

GROUP FINANCE DIRECTOR'S REVIEW

Turnover and Operating Profit

Turnover in the year was £770.1m (2005: £780.4m). Turnover in the Homes business was 2% ahead of the previous year as a result of an 8% increase in legal completions to 4,735 (2005: 4,372) which more than offset a reduction of 6% in the average selling price to £161,700 (2005: £172,400). This reduction in average selling price reflected a change in the product and geographical mix of In the City legal completions compared to last year and the inclusion, for the first time, of a significant number of Debut homes.

Turnover in the Group's Mixed Use & Regeneration activities was £4.6m (2005: £26.6m), principally as a result of the disposal of Aspect, an office development in Altrincham, and disposals at Buckshaw Village, near Chorley. Turnover in the previous financial year was higher as it included the sale of our remaining interest at Western Approach Distribution Park near Bristol.

As a consequence of the anticipated, and previously flagged reduction in operating margins, operating profit in the Homes business decreased by 9% to £133.8m (2005: £147.4m). The reduction in operating margin to 17.5% (2005: 19.6%) reflected the combined effect of the more competitive selling environment, together with the continued unwinding of the beneficial impact of the higher than normal sales price inflation of recent years within the existing land bank.

Mixed Use & Regeneration activities generated an operating profit of £0.7m (2005: £4.5m), including Redrow's share of the operating loss of The Waterford Park Company Ltd, the joint venture company established to pursue the potential redevelopment opportunity at Watford Junction railway station.

Redrow's share of the operating loss of Framing Solutions, its 50:50 joint venture with Corus, was in line with expectations at £0.8m (2005: £1.2m) and showed an improvement on the prior year. This reduction in the operating loss was as a result of continuing operational improvements and an increase in turnover.

As a result of an issue on a development in Jersey which was built on behalf of Redrow and was construction complete in 1999, the Group has made a provision of £2.0m. After taking appropriate professional advice, it is the Board's view that a significant proportion of this sum should be recoverable by the Group in due course. However, a provision has been made in line with the requirements of IAS 37 until recovery of such monies is achieved.

Operating profit after the provision in respect of Jersey and including Redrow's share of its joint ventures' operating losses was therefore £131.7m (2005: £150.7m).

Under the equity method of accounting for joint ventures under IAS 31, results from such entities must be reflected as a separate item on the income statement after financing costs and tax. Operating profit on this basis, once the operating loss of £1.1m in respect of joint ventures is deducted, is £132.8m (2005: £154.0m) as shown on the face of the income statement.

Finance Costs

The Group's net financing costs were £11.5m (2005: £12.6m), which were covered 11.5 times by operating profits. In accordance with IAS 39, deferred payments arising from land creditors are held at discounted present value, hence recognising a financing element on the deferred settlement terms. The value of the discount is expensed through net financing costs and amounted to £3.0m in the year (2005: £2.5m). Underlying bank interest costs of £8.6m were £1.2m lower than the previous financial year.

Share of Joint Ventures

As noted above, we are required to present the results of joint ventures on the income statement after interest and tax. Framing Solutions and Waterford Park delivered a loss attributable to Redrow after interest and tax of £0.8m (2005: £2.4m), a £1.6m improvement. The previous year included significant option and pre-development expenditure in respect of Waterford Park.

Profit before tax and earnings per share

Redrow delivered a profit before tax of £120.5m (2005: £139.0m). Basic earnings per share were 52.9p (2005: 60.7p).

Taxation

The Group's effective tax rate was 30.2% (2005: 30.6%) during the year and it is currently anticipated to remain at a similar level in the next financial year.

Dividend

In line with the Board's previous commitment and subject to approval at the Annual General Meeting on 7 November 2006, a final dividend of 8.7p per share will be paid on 17 November 2006, representing an overall increase in the full year dividend of 20% to 13.0p (2005: 10.8p). Dividend cover remained strong, with the full year dividend per share 4.1 times covered by basic earnings per share (2005: 5.6 times).

Balance Sheet

Net assets per share increased by 13% to 322.0p over the period (2005: 284.3p). Net assets at 30 June 2006 were £513.8m (2005: £452.5m).

Capital employed grew by £87.9m to £643.6m and reflected continued investment into our land bank. In the Homes' business, land held for development increased by £62.9m to £522.5m, representing 16,500 plots owned with planning as at 30 June 2006 (2005: 15,800 plots). Costs incurred in connection with the acquisition and promotion of the Group's forward land bank, a contributor to 25% of the net plots acquired during the year, are provided for when incurred and the provision only released once planning permission is obtained and the land acquired.

Work in progress in Homes increased by £19.1m to £295.6m (2005: £276.5m). As anticipated, work in progress on In the City schemes increased over the last twelve months and accounted for roughly half of this growth. As at June 2006, work in progress on In the City schemes totalled £52.8m (2005: £43.8m). The Group's exposure to this element of its business remains carefully managed given the relatively

high level of capital employed that is required on such schemes prior to legal completions being achieved. Work in progress on Signature and Debut developments increased by £10.1m, reflecting continued investment into the level of product available on site. Our investment in showhomes also increased by £3.2m to £14.2m to provide our customers with greater opportunities to view our product, a factor that is particularly important in a more competitive marketplace.

Part exchange does not feature as a central component in the Group's marketing proposition. At the year-end, working capital invested in part exchange properties was £6.6m representing 39 properties (2005: £7.1m and 37 properties).

