Annington Half-Year Statement 2013

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Following the publication of the Annual Report for the year ended 31 March 2012, I am pleased to provide a half-yearly update on the performance of the Annington Holdings plc Group.

Ownership of the Annington Group

This half-yearly statement deals with the operations and financial results of the Annington Holdings plc Group to September 2012, during which time the Group was owned by Annington Holdings plc. On 13th December 2012, Terra Firma Special Opportunities Fund I announced the completion of the acquisition of the business from Nomura International plc. As part of this wider transaction, Annington Holdings plc ceased to be the parent company for the Group, and the Group also divested its German interests. At the same time, the Group issued £550 million of new debt in the form of a PIK issue, to add to the Group's existing £2.2 billion of debt funding.

Market Environment

As of 30 September 2012, residential property prices had remained broadly unchanged at a national level, although the market was still experiencing regional variations. Month on month changes tended to be within narrow bandwidths and balanced out over the year. The Nationwide reported that ten out of thirteen UK regions saw annual house price falls in Q3 with only London, the South East and East Anglia showing any positive improvement. According to the Land Registry, property prices in London increased by approximately 5.5% over the twelve-month period from September 2011. In September 2012, the RICS reported that while the sales-to-stock ratio had edged up during August, new-buyer enquiries had decreased for the fourth consecutive month. In October 2012, RICS then confirmed that, at the national level, prices and transactions had remained broadly flat through September. With buyer demand dropping and housing supply increasing, the gap between supply and demand was widening, and HMRC reported in October 2012 that residential transactions fell from an average of 82,000 in the first quarter of 2012 to 74,300 in the second quarter, with only a slight improvement to 76,300 in the third quarter. Notwithstanding minor month on month variations, activity levels remained subdued but stable and this is expected to continue in to 2013.

Construction activity in both the public and private sectors remains sluggish. Housing supply remains a key issue and will continue to be so going forward. The total number of housing starts in 2012 of 118,000 is less than half the number of new households being created. This has led the Future Homes Commission to suggest that Government targets should be raised to 300,000 homes per annum.

Overall, the sales market is subdued with transaction volumes at historic lows. The uncertain economic outlook, the lack of mortgage availability together with affordability pressures and the inability to fund a deposit will continue to act as a drag on housing market activity and this will continue in to 2013. The Council for Mortgage Lenders reported the lending market broadly flat over the year.

Hometrack has reported that most commentators are unwilling to make forward house price predictions, while the RICS notes that London and the South East continue to be the only regions where further sales increases are anticipated in the short term. There have been some slight revisions down in forecasts for 2013 from the Treasury and Reuters, with Reuters' average forecast for 2013 now 0%, down from the previous forecast of 1.9% in June 2012. The Government has stated its intention to make further efforts to help kick-start the housing industry and it is already taking significant steps, but it is too early to assess whether any of these initiatives will have a material impact on the market.

On the other hand, the rental sector has had a buoyant year with a surge in demand as people have struggled to get on to the housing ladder. According to LSL Property Services plc's latest Buy-to-Let Index, published in November 2012, reported rents rose for a seventh consecutive month, reaching a new national average high of £744 per calendar month. Average October rents rose by 0.4% compared to September, hitting highs in London and the South East. Rents in October 2012 were 3.4% higher than they were in October 2011, with London and the South East seeing the fastest annual rent rises, at 7.0% and 3.2%, respectively.

Operational Strategy

Given market conditions and the continued low release levels from the Ministry of Defence, which are not dissimilar to last year, Annington's operational strategy remains largely unchanged. We are continuing with our strategy of refurbishing a small number of units on each site, to maintain a sales presence but at the same time as a means of controlling cashflow. This helps to preserve sales values as it reduces the need to offer increased discounts in order to sell fully refurbished stock and prevents flooding the market in any one area with stock. Where sales rates are slow the Group utilises its strategy of short term rental to generate income and on larger sites a twin sales and rental strategy has been adopted to minimise void units.

The main rental businesses continue to perform strongly and the Group will look for further acquisitions where circumstances allow and if strict investment criteria are met. The ability of the group to balance its sale, rental and development strategies allows it to be flexible in the current market. Alternative strategy options on individual sites are appraised on a case by case basis, with the best investment strategy being implemented in each individual circumstance.

Operational Update

As at 30 September 2012, the Retained Estate comprised 39,966 Units and 184 Related Assets and the Surplus Estate comprised 524 Units ("Surplus Units") and 3 Related Assets. As of the same date, Annington owned an additional 1,549 Units outside the Married Quarters Estate (including 147 leaseholds) in its Rentals Subgroup.

