FINANCIAL REVIEW

DEVELOPING IN LONDON: A RECORD YEAR

'Telford Homes has experienced another year of excellent results, achieving growth in profit before tax for the fifth year running from £3 million in 2012 to just over £34 million this year.'

The Group has seen success in forward selling homes through traditional channels but has also increased its focus and prominence in the London build to rent sector, entering into three more build to rent contracts in the year. The Group has continued to invest in land and work in progress but still has substantial headroom within its £180 million revolving credit facility available to achieve its aspirations of increasing profit to over £50 million by March 2019.

Presentation of joint ventures

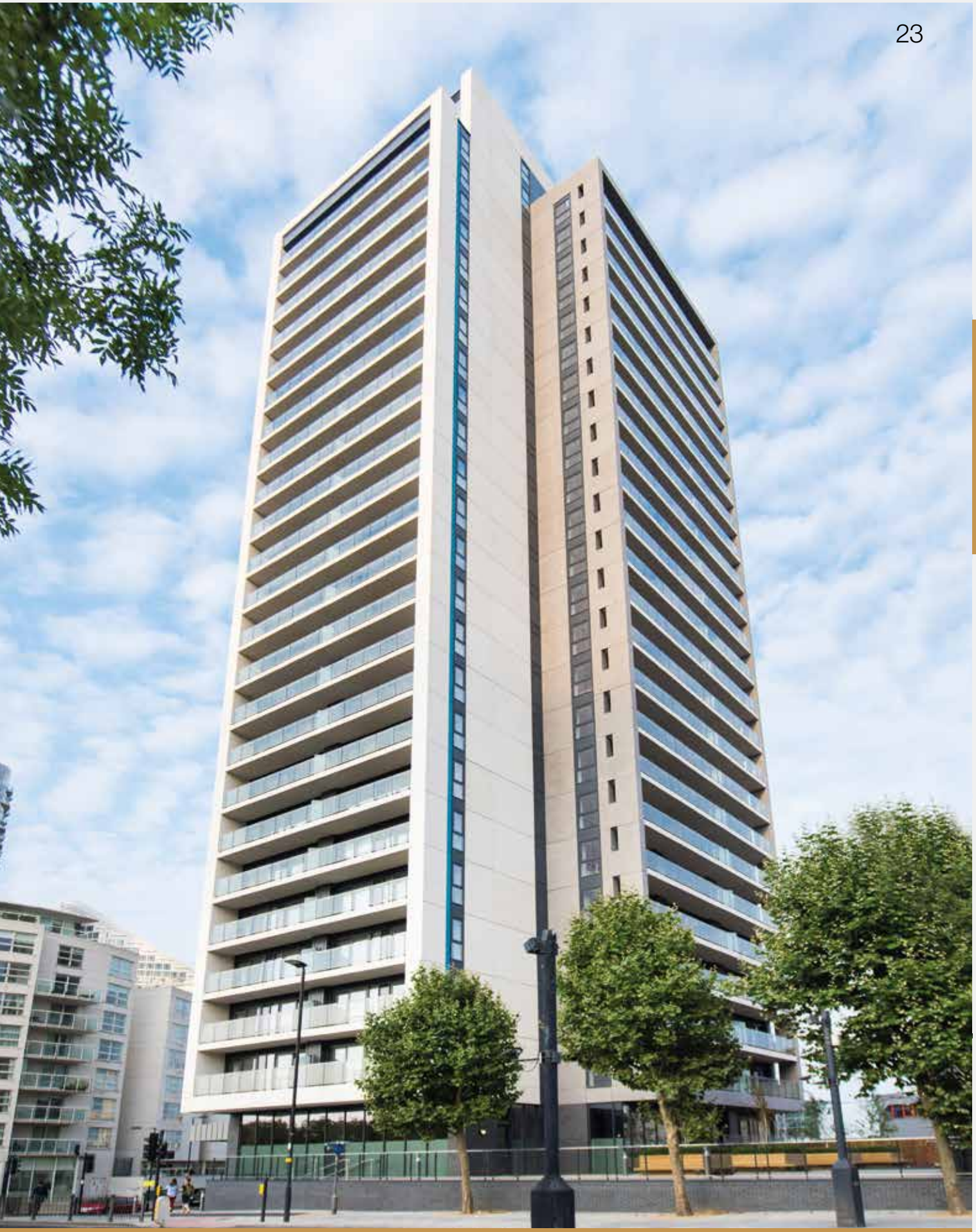
In the year to 31 March 2015, the Group adopted IFRS 11 'Joint Arrangements' which states that joint ventures should be accounted for as equity investments rather than by proportional consolidation. The Group's joint ventures are an integral part of the business and as such the Board believes that the financial results are most appropriately presented using proportional consolidation which means including the relevant share of the results of joint ventures in each line of the income statement and balance sheet. This therefore remains the method of presentation within the Group's internal management accounts.

