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PSN.L - Q2 2010 Persimmon plc Earnings Presentation

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PRESENTATION

John White - ***Persimmon plc - Chairman***

Good morning, ladies and gentlemen, and welcome to the presentation of Persimmon's interim results to June 30, 2010.

Just for housekeeping purposes, the usual reminder; could you make sure your mobile phones are switched off?

If I could turn you to the very first slide, you will see there that our reported pre-tax profits for this year are just at just over GBP101 million, supported by an underlying performance which involved an increase in turnover up by 27%; operating profits up to GBP62 million, up from GBP10 million last year; pre-tax profits ahead at just under GBP40 million before exceptionals; earnings per share similarly up to 12p; and borrowings down to GBP122 million. And finally on that chart, our dividend per share, we have restored the dividend at this interim stage at 3p; more about that in a moment.

If we move forward, some of the key factors in achieving this improvement in performance over the period was that we achieved volume and price growth across all the divisions, with completions overall increasing by 16%.

The improvement in operating margins was due to selling price gains, build efficiencies, keeping a very tight cost control and a leaner structure with the resulting low overheads. Debt continues to reduce. Gearing was at 7% at June 30. And as I just mentioned, the Board is proposing to pay a 3p per share dividend at the interim stage.

I would just point out to you that we are on record over several years and fairly recently as stating that we wish to move towards a policy of a 40% to 60% split interim/final. We have a desire to move that at some stage to 45%/55%. But whatever, future dividends will depend upon the performance in each period, as well as our outlook to the future in cash generation and the like. So that's just a comment on where we're at with the 3p per share.

Following two years of difficult trading, we believe we can demonstrate now that we have a sound platform for growth, but we've not finished yet. But we continue to change planning consents where we believe they can add greater value and better margins, whilst keeping our outlet network going at similar levels. Now part of that planning process is where we're removing three and four storey units, for instance, as well as working through some of that lower margin sites.

We have substantial land holdings with good consents. We've got a strategic portfolio which we continue to work with. That will support future returns, and we put a lot of effort into that still. And indeed, we've introduced new initiatives, such as the JV that was recently announced with St Modwen.

Moving to more immediate facts, we have strong forward sales with 95% sold for 2010, with about 1,700 units carry-forward into 2011. So, I think you can see that's a pretty strong position to be in at this stage of the year. So all in all, we believe our strategy of margin improvement and debt reduction, not chasing volumes, is one that's showing to be successful.

At that -- this stage, can I now hand over to Mike to take you through his review?

Mike Farley - ***Persimmon plc - Group Chief Executive***

Thank you, John, and good morning, everybody. I'd like to take you through the Group overview, our current position on land holdings and its replacement, our current strategy on trading, our strategy and our further outlook on the business.

So looking at the current Group overview, we trade from 25 local offices, and we have been very successful in our dual branding with Charles Church and Persimmon throughout the 25 regional offices, and I think I'll give you some details of the strength of Charles Church as a result of that dual branding.

We've been fairly active, opened 90 new sites in the first half, and have a further 75 to open in the second half, which will maintain our outlook and outwork network so -- for the business through the second half of the year.

We have a focus now on building more traditional houses, and you'll see that 22% of our completions came from traditional houses -- sorry, apartments rather than houses, and that figure will drop to 15% in the longer-term as we look at our land holdings for the future.

We've completed over 1,000 houses on the HomeBuy Direct scheme. And more of that to come, but we still have around 1,500 allocated under the KickStart program out to 2012. And our Partnership business will also continue to grow as we have opened up a large number of sites, both in the first and second half of the year.

Looking to the actual review of the operations, you'll see a good growth in the first half of around 16%, 4,600 (sic - see presentation) units; average selling price increasing there by about 9%. 3% of that is underlying price growth. The balance is as we change that mix from houses -- from apartments to houses.

The operating margin is -- has been our focus; as you can see, an improvement from the 1.6% of 12 months ago. And we're looking to see that operating margin being maintained at around the 8% figure through the balance of this year.

A good focus on cash flow still, and obviously, GBP185 million of net increase of cash in the first half, leaving gearing at a comfortable 7%.

Looking at the overview of the Group itself, as I say, across the board, a fairly even split in completions, and our landbank matching also. Obviously, I think the market is probably stronger in the south than the north. I think we're reiterating what we've seen on a national basis in -- from others. And -- but having said that, I think in the north, we've seen strong performance in Scotland. Our Scottish business has performed well, and our homeland in Yorkshire has also seen a good increase in its volumes.

In the Central division, again, that covers areas around Thames Valley, Essex, and East Anglia. They have performed well in this market, as well as the southern market itself, Southern division itself.