Turnover

Group turnover increased by 1.8%, or £1.6 million, from £87.5 million for the six months ended 30 September 2011 to £89.1 million for the six months ended 30 September 2012.

Turnover in the Homes Subgroup increased by 1.6%, or £1.3 million, from £80.0 million for the six months ended 30 September 2011 to £81.3 million for the six months ended 30 September 2012. This increase was primarily due to an increase in passing rent on the Retained Estate as a result of the December 2011 Rent Review.

Turnover in the Rentals Subgroup increased by 3.8%, or £0.3 million, from £7.5 million for the six months ended 30 September 2011 to £7.8 million for the six months ended 30 September 2012. This increase was primarily due to additional properties acquired over the year.

The Developments Subgroup's share of turnover from joint ventures increased by 15.4%, or £1.4 million, from £8.8 million for the six months ended 30 September 2011 to £10.2 million for the six months ended 30 September 2012. This increase is primarily due to the receipt of our share of the turnover following the completion of the sale of properties by The Inglis Consortium LLP from the first two phases at the Millbrook Park development at Mill Hill in North London.

Cost of Sales

Our cost of sales decreased by 58.3%, or £4.0 million, from £6.9 million for the six months ended 30 September 2011 to £2.9 million for the six months ended 30 September 2012, primarily due to a reduction in the number of properties being prepared for sale, resulting in lower refurbishment activity recorded in cost of sales during the six months ended 30 September 2012.

Administration Expenses

Our administration expenses decreased by 41.7%, or £3.9 million, from £9.3 million for the six months ended 30 September 2011 to £5.4 million for the six months ended 30 September 2012, primarily due to the end in the provisioning for the Management Long Term Incentive Plan in March 2012. In addition, during the six months ended 30 September 2011, professional fees were higher than in the six months ended 30 September 2012 due to fees incurred in connection with a project to review the corporate structure during the six months ended 30 September 2011. Our other administration expenses have increased below the level of inflation in the economy.

Operating Profit

As a result of the factors discussed above, operating profit increased by 13.3%, or £9.4 million, from £71.4 million for the six months ended 30 September 2011 to £80.8 million for the six months ended 30 September 2012.

Share of operating profit in joint ventures

Our share of operating profit in joint ventures increased by £3.2 million, from a profit of £0.9 million for the six months ended 30 September 2011 to a profit of £4.1 million for the six months ended 30 September 2012, primarily due to our share of the profit on the completion of the sale, by The Inglis Consortium LLP, of the properties in the first two phases at the Millbrook Park development at Mill Hill in North London.

Profit on disposal of properties

Our profit on disposal of properties increased by 132.6%, or £5.6 million, from £4.3 million for the six months ended 30 September 2011 to £9.9 million for the six months ended 30 September 2012, primarily due to higher margins achieved at Mill Hill and Rowner as compared to margins achieved on disposals during the six months ended 30 September 2011, during which the low-value bulk sale of 124 Units at St Eval accounted for a significant portion of the disposals. In addition, as the Profit Share Agreement came to an end on 5 November 2011, no profit share on disposals was due to the MoD during the six months ended 30 September 2012.

Amounts written off investments

For the six months ended 30 September 2012, the directors obtained appraisals of the valuation of the Group's German Minority Interests, leading to an impairment review being undertaken on each of these investments. As a result of these reviews, the carrying value of both investments was impaired to net realisable value at 30 September 2012.

Interest receivable and similar income

Interest receivable and similar income decreased by 48.2%, or £0.6 million, from £1.2 million for the six months ended 30 September 2011 to £0.6 million for the six months ended 30 September 2012, primarily due to a change in investment strategy for cash balances from mainly bank deposits to short-term government treasury bills, offering improved security but a reduced rate of interest. As a result, our interest receivable from our cash investments decreased by £0.5 million from the prior period.

Interest payable and similar charges

Interest payable and similar charges decreased by 23.5%, or £34.4 million, from £146.7 million for the six months ended 30 September 2011 to £112.3 million for the six months ended 30 September 2012, primarily due to fair value movements on interest rate swaps, which represented £33.9 million of the decrease.

Tax charge on loss on ordinary activities

Tax charge on loss on ordinary activities amounted to a charge of £1.4 million for the six months ended 30 September 2011 compared to a charge of £0.1 million for the six months ended 30 September 2012. This reduction in tax charge was primarily due to foreign tax. The six months ended 30 September 2011 included a write-off of withholding tax on a foreign dividend paid by one of our German subsidiaries.