The Board has prepared an income statement and a balance sheet using proportional consolidation along with Generally Accepted Accounting Principles (GAAP) compliant versions presenting joint ventures as equity investments. The key performance indicators and other figures within this report include the Group's share of joint venture results. The Board suggests investors follow its lead in assessing the business on the results that include a proportional share of joint ventures.

Operating results

Revenue, including the Group's share of joint ventures, has increased to a record £291.9 million (2016: £245.6 million), up 18.9 per cent on the prior year. On a GAAP basis, excluding the Group's share of joint ventures, revenue increased to £266.0 million (2016: £242.7 million).

Katie Rogers
Group Financial Director



HORIZONS E14

- Completed residential development of 190 apartments
- Stunning views of the O2 arena, the River Thames and Canary Wharf
- Re-designed to include an additional nine storeys versus original planning consent

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The number of open market residential completions was lower than the prior year at 289 (2016: 482), however the average selling price was higher at £531,000 (2016: £417,000). The reduction in completions is purely down to availability of finished stock with fewer units physically available to handover in the current financial year. Similarly, the increase in average price is a function of the mix of developments completing in each year in terms of product and their location together with relatively modest sales price inflation.

The reduction in revenue from open market completions was more than offset by an increase in both subsidised affordable housing revenue and build to rent revenue recognised in the year. In the year to 31 March 2017, the Group exchanged contracts to deliver 400 affordable homes (2016: 87 homes) and entered into three new build to rent contracts to deliver 387 build to rent homes (2016: 156 homes) over the next few years.

The Group continues to recognise revenue from the sale of affordable homes and build to rent homes under contract accounting on a percentage of completion basis throughout the build programme. Revenue recognised from affordable housing was £50.1 million (2016: £19.1 million) and from build to rent contracts it was £76.5 million (2016: £19.9 million). This includes the new contracts exchanged during the year together with the ongoing profit recognition on contracts exchanged in previous years.

The increased focus on build to rent will, over time, result in a greater proportion of the Group's revenue and profit being recognised on a percentage of completion basis over the life of the development as opposed to individual open market sales where revenue and profit which is recognised at the point of legal completion. Build to rent sales can therefore result in the Group recognising revenue and profit earlier than if the homes had been sold to individual purchasers.

A further advantage of build to rent sales is that they are forward funded by the investors and therefore they offer exceptional returns on capital.

THE JUNCTION E1

- Completed residential development of 42 apartments
- Close to St. Katharine Docks and the River Thames
- Land originally purchased from Eastend Homes

Forward funding broadly means an initial payment reimbursing the cost of the land followed by monthly construction payments and finally a payment on completion. As such very little, if any, equity is used during construction and no debt is required. In return for these benefits the Group is accepting a moderately reduced net margin on build to rent contracts with a lower sale price being partly offset by savings in selling expenses and interest costs.

During the year to 31 March 2017, the Group sold one small undeveloped site for £5.0 million. Similar to the two sites sold in the prior year for a total of £6.7 million, this sale is a result of a change in strategic direction where smaller sites have become less attractive to build out and the Group is able to leverage its greater operational size to focus on larger scale developments. The Group has also continued its programme of disposing of older freehold assets, generating revenue of £4.9 million (2016: £1.7 million).

Gross profit has increased to £63.2 million from £63.1 million, including the Group's share of joint ventures. Gross profit is stated after expensing loan interest that has been capitalised within inventories of £1.9 million (2016: £1.9 million) and, before charging this interest, the gross margin was 22.3 per cent compared to 26.5 per cent last year.

The decrease in gross profit margin was as expected with two main reasons for the reduction. Firstly, the margin achieved on open market sale completions of 25.4 per cent was lower than that achieved last year (2016: 27.3 per cent) but slightly ahead of the Group's target when appraising new sites of 24 per cent. The margin recognised on open market homes is expected to trend down towards the target margin over time as older developments which benefitted from more significant sales price inflation and minimal build cost inflation are replaced with sites appraised more recently.

Secondly, a greater proportion of the revenue this year is generated from build to rent contracts which attract a lower gross margin to compensate for the advantages of being forward funded and for savings in selling expenses and interest costs. The Group expects build to rent transactions to achieve a gross margin of approximately 12 to 13 per cent which represents the normal target margin of 24 per cent less savings in selling expenses and interest costs of circa eight per cent and therefore a net difference of up to four per cent offset by a substantially improved return on capital. The margin achieved on the build to rent revenue recognised in the year to 31 March 2017 was well ahead of that target at 16.0 per cent due to some of the land being purchased at more advantageous rates prior to becoming part of the build to rent portfolio. Future build to rent margins are still expected to be around 12 to 13 per cent.