Again, you can see here for Charles Church a good increase of 24% in its volumes for the business, and 50% of that volume increase would be into the Southern Division. So again, a slight bias with Charles Church, higher average selling price, but well received in the southern market.

Again, our Partnership business moving along well as, again, we see opening new sites in the second half of this year.

Over the page again, graphically you can see where the business is trending. And again, in all businesses, we can see an improvement from the H1 '09 figures against 2010, so all businesses moving well. Again, Charles Church showing a good performance, a 24% growth, and that's actually compounded by 36% by turnover; so again, a strong performance for Charles Church when measured against the business. So you can see this dual branding strategy of Persimmon/Charles Church working well throughout our business.

As usual we've worked quite hard on our landbank, our raw material, and we've been making good progress and replanning a number of our sites now to more traditional two storey housing, with again 15% just being apartments.

Also working on the NRV provision, you'll see a good release of some GBP70 million in this period. Some of that is to do with obviously our reduced costs on building, better planning consents we've got there. Some of that ability to release NRV is due to the work we're doing on sites as we open them up.

As I say, you can see we've nearly replaced our landbank in the first half at 4,200 plots, again, a fairly -- a bias towards the southern market. Continuing our pull-through of strategic land; 30% of those plots being pulled through at strategic land. And just some background on those, the average plot cost ratio of that strategic land was 15%, so that gives you a flavor of the potential margin for the future of those plots into 2011 and beyond.

You can see 15% of our legal completions predominantly in the next half of the year, 2011 and beyond, will be from new sites we've acquired; so hence, again potential for improving our margins for the future.

Talking about 3,600 plots proceeding to contract; again, over 80% of those in southern markets for both Persimmon and Charles Church.

Again, as John's mentioned, we have entered the joint venture with St Modwen's, and this will obviously give us good long-term access to land. Initially, it's for seven sites on -- for a circa 2,000 plots. Those are the seven sites that do currently have a planning consent. There are other sites that St Modwen's are working on, and we will talk to them in increasing that joint venture in the longer-term.

But as I say, we believe there's some good sites. One of our first sites at Stratford is a good location, and we believe this will give us good access for the business. It's land that we won't have to acquire in the open market. We have an exclusive arrangement with St Modwen, and it's a good pipeline for our business in the longer-term.

Talking about the current trading, as I say, I think we've seen a more traditional feel to the air where we've taken higher sales in the first and the second quarter; a more flat, slower summer period that we have experienced. Having said that, cancellation rates remain consistent, around 16%, showing purchaser confidence in the marketplace and, as I say, we believe that the business can sustain, as we are now 95% sold up for the year, so we're in a very strong position.

On sites we've been working very hard with our build costs and making sure we've got good tight control there. Build costs down 14% from their peak, again assisting our improvement in our operating margins.

Very tight control of work in progress; we're now getting the balance sheet back into shape now and back to its historic levels. We like to turn our working progress over four times a year, and we're getting down to that sort of level there now. And there's probably only about another GBP20 million to GBP30 million that we can take out of our work in progress to get down to what we believe is a natural size of the business.

Shared equity has been good for our business, as we've mentioned. We've taken advantage of the Government's first round of HomeBuy Direct, and obviously our sales have benefitted from that. But as I've mentioned before, we still have allocation of further 1,500 units for the future of -- under KickStart, which will take us right out to 2012.

One of the other benefits of the KickStart arrangement and HomeBuy Direct is our selling costs are down now to an all time low of 2.6%. So we do have other benefits through this method of sales as well. But I think we will see the amount of shared equity diminish over time, as we probably increase the amount of part exchange in our offering for the business.

Going forward on to current trading, and obviously just really updating you from our last update from the half-year, and I think you can see here, on comparison, the sales figures are fairly flat on a like-for-like basis when you look at the detail there. But I think you've got to look -- put this in context, because we have taken a large increase in H1. We can only take the sales once, and we've seen that large increase of 27% in the first half of the year.

So we've had a good uplift. So I think we're well on target. We are concentrating on growing our turnover, and now we're looking to increase our turnover by circa 10% this year. And obviously by being that, we're 95% sold up to achieve that target which is a strong position in line with where we expect to be for this time of year.

Looking further forward onto our strategy; as I say, margin repair has been our main focus, well on the way with that and we continue to maintain low build costs and looking at our existing landbank and acquiring site at higher margins.

We are obviously still focused on cash generation. Having said that, I think we are now reaching a stage where the business will need to reinvest in work in process, as I've outlined before, and also reinvesting in the land market. So I think the large decreases in our borrowings that we have seen in the past will probably tend to slow now as we come to a more replacement position.

