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Berkeley Group

10:21 11 Jul 2019

Housebuilders' pay big yields but do they offer value any more?

After a mixed year, housebuilding shares perked up on news of a potential upturn in the housing market - although many investors are still very hesitant about the sector.

Residential builders have been rewarding shareholders with bumper cash returns for years now, but dividend yields ranging up to 10%, 11% and even 12% are seen as waving a red flag about the sustainability of these payments.

READ: Blue chip builders boosted as housing market brightens up
Thursday's RICS survey showed interest among house buyers rose for the first time in more than two and a half years, giving a leg up to a sector that has seen a mixed performance over the past year.

While Barratt Developments PLC (LON:BDEV) is up 17% in 12 months, the next best performer is Berkeley Group Holdings PLC (LON:BKG) with a 4% gain, while all the others have subsided.

Redrow plc (LON:RDW) is down 1%, Bellway PLC (LON:BWY) and Crest Nicholson Holdings PLC (LON:CRST) have both lost 7%, Taylor Wimpey PLC (LON:TW.) and Countryside Properties PLC (LON:CSP) are down 9% and 10%, with Persimmon PLC (LON:PSN) the worst at 24% in the red.

This is despite the supportive environment that has allowed cash to roll into the companies' coffers and out again in the forms of generous shareholder returns and executive pay packages.

Supportive market backdrop
"The backdrop has been supportive for some considerable time, as historically low interest rates, government initiatives such as Help to Buy and a general housing shortage have played into the hands of the likes of Barratt," says Richard Hunter, head of markets at Interactive Investor.

Price: 4544

Market Cap: £5.72 billion

1 Year Share Price Graph

Share Information

Code:		BKG
Listing:		LSE
52 week	**High**	**Low**
	4629	**3170**
Sector:		**Real Estate**
Website:		**www.berkeleygroup.co.uk**

Company Synopsis:
The Berkeley Group Holdings plc engaged in residential and commercial property development focusing on urban regeneration and mixed-use developments.

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Companies have been looking to capitalise on this environment, while also being mindful of not repeating the mistakes they may have made in the financial crisis, and also dealing with various other individual problems.

Of the cash that companies have been able to return to shareholders, Hunter says special dividends are the most "sensible" move as by their nature as the special nature of these dividends means that they do not have to be repeated if the environment turns tough, which often sees the housebuilders hardest hit.

Eye-popping dividends
There are some eye-popping yields at present with Berkeley and Bellway around 5% up to 8% for Barratt, 10% for Bovis, Taylor Wimpey at 11% and Persimmon at 12%.

Barratt and Berkeley, are the two builders with the most flexible shareholder returns policies, says George Salmon, equity analyst at Hargreaves Lansdown.

Even so, he says the sheer weight of cash on the balance sheet at the likes of Taylor Wimpey and Persimmon means their dividends look sustainable for at least the next year or so too.

"However," he cautions, "as one might imagine given the attractive yields on offer, the question of sustainability becomes more hazy the further out you look, especially around the special component of the dividend.

Brexit and the end of Help to Buy

"For example, a no-deal Brexit could pull the rug from under the builders feet. Any economic wobble would hit affordability for UK buyers while confidence of international buyers, which has driven the London market in recent years, may fall.

"There's even a case for the Bank of England raising rates if there's a run on sterling, which would increase mortgage costs.

"Looking past Brexit, the other potential roadblock to the builders' special dividends in the end of Help to Buy, due in 2023."

With close to 50% of Persimmon's buyers making use of this government scheme, it's not surprising to see this FTSE 100 company has been the worst performer, even more so when the group has been forced to take action to improve customer satisfaction levels following complaints about the quality of homes and leasehold charges that could see it left out of the programme.

It is difficult to see how current levels of profitability can be sustained for all the builders once Help to Buy closes.

Telford takeover poses questions

Last month's takeover by US giant CBRE of London-focused Telford Homes plc (LON:TEF) led many to wonder whether there was more value in the sector than they had perceived.

"Someone clearly thinks that there is value to be had from an investment in the industry," said Russ Mould, investment director at AJ Bell, who observed that the bid "comes seemingly irrespective of concerns about Brexit and what it may mean for the wider UK economy and sterling".

Looking at the 350p-a-share cash offer, which puts a £267mln price tag on Telford, the price implied a valuation of just under 14 times forward earnings might have implied the housebuilders were undervalued, with most on a p/e ratio near seven times, with Bellway and Redrow even lower.

But not only did Telford's lofty multiple actually reflect the depressed nature of the company's profits as it sales mix shifts towards build-to-rent, but Mould also points out that the CBRE offer represents a just 1.06 times historic net asset value per share, the lowest rating afforded to any of the quoted builders and below the sector average of 1.40 times.

READ: What is build-to-rent?

"This may reflect Telford's relatively modest size and the mix of its business but it does not imply a huge amount of upside for the other builders if that valuation is taken at face value," Mould says.

The good news is that there has been a bid at all, Mould says, as it suggests that the buyer firmly buys into the strategic thesis that demand for good-quality rental properties in London continues to outstrip supply.

"So at least the valuation could put a floor under a sector where share prices have largely lost their way of late, despite record profits and fat dividend yields."

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