Administrative expenses have increased to £20.8 million (2016: £19.3 million) including the Group's share of joint ventures and £20.7 million excluding joint ventures (2016: £19.1 million). This increase is mainly due to higher employee costs as the Group continues to recruit and reward the talent required to establish a structure appropriate for growth. As a percentage of revenue administrative expenses remain consistent year on year at circa seven per cent.

Selling expenses have reduced significantly to £5.1 million (2016: £9.4 million) including the Group's share of joint ventures and £4.1 million excluding the Group's share of joint ventures (2016: £9.2 million). This reduction is partly due to the lower number of open market completions but also reflects the Group's move towards build to rent, which has reduced the number of homes available to sell on the open market. During the year, there was only one significant launch, City North, incurring selling expenses of £0.9 million, compared to three launches in the previous year which resulted in combined selling expenses of £4.5 million. The homes sold under the three build to rent contracts entered into during the year would previously have been anticipated to be sold on the open market at some point over the next few years and therefore the build to rent transactions will generate significant sales cost savings over the same period.

The Group's operating margin, calculated before interest and the costs associated with the United House acquisition in the prior year, reduced to 13.4 per cent (2016: 15.0 per cent). This reduction is due to the increased proportion of build to rent profit this year which also generates interest cost savings below the operating margin line.

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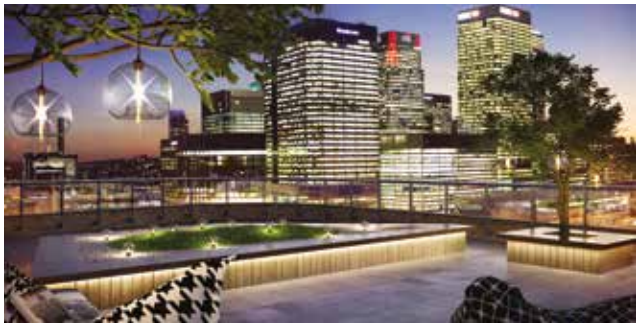

Profit before tax including the Group's share of joint ventures has increased to a record high of £34.1 million from £32.2 million and to £34.6 million excluding the Group's share of joint ventures (2016: £32.3 million). The Board expects the year to 31 March 2018 to show significant growth in pre-tax profits and again in the following year. A large proportion of this growth is already visible due to the scale of the development pipeline and the Group's substantial forward sold position.

Finance costs

Finance costs actually incurred in the year, including the Group's share of joint ventures increased to £5.3 million (2016: £4.5 million) and reduced to £4.3 million excluding the Group's share of joint ventures (2016: £4.4 million).

Average borrowings in the year were higher at £55.1 million (2016: £50.6 million), with the interest charged on these borrowings of £2.2 million (2016: £2.2 million) being capitalised into work in progress as required by IAS 23.

Finance costs charged directly to the income statement primarily consist of amortised arrangement fees and non-utilisation fees on the Group's £180 million revolving credit facility and the new £110 million facility with LaSalle Residential Finance Fund secured in July 2016 to fund our joint venture scheme, City North. Non-utilisation fees including our share of joint ventures have increased to £2.5 million (2016: £1.7 million), of which £1.6 million is attributable to the revolving credit facility (2016: £1.7 million) and £0.9 million to the City North facility (2016: £nil).

Dividend

The Board's policy is to pay one third of earnings as dividends. Following the equity placing concluded in November 2015, the Board committed to paying a dividend equivalent to one third of earnings adjusted to remove the dilutive effect of the new shares for both the year to 31 March 2016 and the year to 31 March 2017. As a result, a final dividend of 8.5 pence per share has been proposed. Together with the 7.2 pence interim dividend paid on 6 January 2017 this makes the total dividend for the year 15.7 pence (2016: 14.2 pence). This equates to just over 40 per cent of earnings and delivers a yield of circa four per cent based on the share price at 31 March 2017. The final dividend is expected to be paid on 14 July 2017 to those shareholders on the register at the close of business on 16 June 2017.

Despite an increase in profit after tax, earnings per share has decreased from 39.3 pence to 36.8 pence. This is due to the equity placing which increased the number of shares in issue throughout the year to 31 March 2017 but only for part of the previous year, thereby increasing the weighted average number of shares in issue year on year.