As you know -- some of you know, our Space4 business, a modern method of construction, our factory in Castle Bromwich, Birmingham is performing well. It's made a small trading profit for the first time and we're set to do volumes around 2,500 units for this year. So that's on track and will give us further benefits in cost savings in the future as new building regulations come into play post October.

Our landbank enhancement continues. We have a six-year landbank, strong position to operate from and we continue to target our strategic land holdings.

Looking at the market overall, obviously there is still some concern by the macroeconomics. And I think obviously there may be some pause while people wait to see what the outcome of the comprehensive spending review. We did see at the budget round that people did wait on sales to see how the budget performed in June, so I wouldn't be surprised to see October a similar scenario. So we may see a slight slowing of the autumn selling period at that time.

Having said that, we believe that the fundamentals are still there, mortgage availability is improving. It appears to have stabilized around 50,000 a month, but lenders are more inclined to lend for new homes now and we're seeing some higher loan to value products in the market. We'd like to see more, but I think we are seeing more lending in that area. And I think, overall, the business is in good shape.

So if you look at Persimmon's outlook and positioning, as I say, we've been working hard on our marketing and skills, and will continue to do so. Our long landbank has excellent planning consents.

We have got efficient overhead structure. Our overheads now are down at 4.6%, up from over 5.8% at its peak and a saving of over GBP50 million from its peak period, so a good cost control there. As John's mentioned, we are continuing to maintain our tight cost control and disciplines across the board. So I think you can see we have the landbank, the margins and the experience to grow our business across the UK.

Now I'll hand across to Mike. He'll take you through the financial review.

Mike Killoran - ***Persimmon plc - Group Finance Director***

Thanks Mike. What I'd like to do is touch on a little bit of detail behind the trading performance in the first half. We'll take a look at the balance sheet, one or two key features in the balance sheet, and then have a look at cash and the debt portfolio.

So looking at the trading overview, the first half of this year has delivered a significant increase in reported pre-tax profit, as you can see GBP101 million compares with around about GBP10 million for the comparative period.

So we'll see just turning the page there the strength of the underlying performance of the business is obviously critically important and these numbers focus in on that underlying performance. And you can see the top line there, the gross margin advance to 12.3% being a full 5.7 percentage points up on the previous half-year. So we've made great strides in terms of our offsite gross margin; that's where the action is. And all the efforts that the management have put in through the first half is -- we can see is yielding benefit, which is dropping through to support the growth in operating margins that we've delivered, which is further supported by continuing to run a tight ship in terms of our overheads, that Mike's just touched on, with operating expenses and selling costs under tight control.

A feature of the first half is obviously the pricing environment that we're working in and its impact on the quality of our asset base. I'd like to emphasize that we are working very hard on our legacy assets; i.e. the sites that we acquired and the land that we acquired before 2008 in terms of vintage.

And the improvements in development costs and pricing here and there is delivering an improvement in that underlying asset quality. What that has resulted in is obviously the release, the further release of NRV provision at June. We've approached that review in an identical fashion to the methodology that we've deployed previously. And you can see there that we retain provision that would allow and cover for a further 6% price weakness at June. So if we don't see that, obviously we are carrying provision there that will be available for release moving forwards from this point in time.

Looking at the provision numbers, we -- as you can see, we're holding onto just shy of GBP290 million at close of business on June 30. And I think if we don't see that price weakness, that 6% further price weakness, then around about half of that provision is -- would be found to be surplus if the -- what we would say quite a defensive position on our balance sheet in terms of carrying value of inventories, if that is seen to be a tad too cautious. So we do have quite a bit of cover built into the balance sheet to protect us should we see conditions that creates a bit of price weakness moving further out.

How does that impact on the landbank? Well, a key statistic there is a plot cost to revenue percentage of between 20% and 21%, is still at keen levels of cost that have to be recovered through the income statement. And as Mike's already pointed out, just shy of 4,000 plots in the pipeline proceeding to contract at good values, again predominately in southern markets, over 80% southern markets. Cost to revenue percentage there of 23.6% is still at very good levels in those markets in support of future sales.

Looking at one or two other features in the balance sheet, we're pointing to a committed land spend number of around about GBP100 million for the second half. That just gives you a feel for our underlying commitment on land, and that should be viewed as a minimum. It's not what -- it's not the total we're planning to spend. Obviously we've got a good deal of extra capacity to replace land as we move forward. And indeed, as you can see, as Mike's already touched on, we've more or less fully replaced what we consumed in the first half.

