E CAGR EPS growth 17.6% pa.
- Price Target 1275p

Upside Scenario

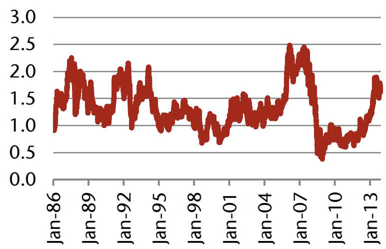
- Volume growth 2% ahead of Base Case.
- Average Selling Price growth 2% ahead of Base Case.
- Build cost inflation in line with house price inflation.
- Land cost inflation in-line with house price inflation
- Price Target 1373p

Downside Scenario

- Volume decline of 2% pa
- No house price inflation.
- Build costs in line with Base Case
- Operating costs in line with Base Case
- Price Target 933p

Long Term Analysis

1 Year Forward P/B



Source: Bloomberg, Jefferies estimates

Long Term Financial Model Drivers

FY2012-15 growth rates	
Volume growth (%pa)	**8.4%**
ASP growth (%pa)	**2.3%**
Operating Margin Expansion	**276bp**

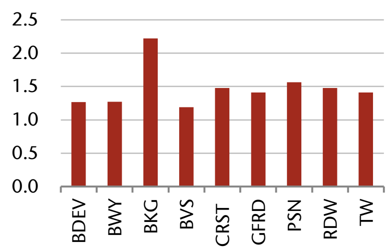
Other Considerations

Persimmon announced in February 2012 its intention to return 620p per share to shareholders between June 2013 and June 2021.

The group is regarded as having the most attractive landbank in the sector and has for a long time been a major player in the strategic land market, which in part explains its superior margin performance.

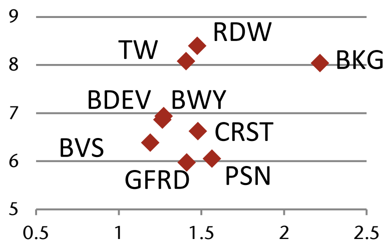
Peer Group

Group P/B CY 2014E



Source: Bloomberg, Jefferies estimates

NBV Growth vs P/B



Source: Bloomberg, Jefferies estimates

Recommendation / Price Target (p)

Ticker	Rec.	PT
BDEV	Buy	474
BWY	Buy	1954
BKG	Hold	2398
BVS	Buy	987
CRST	Hold	387
GFRD	Buy	1303
PSN	Hold	1275
RDW	Buy	344
TW/	Buv	132

Catalysts

- Unexpected increase in mortgage supply.
- NPPF presumption in favour of sustainable development perceived to be effective.
- Capital returns announced ahead of schedule.
- Underlying house price inflation.
- Reduction in property related taxes and regulation.

Company Description

Persimmon is a UK national housebuilder. The Group operates under three main brands, Persimmon Homes, Charles Church and Westbury Partnerships. Persimmon Homes is the core business of the Group building open market homes across a wide range of property types from detached homes through to apartments. Charles Church is the Group's premium brand and Westbury Partnerships its business which focuses on social housing. The Group is based in York.

Redrow

Buy: 344p Price Target

Scenarios

Target Investment Thesis

- Volume growth 12.3% pa.
- ASP growth 6.8% pa.
- Sales rates 0.70 (sales per site per week)
- FY2013-16E CAGR EPS growth 29.2%
- Price Target 344p

Upside Scenario

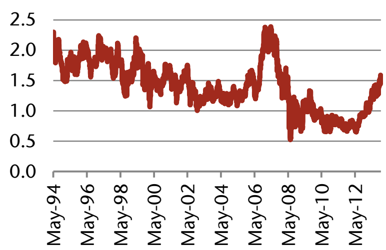
- Volume growth 2% ahead of Base Case.
- Average Selling Price growth 2% ahead of Base Case.
- Build cost inflation in line with house price inflation.
- Price Target 394p

Downside Scenario

- Volume decline of 2% pa
- No house price inflation.
- Build costs in line with Base Case
- Operating costs in line with Base Case
- Price Target 109p

Long Term Analysis

1 Year Forward P/B



Source: Bloomberg, Jefferies estimates

Long Term Financial Model Drivers

FY2012-15 growth rates	
Volume growth (%pa)	**9.8%**
ASP growth (%pa)	**6.8%**
Operating Margin Expansion	**556bp**

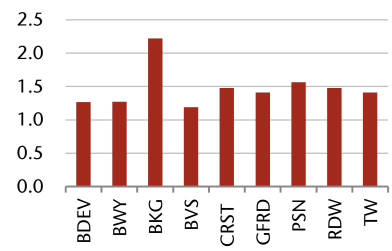
Other Considerations

Mr Morgan controls around 40% of the group and therefore has significant influence over the group.