The level of stock in the Group's Mixed Use & Regeneration activities increased by £3.9m to £10.7m primarily reflecting the commencement of construction on our first Redrow Regeneration project at Barking.

Land creditors of £78.3m remained at a similar level to the position a year earlier (2005: £78.8m).

Return on capital employed for the financial year, measured by using the average of opening and closing capital employed, stood at 22.0% (2005: 28.7%) with return on equity at 23.5% (2005: 30.7%). The exceptionally high levels of return on capital employed and return on equity achieved in the last few years were very much a function of the strong gains in house prices experienced during that period. Nevertheless, return on capital employed remains a very important financial metric for Redrow. Whilst a pre tax measure of financial performance for the business, it nevertheless acts as a simple focus to ensure that our overall post tax returns exceed our estimated weighted average cost of capital of approximately 8.5%. Whilst continued investment into land and work in progress as part of our clearly set out growth strategy may result in an increase in capital employed and gearing, our objective remains to deliver returns which comfortably exceed our cost of capital.

Cash Flow

The cash generated from operations was £38.7m despite additional investment of £88.6m into land and work in progress. Net debt increased by £26.6m to £129.8m (2005: £103.2m) and gearing, calculated as the proportion of net debt to shareholders' funds, increased only slightly to 25% (2005: 23%).

Treasury Management

It is Redrow's policy to fund itself through an appropriate mix of debt and equity and growth has historically been financed through a combination of retained profits and bank funding. When appropriate, we will seek to purchase land on deferred terms and in these cases, the vendor may retain a legal charge over the land to which the transaction related or be provided with a guarantee to support future payments.

Treasury management is conducted centrally with the focus being upon liquidity and interest rate risks. Redrow operates wholly within the UK and foreign exchange risk is not material.

Group policy determines that liquidity risk is managed through the review of regularly prepared cash forecasts and the maintenance of sufficient committed banking facilities to meet both anticipated requirements and also to provide a prudent level of headroom.

As at June 2006, the Group had committed funding of £300m provided by way of a syndicated loan facility which matures in November 2009. In addition, we have further uncommitted bank facilities totalling £60m which provide overdraft and money market loans which assist in cash management. Day to day cash management is achieved by each company operating its own bank account with bank accounts managed at a Group level under a set off arrangement.

Within the Board's interest rate risk management framework, interest rates and cash flow forecasts are constantly monitored to ensure that the level of hedging remains appropriate. The policy prohibits any trading in derivative financial instruments and requires any hedging activity to use simple risk management products, such as interest rate swaps.

The notional level of debt protected by interest rate swaps as at 30 June 2006 was £62.5m and this compares with the Group's year-end net debt of £129.8m. These swaps had an average remaining life of 2.1 years at a fixed average interest rate of 4.7% before borrowing margins are added.

The net debt position of the Group during the year is heavily influenced by the timing of land purchases and the profile of legal completions. In the year ended June 2006, average net debt was approximately £167m.

Pensions

The Group believes that pension provision is one of the most important benefits made available to its employees and provides both defined benefit and defined contribution pensions. The defined benefit section of the pension scheme was closed to new members generally in October 2001 following the introduction of a defined contribution section. The defined contribution section represents an excellent employee benefit, with monthly paid members of the defined contribution scheme contributing 5% of pensionable salary whilst Redrow makes age dependent contributions ranging from 5% to 12.5%. Weekly paid members contribute 3% of pensionable salary with a matching contribution of 3% from Redrow.

During the year, the scheme actuary concluded the formal triennial valuation of the defined benefit section as at 1 July 2005. Defined benefit pension schemes generally have been under pressure from a combination of increased member longevity estimates, reduced investment returns and falling long term interest rates. These factors contributed to the triennial actuarial valuation showing a past service deficit of £11.5m at 1 July 2005 compared to £2.2m at the 1 January 2003 valuation.

As a result of the changes in assumptions and following due consideration of how best to address the on-going cost of future service and past service deficit, the decision was taken to increase both employer and member contribution rates for the defined benefit section from 1 July 2006. Member contribution rates have increased from 6.0% to 10.0% (from 8.0% to 13.3% for Executive members) with the employer contribution rising from 12.0% to 16.0% (from 16.0% to 21.3% in respect of Executive members). Defined benefit section members who preferred not to bear the increased contribution had the opportunity to join either a new Career Average Earnings ("CARE") section or the existing defined contribution section of Redrow's pension scheme instead. In the event, take up for the proposed CARE section was so low that the offer was withdrawn with almost all defined benefit members choosing to remain within this section.

In order to address the past service funding deficit, Redrow agreed to make a special contribution of £11.0m. £3.0m of this special contribution was paid in June 2006 with the balance paid in July 2006. The Company, together with the Trustees, continues to monitor closely the financial position of the defined benefit section of the pension scheme closely. As regards the Group's 2006/07 income statement, no significant adverse movement is anticipated in the Group's annual pension charge in respect of the defined benefit section.

Financial Reporting

This is the first year that the Group has presented its full year consolidated financial statements under International Financial Reporting Standards ("IFRS") rather than UK GAAP. All prior year comparatives have been restated and a full reconciliation of the 2005 income statement and balance sheet was provided in the interim financial statements.

As part of our transition process to IFRS, the Group published its "Transition to International Financial Reporting Standards" document in November 2005 which included a summary of principal impacts together with restated financial information for the year ended 30 June 2005.

The adoption of International Financial Reporting Standards has no impact on the Group's strategy or its ability to deliver shareholder value into the future.

David Arnold
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