Work in progress, within that GBP470 million of work in progress investment that we're carrying at June, there is a large slice of carried interest on infrastructure that's already laid down on sites up and down the country. And that would -- will give us the opportunity to release further cash as we move forward.

As you can see, 30% of sales work in progress at June; as you know, we consider our sweet spot in terms of asset turn for work in progress somewhere between 25% and 29%, which largely we'll hopefully be able to achieve by the end of this year.

Shared equity receivables expansion to just over GBP90 million. We've got plenty of capacity to support sales with a balance sheet of GBP1.7 billion to support our sales activity moving out. So we're very comfortable with how that's working with good support on the KickStart.

And land creditors, we're doing deals, new deals using deferred terms, as you can see. The land creditor has more or less stayed at the same sort of level over last six months and with new creditors of GBP90 million, that implies that we've paid off around GBP90 million of credits that we brought forward at December behind that number.

In terms of cash generation in the first half, we feel that the business has delivered strong free cash of GBP145 million which has allowed our absolute debt levels to reduce further.

We're pointing to at least a further GBP25 million of free cash in the second half. That takes us below the GBP100 million exit number for net debt come December. The caveat on that is obviously land replacement. But obviously, we've got a good deal of flexibility to give us a little bit more free cash.

But I think when you look at the cash flow, GBP186 million operating cash really so it's GBP66 million underlying trading cash flow and GBP120 million squeezed out of the balance sheet within the first half. The expansion of that trading cash flow is of paramount importance, because that's sustainable in the long-term. Obviously the journey we've traveled on the balance sheet and right-sizing the balance sheet will largely be completed as Mike's mentioned by the end of this year. So it's that underlying trading cash generation that's critically important and we'll see further improvement in that as we move on.

The strong (technical difficulty) in the first (technical difficulty) drawn debt within our senior note portfolio, GBP105 million prepaid a little early that was -- had a due date of '13, and you'll see the GBP7 million exceptional cost of that in the income statement. (Technical difficulty).

Operator

Please stand by. This is your operator. We're experiencing a momentary interruption in today's conference. Thank you for your patience and please continue to hold.

Mike Killoran - ***Persimmon plc - Group Finance Director***

the business as we move forward from this point. I'll now hand over to John to summarize.

John White - ***Persimmon plc - Chairman***

Yes, thanks Mike. Yes, well, before we go into the usual Q&A, I would just like to summarize, first of all, by saying how pleased we are to present this set of results. It follows two years of very tough decision-making and hard work. And we may not be out of it completely, but I think you can see from these results we have targeted, with success, a variety of issues.

We've been able to increase revenues. We've increased margins. We've increased PBT. We've acquired new land. We've been active acquiring new land but, nevertheless, we have the ability to be very selective as well. We're not pushed into a corner on -- by buying new land.

We've reduced our debt considerably over that period. I could just remind you without recourse to our shareholders, so the only house builder to do that. And now we are restoring the dividend; we're back on the dividend list. So I hope you agree with me that we have good cause to be optimistic about the future of our business.

Thank you very much.

QUESTION AND ANSWER

John White - ***Persimmon plc - Chairman***

Right. Now I hope we have a microphone and yes we do, as we speak. We have a microphone here. There are people listening on the telephone, so it is important that whoever asks a question speaks clearly into the microphone and gives their name and the company they represent. Chris?

Chris Millington - ***Numis Securities - Analyst***

Chris Millington, Numis Securities; can I just ask two if I may please? One, just a straightforward detailed question, the site numbers going into 2011, and what you see the average number being through there?

And the second one really is following on from one of your peers who gave us a feel of the gross margin in the landbank. Just wonder if you can give us any sort of detail as to what you think the returns embedded in your land holdings are now, given you've actually brought some new land on board as well.

Mike Farley - ***Persimmon plc - Group Chief Executive***

The first question, it's around 380 outlets and I think we'll look to maintain that level, Chris; that's where we're at and we're driving. And I think you need to put that into context if you -- we're selling at a fairly low rate in line with the marketplace.

But on 380 outlets, if we could generate the selling rate of 0.7, which has been our long-term history, you could see -- do the math, the numbers that the business could generate in terms of completions. But our drive I think is really on turnover rather than looking at increasing our volumes for volume-sake. So, I don't expect to see vast increases in volumes for the business. But I think at 380, we think we've got a good sustainable business at that sort of level.

In terms of the margin scenario, I think, as I say, it's difficult to say because it's a moving feast, Chris. As I say, as we're importing new land, A) from our strategic land. We saw those at obviously 15% valuation scenario there in terms of plot cost ratio; work in the planning consent, so that's enhancing the margins. We're obviously acquiring new land, so the blend is changing all the time and obviously the NRV exercise.