There is the potential of a take private bid from a consortium led by Mr Morgan.

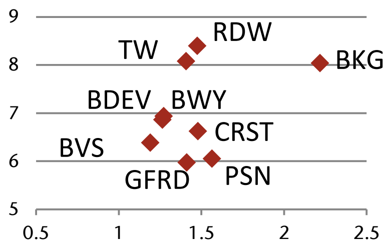
Peer Group

Group P/B CY2014E



Source: Bloomberg, Jefferies estimates

NBV Growth vs P/B



Source: Bloomberg, Jefferies estimates

Recommendation / Price Target (p)

Ticker	Rec.	PT
BDEV	Buy	474
BWY	Buy	1954
BKG	Hold	2398
BVS	Buy	987
CRST	Hold	387
GFRD	Buy	1303
PSN	Hold	1275
RDW	Buy	344
TW/	Buy	132

Catalysts

- Unexpected increase in mortgage supply.
- Offer to take group private.
- NPPF presumption in favour of sustainable development perceived to be effective.
- Underlying house price inflation.
- Reduction in property related taxes and regulation.

Company Description

Redrow is a UK national housebuilder, which was founded by Steve Morgan in 1974. Mr Morgan is currently the Executive Chairman of the Group he founded and in our view the Group retains the entrepreneurial spirit of an owner managed business. The Group operates from nine divisions across the UK.

Taylor Wimpey

Buy: 132p Price Target

Scenarios

Target Investment Thesis

- Volume growth 5.5% pa.
- ASP growth 2.5% pa.
- Sales rates 0.68 (sales per site per week)
- FY2013-16E CAGR EPS growth 23.4%
- Price Target 132p

Upside Scenario

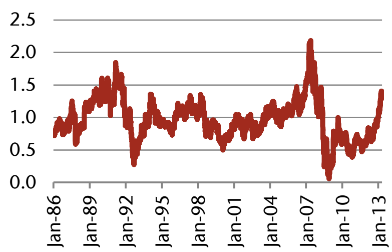
- Volume growth 2% ahead of Base Case.
- Average Selling Price growth 2% ahead of Base Case.
- Build cost inflation in line with house price inflation.
- Land cost inflation in-line with house price inflation
- Price Target 157p

Downside Scenario

- Volume decline of 2% pa
- No house price inflation.
- Build costs in line with Base Case
- Operating costs in line with Base Case
- Price Target 83p

Long Term Analysis

1 Year Forward P/B



Source: Bloomberg, Jefferies estimates

Long Term Financial Model Drivers

FY2012-15 growth rates	
Volume growth (%pa)	**5.5%**
ASP growth (%pa)	**2.5%**
Operating Margin Expansion	**437bp**

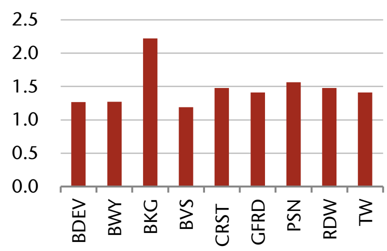
Other Considerations

The group completed a strategic review in September 2011, which resulted in the group shifting from a volume to a value strategy.

In our view, if this strategy is adhered to, the shares will re-rate as it leaves its volume heritage behind.

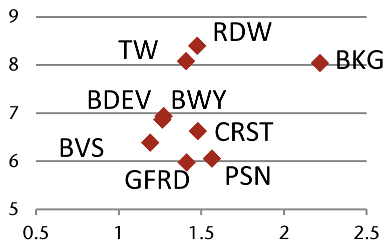
Peer Group

Group P/B CY2014E



Source: Bloomberg, Jefferies estimates

NBV Growth vs P/B



Source: Bloomberg, Jefferies estimates

Recommendation / Price Target

Ticker	Rec.	PT
BDEV	Buy	474
BWY	Buy	1954
BKG	Hold	2398
BVS	Buy	987
CRST	Hold	387
GFRD	Buy	1303
PSN	Hold	1275
RDW	Buy	344
TW/	Buy	132

Catalysts

- Unexpected increase in mortgage supply.
- NPPF presumption in favour of sustainable development perceived to be effective.
- Underlying house price inflation.
- Reduction in property related taxes and regulation.
- Decisions taken to further de-risk the pension deficit.