Minority interest

The minority's share of the loss increased by 140.0%, or £85.7 million, from £61.3 million for the six months ended 30 September 2011 to £147.0 million for the six months ended 30 September 2012. This decrease was primarily due to an increase in losses in the Homes Subgroup.

(Loss)/profit for the period

As a result of the factors discussed above, our loss for the six months ended 30 September 2011 was £9.1 million, compared to a gain of £90.3 million for the six months ended 30 September 2012, representing an overall improvement of £99.4 million, or 109.4%, over the same period for the prior year.

Investment properties

Investment properties decreased by 3.4%, or £152.6 million, from £4,530.1 million as of 30 March 2012 to £4,377.4 million as of 30 September 2012. This decrease was primarily due to a fall in the value of the properties within the Retained Estate and the Surplus Estate between 31 March 2012 and 30 June 2012. The properties within the Retained Estate and the Surplus Estate were revalued by Allsop on 30 June 2012 for purposes of the PIK issuance and associated sale and purchase transaction, and this valuation, after adjusting for disposals between 1 July 2012 and 30 September 2012, was used as the basis for the reported valuation as of 30 September 2012.

Corporate Responsibility

In the six months ended 30 September 2012, the Group paid £33k to The Annington Trust (2011: £50k), and has secured future funding from the Group of £50k per annum until 31 March 2014. Separately the Group has continued to support local communities by donating £17k (2011: £29k) to various groups and clubs.

During the six months ended 30 September 2012, The Annington Trust donated £16k (2011: £37k) to a variety of causes associated with the Married Quarters Estate. During this time, the Trust has maintained membership of the Confederation of British Service Charities (COBSEO), an organisation that exists to work for the interests of the Armed Forces community and to bring together the work of the many and varied military charities.

The Trust has been making efforts to raise its profile within the service community and in 2012 instigated an initiative with the Outward Bound Trust to sponsor children from service communities on adventure courses. During the Summer of 2012, The Annington Trust sponsored 43 young people from across the UK on 8-day adventure courses at the Outward Bound Trust's centres at Ullswater, Loch Eil and Aberdovey. Such was the success of this pilot scheme that The Annington Trust will be repeating the initiative in 2013.

Outlook

The year has been typified by a slow but stable market and continued low release levels, both of which have had an impact on sales volumes and values as well as overall workloads within the Group. However, these factors are outside the control of Annington.

It is unlikely that market conditions will improve in the short term but, equally, we do not see them deteriorating to any significant degree either. There will be monthly and regional variations but, in general, price movements will balance out. In the medium to long term, supply will inevitably act as a driver of value as economic conditions and mortgage availability improve.

Given the market conditions, Annington's sales have held up well although volumes will be down on prior years due to the availability of stock. Regular price reviews and careful use of incentives have meant that performance levels have been maintained and we are on track to exceed business plan targets by the year end in terms of both values and volumes.

Such success, albeit small, comes at a price because it means we go in to 2013 with even lower stock levels. Previously, we have been able to rely on releases to replenish stock but to date we have been notified of only 286 properties for release in 2013.

It had been hoped that greater clarity on the MoD's housing demand would start to emerge from the various studies arising from the Government's Strategic Defence and Security Review (SDSR) (2010), but this has not been the case. The Basing Review, in particular, on which an announcement was due by end 2012, was intended to identify a basing strategy in the United Kingdom from which we would have been able to extrapolate housing locations and requirements. However, further budget cuts in the Autumn Statement on top of those announced already have caused a rethink of how to achieve the original objectives of SDSR and it will now not be until early 2013 that we will hear anything of substance. Even then, it could be another 12-18 months before anything impacts on release levels.

Annington's operational strategy will continue largely unchanged from previous years. We will continue to examine and exploit the best options on a site by site basis. We will continue to operate dual sales and rental strategies on sites where numbers or sales rates dictate we should. Rental markets have performed strongly though and we are expecting this to continue in to 2013.

A combination of market conditions and release levels has had an adverse effect on workflows and we have had to make a number of redundancies. Many of those affected had long employment records with Annington and the loss of the experience and knowledge was regrettable but unavoidable given the circumstances.

With its experienced management team, and its robust financial structure, strategies and plans, Annington will be able to meet the challenges and uncertainties of the MoD release programme and the market.

James Hopkins
Chief Executive