So it's a fairly dynamic and moving position, I think, as I say. But the general trend is upwards in our operating margins and our gross margins for the business, so I think without giving precise, it's -- the trend of where we're going is an upward trend, as I say, as we blend in those -- all those moving parts of the business.

Mike Killoran - ***Persimmon plc - Group Finance Director***

I think we've said publicly before that we'd expect our medium-term target to deliver operating margins of 15%, 16%, 17% is an achievable target based with the assets that we currently hold as supplemented by the new additions that Mike touches on. So the timing exactly how -- at what point we'll arrive at that position really depends on asset turn to a certain degree.

But you can see the underlying profit performance is based on all the hard work on principally the legacy asset, so that's obviously a key part of the jigsaw that we're working hard on, that we're keen to continue to improve on.

Tessa Guy - ***Investec - Analyst***

Morning, Tessa Guy from Investec; three questions please. Could you just say what you're seeing in terms of pricing over the last few weeks? And related to that, a comment on current sales rates?

And then just on the tax charge, could you just give us a bit more detail and what we should expect going forward?

Mike Farley - ***Persimmon plc - Group Chief Executive***

I'll do the first two. Mike, you do the tax.

Mike Killoran - ***Persimmon plc - Group Finance Director***

Yes.

Mike Farley - ***Persimmon plc - Group Chief Executive***

Okay. On pricing Tessa, we've seen prices pretty stable over the period. As I say, first half of the year, we saw about a 3% price growth and -- but we're seeing prices being maintained pretty steady from now on. And I think to be fair, that's how we're seeing it I think for the rest of this year. I don't foresee much change in that (inaudible) across the board.

In terms of current trading, as I say, just giving you that flavor, that graph, we are obviously in the quiet summer period. We look forward to the upturn in trading in September, and October and November prior to Christmas. But as I say, the year is more a balanced year with the sale -- bulk of the sales taken in the first two quarters and then obviously a slower summer period and then increasing back into that autumn period. As I said, it may be slightly delayed because of this potential situation with the October spending review, so we could see a slightly slower august -- October -- sorry, autumn take up [experience], because of that factor.

Tessa Guy - ***Investec - Analyst***

And just in terms of sales per site per week, can you actually give us (inaudible)?

Mike Farley - ***Persimmon plc - Group Chief Executive***

In actual terms, our sales per site per week are probably about year-on-year about 6% down. But, as I say, that's a year-on-year figure, but obviously compared with that we did more than that. We were 12% up in the previous quarter. So it's really if you're looking on a [like-for-like] basis. We're selling on average about 0.35 sales per week (technical difficulty).

Mike Killoran - ***Persimmon plc - Group Finance Director***

On the tax, yes, the tax rate this year is benefiting from recognition of the deductibility of our pension contribution, which we were a little bit more circumspect last year given the lack of visibility in terms of the available profits to charge those deductions against. So we've recognized deferred tax asset relating to the pension contribution.

I think moving further out, we will return to a more normal level of standard rate. Obviously, the Government has announced reduction in that moving forward, which is helpful in terms of overall cash management. But yes, we'll move towards a more standard rate from '11 onwards.

John White - ***Persimmon plc - Chairman***

Will, did you? Yes, on the front row.

Will Jones - ***RBS - Analyst***

Thanks. It's Will Jones from RBS. Just a couple of questions around the gross margin please. I notice the Partnership's gross margin at 16.5% was quite strong. Can you just comment around that please and the sustainability of it.

And then just in terms of new land coming through, I think you said 15% for the next year. Was there anything in the first half, new land? I assume very little but --

Mike Farley - ***Persimmon plc - Group Chief Executive***

Yes, I think the margin on the Partnership business, I think we believe is sustainable. We obviously are concerned. Obviously the Government expenditure will be down, but majority of our completions are taken from sites under the 106 Agreement, so those are factored and are in place. And we've never factored in any Government funding into that. So these are figures that are solely related to what the Housing Association can afford to pay. So our margin is generated on that.

Obviously the gross margin on the Partnership business aren't impaired because they're obviously actual margins across the board, so that's why they're stronger margins percentage-wise. But obviously in actual volume terms, because they're a lower average selling price, the quantum of margin is that much smaller, so you need to bear that in mind. But -- so we think they are sustainable in the long-term.

And you're right, in terms of the first half, no, there's not much new land in that. And I think towards the second half, because we're 95% sold up for the year, you're really going to see the new sites start kicking in 2011 and beyond.