Balance sheet and cash

Net assets at 31 March 2017 were £204.3 million, an increase from £187.0 million last year mainly due to retained profits. This equates to net assets per share of 271.3 pence (31 March 2016: 249.8 pence). There has been a significant amount of investment in land and work in progress with inventories, including the Group's share of joint ventures, increasing from £285.6 million to £339.4 million. Excluding joint ventures, inventories increased from £239.0 million to £287.7 million with the balance being recorded within investments in joint ventures.

Investment in joint ventures has increased from £42.1 million to £47.6 million. The increase is mainly a result of completing on the purchase of Gallions Quarter during the year. This is a joint venture with Notting Hill Housing Group and was part of the acquisition of the regeneration business of United House Developments in September 2015. Completion on this site was conditional on the satisfaction of certain conditions which were concluded on 28 July 2016.

The majority of the inventories balance is land and work in progress with minimal finished stock units due to our successful forward sales strategy. The Group does not typically land bank sites and therefore the vast majority of land held within inventories is under construction or is being progressed through the planning system. Included within inventories are £4.3 million of freehold assets held for future resale (2016: £5.7 million).

Land creditors, including the Group's share of joint ventures, are £28.4 million (2016: £nil) and £26.9 million (2016: £nil) excluding joint ventures.

MANHATTAN PLAZA E14

Computer generated images

- Phase one of the redevelopment of Poplar Business Park delivering 195 homes
- Provision of commercial space for Workspace Group Plc
- Close to Poplar and Blackwall Reach DLR stations with completion in 2017

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Included within land creditors is £26.9 million in relation to a development site on Cambridge Heath Road E2, where the Group has exchanged contracts with completion due upon vacant possession of the site expected in the next few months. The remaining land creditors relate to our share of the land payment for two of our joint venture sites, Balfron Tower (£0.3 million) and Gallions Quarter (£1.1 million), where the original land contracts include a deferred land payment mechanism.

The Group continues to secure forward sales and benefit from the deposits received in advance of those sales completing. The Group had secured £546 million in forward sales at 1 April 2017 which will be recognised in future years. This is comprised of £397 million in relation to individual open market contracts, £40 million of affordable housing revenue and £109 million of build to rent revenue.

Total deposits received in advance on the open market contracts secured as at 31 March 2017 reduced slightly to £68.1 million (2016: £70.3 million). Non-refundable deposits are paid on exchange of contracts with a minimum 10 per cent received at that point and, where the Group is selling well ahead of completion, a further 10 per cent is paid 12 months after exchange. The full amount of any deposit paid is released to the Group to invest in the business.

Borrowings

The Group continues to fund its development costs through a combination of debt and equity and, despite significant investment in land and work in progress, net debt has reduced to £14.3 million (2016: £17.3 million). This is partly due to open market completion proceeds received during the year, but also deposits and upfront payments received on forward sales including build to rent contracts.

As a result, gearing has decreased to 7.0 per cent (2016: 9.3 per cent) and remains at a very low level for the Group. Gearing is anticipated to increase to enable the significant growth expected over the next few years. The rate of increase will depend on the timing of future land purchases and how much the business moves towards a build to rent model.

The Board is comfortable with the potential for increased levels of debt and gearing given that many of the Group's developments have been substantially de-risked by the level of forward sales secured.

Telford Homes has a £180 million revolving credit facility which is available to fund developments that are not joint ventures. This facility, from a club of four banks, runs until March 2019 and is governed by standard corporate covenants together with site covenants on a portfolio basis. The margin payable on this facility varies from 2.8 per cent to 4 per cent over LIBOR depending on gearing. The Group has benefited from low gearing levels throughout the year and therefore the margin paid has been at the lower end of the range. As at 31 March 2017, the Group had drawn £55 million (2016: £40 million) of this facility, leaving headroom of £125 million to fund future site acquisitions and construction costs.

Joint venture developments are funded outside of the revolving credit facility with site specific loans secured as and when required. In July 2016, the Group secured a £110 million facility with LaSalle Residential Finance Fund to fund its 50 per cent owned joint venture at City North and, in February 2017, it signed a £33 million facility with Williams and Glyn to fund Balfron Tower, in which the Group has a 25 per cent stake. The Group's joint venture with Notting Hill Housing Group at New Garden Quarter is not expected to require any external debt finance due to a proportion of the development being sold for build to rent.

The Group has excellent long term relationships and is well supported by the banks that fund the revolving credit facility. The Board is pleased to have added to these relationships with the new institutions involved in the facilities signed during the year. Telford Homes is in a strong financial position with significant headroom within existing debt facilities and equity available to enable the growth targeted over the next few years.

Katie Rogers
Group Financial Director
30 May 2017

THE LIBERTY BUILDING E14

Computer generated images

- Residential development of 155 apartments
- Located close to Canary Wharf and Crossharbour DLR station
- Under construction with completion due in 2019