Company Description

Taylor Wimpey is one of the three largest housebuilders in the UK, operating from 24 regional offices across England, Scotland and Wales. The Group builds a broad range of homes, from one and two bed apartments to five bedroom detached homes. The Group also has a small housebuilding operation in Spain, accounting for less than 2% of group revenue.

Company Description

Bellway is a UK-based housebuilder.

Barratt Developments is a UK-based housebuilder.

Berkeley is a UK-based housebuilder.

Bovis is a UK-based housebuilder.

Crest Nicholson is a southern-based UK housebuilder.

Galliford Try is a UK based housebuilder.

Persimmon is a UK-based housebuilder.

Redrow is a UK-based housebuilder.

Taylor Wimpey is a UK-based housebuilder.

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Jefferies Group, Inc. makes a market in the securities or ADRs of Bovis Homes Group PLC
Jefferies Group, Inc. makes a market in the securities or ADRs of Galliford Try PLC

Company Specific Disclosures

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Meanings of Jefferies Ratings

Buy - Describes stocks that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.
Hold - Describes stocks that we expect to provide a total return (price appreciation plus yield) of plus 15% or minus 10% within a 12-month period.
Underperform - Describes stocks that we expect to provide a total negative return (price appreciation plus yield) of 10% or more within a 12-month period.
The expected total return (price appreciation plus yield) for Buy rated stocks with an average stock price consistently below $10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated stocks with an average stock price consistently below $10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated stocks with an average stock price consistently below $10, the expected total return (price appreciation plus yield) is minus 20% within a 12-month period.
NR - The investment rating and price target have been temporarily suspended. Such suspensions are in compliance with applicable regulations and/or Jefferies policies.

CS - Coverage Suspended. Jefferies has suspended coverage of this company.
NC - Not covered. Jefferies does not cover this company.
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Monitor - Describes stocks whose company fundamentals and financials are being monitored, and for which no financial projections or opinions on the investment merits of the company are provided.

Valuation Methodology

Jefferies' methodology for assigning ratings may include the following: market capitalization, maturity, growth/value, volatility and expected total return over the next 12 months. The price targets are based on several methodologies, which may include, but are not restricted to, analyses of market risk, growth rate, revenue stream, discounted cash flow (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount)/average group EV/EBITDA, premium (discount)/average group P/E, sum of the parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

Conviction List Methodology

1. The aim of the conviction list is to publicise the best individual stock ideas from Jefferies Global Research
2. Only stocks with a Buy or Underperform rating are allowed to be included in the recommended list.
3. Stocks are screened for minimum market capitalisation and adequate daily turnover. Furthermore, a valuation, correlation and style screen is used to ensure a well-diversified portfolio.
4. Stocks are sorted to a maximum of 30 stocks with the maximum country exposure at around 50%. Limits are also imposed on a sector basis.
5. Once a month, analysts are invited to recommend their best ideas. Analysts' stock selection can be based on one or more of the following: non-Consensus investment view, difference in earnings relative to Consensus, valuation methodology, target upside/downside % relative to the current stock price. These are then assessed against existing holdings to ensure consistency. Stocks that have either reached their target price, been downgraded over the course of the month or where a more suitable candidate has been found are removed.
6. All stocks are inserted at the last closing price and removed at the last closing price. There are no changes to the conviction list during the month.
7. Performance is calculated in US dollars on an equally weighted basis and is compared to MSCI World AC US$.
8. The conviction list is published once a month whilst global equity markets are closed.
9. Transaction fees are not included.
10. All corporate actions are taken into account.

Risk which may impede the achievement of our Price Target

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Distribution of Ratings

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY	843	48.03%	189	22.42%
HOLD	770	43.87%	121	15.71%
UNDERPERFORM	142	8.09%	2	1.41%

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