Will Jones - ***RBS - Analyst***

Just separately in terms of HomeBuy Direct, you've clearly been a big user of that over the last year or so. Can you just give us a bit more detail in terms of how you plan to fill that gap as it rolls off? Clearly, you mentioned KickStart, part-exchange, but they're big numbers in terms of [different] --

Mike Farley - ***Persimmon plc - Group Chief Executive***

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Yes, I think we do have 1500 plots still under the take at the present time. As I say, I think the demand for it is still there, and we'll utilize it under our own shared equity scheme as well, on top of that. We have in Scotland and Wales, but they don't have any Home Buy Direct in any event. So, we've been utilizing our own scheme.

But I think the emphasis is shifting, you'll see in two respects. First of all, our Charles Church business is growing quite well, and, obviously [that's] a higher average selling price in the first instance, so, the demand in that area. And, as I say, I think, again, if you see from stats that there is more second-hand property coming on to the marketplace. So we're seeing, obviously, that people are already in property are looking to move.

So, the swing will change from just solely being focused on first time buyers more to second time buyers now, who are putting their property on the marketplace, and we are seeing our part exchange business pick up already. So I think you'll see less shared equity in the medium-term and more part-exchange, which is a more normal position to be in really as those purchasers come back in (technical difficulty).

John White - ***Persimmon plc - Chairman***

Clyde?

Clyde Lewis - ***Citigroup - Analyst***

Thank you. Clyde Lewis from Citigroup; I think I've got two, maybe three.

Probably one for John; the decision to start repaying a dividend, a bold one, and given the uncertainties that are out there, did the Board actually consider possibly going down the alternative route of getting capital back by buying shares? You're obviously trading at a sizeable discount to your NAV. Was that an alternative for you that was actively considered at the Board?

John White - ***Persimmon plc - Chairman***

Yes, we consider all avenues in terms of what we do with our cash. And, yes, we've considered it. But we decided that the appropriate thing to do at the minute is to restore the interim dividend. There's lots of avenues per se [and] we think we've got the right balance between the invested money in the business, giving a bit back to the shareholders and that's an alternative. But, yes, we consider it but, by virtue of what we've decided, that was the decision we made.

Clyde Lewis - ***Citigroup - Analyst***

[Second one was] on the mortgage market, Mike, you talked about there being an improvement in the mortgage market. Presumably, it's still a bottleneck, and a key part of why your sales rate is 0.35 and not 0.7?

Mike Farley - ***Persimmon plc - Group Chief Executive***

Yes, sure.

Clyde Lewis - ***Citigroup - Analyst***

What are you hearing from the banks, in terms of your day-to-day discussions? And, obviously, other -- one of the house builders has gone down its slightly different route of trying to come up with its own mortgage product. Is that something you're considering? What are you trying to do to alleviate that bottleneck that still exists?

Mike Farley - ***Persimmon plc - Group Chief Executive***

Sure. Well, I think, as I say, what we're trying to put out there, I think the trend and the sentiment. I think the mortgage market appears to have settled around 50,000 mortgages a month. That appears to be Bank [linked] data, and I think our discussions with the lenders is that's very sustainable. It's good business for them at the present time; good, profitable business.

So, our first priority is to make sure that wasn't going to decline. And I think there's no sight of anything. I think most lenders are looking to increase their lending capacity at this time.

I think there has been a move to be more favorable against new homes. Certainly, some of the lenders did make criteria a lot more difficult, and mortgages being more expensive to borrow against new homes. We're seeing that unwind. So, I think that's making life better for us and I think we're seeing a change to higher loan-to-value products. Still would like more in the marketplace, but, as I say, there's that trend.

And I think what we're seeing is a general trend and a drift upwards rather than any drift downward, which obviously would be a concern to us. So, I think the movement is generally upwards. But, I think in some respects that's good for us, because it means the market is much more sustainable in the long-term, say if there was a massive amount of money to the marketplace would that fuel inflation and house prices? And we've been there and got -- those problems we don't want -- reiterate.

So, a good, steady, slow improvement I think is good for the sales sector, as long as it can be maintained. And I think there's sign there at the present time. Again, of course, looking at your other question, we continue to look at what support and help we can give to our purchasers. As I say, we've used, very successfully, the HomeBuy Direct scheme, and our own shared equity, and we will look at other products to assist on that.

John White - ***Persimmon plc - Chairman***

I think where we're at as well, having downsized the business, and recently the industry having restructured. At 50,000 mortgage approvals a month, we're confident that we can run a successful business. We would like it to improve, but we're certainly not factoring that into our expectations at the moment. It would be wrong to do so, I would suggest.

But -- and, as Mike says, we're reasonably comfortable it won't [reduce] from that level. So, that's how we're managing our business, and how we're making our decisions based on that sort of level of mortgages at the moment.

Mark, just behind you.

Mark Hake - ***Merrill Lynch - Analyst***

Mark Hake from Merrill's; two questions. Firstly, you touched on the 30% conversion of strategic land in the first half. Could you give us a feel for whether that's the kind of ballpark we should run with for the rest of the year medium-term?

And, then, secondly; obviously there was an exceptional, in terms of the interest charge in the first half, but, in the context of your cash flow comments, [can you] just give us a feel for second half interest charge please?

Mike Farley - ***Persimmon plc - Group Chief Executive***

I'll do the first one, you do the interest.

Mike Killoran - ***Persimmon plc - Group Finance Director***

Yes.

Mike Farley - ***Persimmon plc - Group Chief Executive***

As I say, we like to bring forward as much strategic land as we can. It's, obviously, our best land. It tends to be like buses, they do come forward in areas. But I think around the 30% mark is a reasonable target for us to aim for, and I think we see enough in the pipeline.

Obviously, we are aware of the Government's new stance on planning. So there, potentially, could be some short-term delay on that, but I think the sites will be delayed, rather than stopped that are in some of the planning processes and that's our feedback from local authorities we're talking to at this present time.

So -- but, no, I think, Mark, 30% is [normal].

Mike Killoran - ***Persimmon plc - Group Finance Director***

On interest charge, I think we'd expect a charge for the second half around the GBP20 million, Mark. I think it's GBP23 million in the first half, so a reduction through into the second half. It depends on the working capital profile but, yes, around that sort of level.

John White - ***Persimmon plc - Chairman***

If you go to -- yes, this gentleman here. We'll come to you in a minute Charlie.

Charlie Campbell - ***Liberum Capital - Analyst***

Thanks, John.

Simon Brown - ***Matrix Partners - Analyst***

Simon Brown from Matrix.

Just on the land, the structure of the landbank; obviously, you're running land stocks down to a degree versus the amount that's being bought in currently. Are we now -- the lines on the chart, as it were, crossed over? Are you trying to hold the landbank, in other words, steady at the current number of plots?

And, on that basis, going back to Mark's question, if that 30% is correct, am I right in thinking that there is actually quite an impact on forward potential gross margin within the landbank, because I'm just trying to really draw down from the structure you've got, in terms of strategic land and its locations, as to the impact of average sales price on that plot cost? But -- I know it's too complicated to do just as a desk-top exercise, but it looks quite an interesting potential uplift in margin; a comment on that would be good.

Mike Farley - ***Persimmon plc - Group Chief Executive***

Sure. I think, as I say, on our landbank we have a six-year supply currently. Many of you know that's followed us for a number of years, we can comfortably operate on a five-year land supply. I think the level of our landbank will be determined really effectively of how we strongly see the marketplace. I think we have the ability to hold the landbank at these levels if we think the market is stronger. If the market weakens then I think we're quite happy to let the landbank diminish.

So, I think our strategy on that, Simon, will be dictated on how the strength of the marketplace is. So, I think currently we're quite happy with our current position, and, if the market continues as it is, then I think the six-year land supply is slightly over, but with the planning uncertainties that's fine. If things toughen up then I think we're quite happy to batten down.

In terms of the strategic landbank; yes, you're right. I think the thing you have to look at is that although we've announced those successes in this first half, you're probably 12 months away to start seeing the benefit of those on site. And by the time you start up there's infrastructure to put on these new sites, then there's obviously the building itself. So, there is a lead-in time.

So, yes, you're right; the margins will enhance, but not quick enough for me. But, obviously, there is this lead in, and you just need to factor in that it probably does take about a 12-month from spend to get on the site to start taking those first legals and benefit across the board. So, yes, it is a good source of income for us in the future. And that's why we believe, in the longer-term, we can get our operating margin back up to the sort of 15% to 17% level, because of that (technical difficulty) benefits us.

Simon Brown - ***Matrix Partners - Analyst***

Can I just clarify something? Mike, you mentioned, I think, asset turn on WIP. What was that? Sorry, I didn't catch the figure that you gave for the asset turn [time].

Mike Killoran - ***Persimmon plc - Group Finance Director***

Well, rule of thumb we like to turn our work in progress four times a year. So, if you look at it in the context of the periods, at the end of June, if you look at the previous 12 months' sales, it was around 30%. So, we're getting it back into that sort of area where we feel that the rate of capital lock-up on work in progress is about the right sort of level.

There's another -- the second half of this year I think we'll arrive at December thinking, well, we've done the job in terms of releasing cash out of the work in -- the carried work in progress pot in support of the outlet network, which we've said around about 380 outlets or so would be to maintain the current network we've got.

Mike Farley - ***Persimmon plc - Group Chief Executive***

I think it falls into two areas. You've got the unit build, the house build itself, and that's virtually a turning stop now. We're at a level -- we haven't got much stock on the ground. So we're actually building and selling the houses we need effectively.

Where Mike's talking about is that infrastructure where we've laid down infrastructure on historic sites, and that's where we think we can still drive out a little bit more saving. So that GBP20 million to GBP30 million I talked about would be on the historic sites as we open up new sites, A) that are lower build cost, and we're not laying down as much infrastructure [as we open up] those newer sites. So that's where we're going to get that last bit of work in progress saving.

Simon Brown - ***Matrix Partners - Analyst***

That's great, thanks Mike.

John White - ***Persimmon plc - Chairman***

Charlie?

Charlie Campbell - ***Liberum Capital - Analyst***

Thanks. It's Charlie Campbell at Liberum. I've got two questions, which may be related. The first one's on the St. Modwen. Just wondered if you'd give us a bit more detail about that joint venture? What the size of that is now and how big that could get potentially? So, what are the options for you there?

And then, secondly, just a more general question on the balance sheet really. We've seen quite a few of the other house builders deciding that now is absolutely the right time to buy land and borrowing as much money as they can, and pushing their land creditors up to buy, to be very active in the land market. You seem to be much less active. Is that because you think this may not be the best time to buy land, and you may get as good terms next year?

Mike Farley - ***Persimmon plc - Group Chief Executive***

Sure.

Charlie Campbell - ***Liberum Capital - Analyst***

Or because you're saving the money for something else?

Mike Farley *- Persimmon plc - Group Chief Executive*

Okay. No, I think -- well, just going on to St. Modwen's. As I say, the existing joint venture is a start-up situation, so the first seven sites are agreed. We have now got to get detailed planning consent on those sites.

Effectively, the benefit to us on the joint venture is that St. Modwen's are, obviously, providing the land. We're buying the land at our normal operating margins to buy that. We're paying for it on detailed planning consent, which is a cash flow benefit. And we're paying for it as and when the sites are serviced by St Modwen's. In the longer-term, obviously, as we will build and sell the houses, and split the proceeds on the JV basis, so we believe this will be good long-term business for us, because we're not going to land to acquire that market -- to acquire that.

I think, as I say, potentially St. Modwen's have a landbank of say, in their own figures, of 25,000 plots on 60 sites. Now, we're not going to get a JV on all those plots, unfortunately. But I think in the medium-term, and this depends how things unfold and their planning consents roll out, this could develop between 6,000 and 9,000 plots for us in the medium-term. So, it's just a case of seeing how quickly they can get their planning consent through, and how the JV works for everybody. But we think it's [good] business.

In terms of the wider thing on the landbank, I think, as I say, we have -- our primary focus, Charlie, has been to improve the landbank we've got. We have a six-year land supply. How much land do you need as a landbank is I think the answer? So, we've already got a six-year supply. We've been very focused on improving that and working for that.

You'll see that we have the ability to buy land, and we bought 4,200 plots in the first half of the year, so it's a near replacement of the land. We are looking at the situation.

I think what you need to understand in the business is the actual housing market, and the builders in the marketplace, is an entirely different place than it was say two years ago. The capacity of the industry has probably halved. So, land is still there in the same quantity as it was two years ago. I'm not saying there's an over-supply of land in the marketplace, but there's not a radical shortage of land at this stage. We are able to buy as much land as we want at the margins we see. We don't suddenly see there being a land shortage in 12 months' time.

I think prices appear to have -- they've come up from the low -- low ebb. But I think when the credit crunch really hit there wasn't that many transactions taking place on land at that time. So, I don't see raging inflation on land in the future.

So, to buy a lot of land at this time, if the market turned down, you could just end up with that land on your balance sheet. I think we believe we've got a good long-term model. If we can bring 30% of our landbank through our strategic land any way, that's -- we're masters of our own destiny on that front, so we've got good flexibility on that. And I think we're quite happy to work with a six-year land supply or slightly [less].

So, I think, as I say, our strategy gives us the flexibility. If the market strengthens, we can invest further; if the market weakens, we don't have to invest as much. But it means we won't be caught if the market does go down with expensive land on our balance sheet. We've got the [flexibility]. We're keeping our options open. We don't think we're missing out on opportunities.

John White *- Persimmon plc - Chairman*

Any more questions? No?

Okay, well thank you everyone for coming along, and thanks for listening to us, and you know where we are if you need anything else, or any more information. Thank you.