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Halfords FY17 Preliminary Results

Thursday, 25th May 2017

Market & Performance Update

Jill McDonald

Chief Executive Officer, Halfords

Welcome

Good morning, everyone. It is good to see you all again. As you have probably heard, I am moving on to pastures new in the autumn. However, upfront, I want to say that the board remain confident in Halfords' strategy, with progress evidenced by the strong Group performance that I am going to share with you this morning.

Firstly, I will summarise some operational highlights from the year, give a review of our financial targets, then a brief update on our markets, before focusing on a more detailed update of strategic progress. Jonny will then take you through our financial performance in FY17, and some forward-looking guidance in the context of our financial targets. After that, Dennis will wrap and, finally, Jonny, Dennis and I will be happy to take your questions.

FY17 highlights

First, I will describe some of the key highlights from FY17. We have made strong progress against all of our 'Moving Up A Gear' strategic pillars, and I will talk through each of these in a few minutes. We continued to grow market share in both motoring and cycling. In motoring, we achieved robust growth from bulbs, blades and batteries, as well as strong growth in child car seats, travel equipment, dash-cams and connectivity products and fitting. Workshop products also performed very well, with Halfords' own-brand hand tools continuing to gain popularity.

After a difficult year for the cycling market in 2015 and early 2016, our cycling sales were strong. Our mainstream own-brand bikes, Carrera and Apollo, benefited from range re-launches, our premium bike sales continued to grow well and parts, accessories and clothing ("PACs") returned to good growth for the first time in two years. We also saw increased sales in bike servicing and repair. In fact, we grew service-related sales by 11.1%, reflecting our Gears training, new service offerings and increased awareness of the range of in-store motoring and cycling services.

I am delighted with the strong improvements that we have made in our ability to match sales to customers, and how we are utilising data to both improve customer service and drive incremental sales. 18 months ago, we were only able to match 3% of sales to customers in our retail business; we can now match 46% of retail sales to customers.

Our digital and mobile capability has been enhanced this year, delivering online sales growth of 30.5%, including the businesses we acquired in the year, and like-for-like growth of 11.5%. However, our store network remains key to our overall proposition, with over 85% of Halfords retail online orders collected in-store, meaning that our online sales do not cannibalise our offline sales. In fact, they drive footfall into shops, encouraging add-on purchases and differentiating us as a unique service-led retailer.

We have expanded the Group's reach and capability through the acquisitions of the predominantly online businesses, Tredz and Wheelies, as well as the operating agreement and minority investment reached with mobile tyre-fitter, tyresonthedrive.com.

Financial Target Review

In terms of financial results and targets, momentum has built through FY17 and sales are growing well. We delivered profit before tax of £75.4 million, which is in line with market consensus but down on the previous year. The weaker pound impacted us by £14 million before any mitigation, and more than explains the £6 million decline in profit in the year. Our plans to offset the FX impact are well developed and I am pleased with how they are progressing.

We are not changing our financial targets, which are shown on the slide, and I am pleased to say that we performed well against them last year. We did grow sales faster than the markets by gaining market share in both motoring and cycling. Our EBITDA margin was close to flat other than the impact of FX. We did grow the ordinary dividend, and we made good progress towards our debt target. Jonny will talk more about the financial results and targets later.

Market update – motoring

I would now like to talk in a bit more detail about motoring and cycling, giving a brief update on the outlook and explanation as to why we are best placed to continue to grow market share.

First, our largest market, motoring. Around 70% of Group sales are from motoring, and we maintain strong positions in this fragmented market. There are over 30,000 garages in the UK, the majority of which are independents. We are well placed to grow share given our well known and trusted brand, unique service and WeFit services proposition, our technical expertise and our strong on- and offline footprint.

Cars are becoming more complex, and customers increasingly need support for small as well as larger service maintenance and repair jobs, and we are increasingly seeing an ongoing trend from do-it-yourself to do-it-for-me, which plays strongly to our unique service and services proposition. Our own market research indicates that 80% of Halfords customers want advice or service with their purchase. We also identified that 75% of UK consumers have low or medium expertise in car DIY, and are more inclined to pay for someone else to do it for them. This is, of course, helpful to us.

As you can see from this slide, the car parc continues to grow, and we continue to invest in training and equipment to ensure that we remain at the forefront of technological changes, such as having the ability to replace stop/start batteries on demand and being able to service the increasing numbers of electric and hybrid vehicles.

Our target market is what we call the 'second life' of a car. The average age of cars in the UK slightly increased last year to around eight years old, despite the proliferation of car finance and strong new car sales in recent years.

Going forward, we anticipate the motoring market in which we compete to continue to grow at an average rate of 2–3% per annum over the medium term, and we will continue to aim to better market growth rates.

Market update – cycling

The cycling market is equally highly fragmented, with over 2,500 bike shops in the UK, the majority of which are independents. The majority of the bikes in the UK are sourced in US dollars in the Far East, meaning that the depreciation in sterling affects the whole market.

Prices in the market have started to increase, and some of ours have as well. However, the changing marketplace and macroeconomic environment is making it increasingly difficult for independents to be competitive. They are reliant on third-party brands, making it harder to manage margin, and they have limited scope to mitigate FX other than by increasing prices to customers. Our own research has identified that the number of independent bike shops has declined by almost 10% over the last year, and we expect this trend to continue.

Looking ahead, we continue to see very good growth prospects for the UK cycling market, and those are for the following reasons: participation levels in the UK remain much lower than in many other European countries; a growing number of people want accessible ways to get fitter, and cycling offers significant health and wellness benefits; and there is significant government infrastructure in London and in other cities.

The electric bike or e-bike market also offers a growth opportunity, encouraging more commuters and supporting an older generation into cycling. We are well placed to capitalise on this growing trend, and have invested in our own-branded range of electric bikes. We have delivered e-bike colleague training, and recently tripled the number of shops selling the e-bike ranges. Sales of e-bikes increased 130% last year, and are accelerating. We continue to expect the cycling market to grow on average at 3–5% per annum, and we aim to beat that market growth rate.

Moving Up A Gear strategy

I will now recap on our Moving Up A Gear strategy, and report on progress made during the year. We launched the Moving Up A Gear strategy back in November 2015, and there are five key strategic pillars. I will give you a brief update on the progress against each.

Service in our DNA

First, hardwiring service into our DNA. Within our retail shops, we now offer well over 30 services across motoring and cycling. These services are bang on trend, as customers look for people to do it for them rather than doing it themselves. They are a fundamental differentiator for us.

We remain focused on growing the important metric of service-related sales, which we aim to grow faster than overall sales. In FY17, we achieved growth of 11.1%. In fact, we completed nearly five million retail fitting services during the year, equating to over 10,000 services per store. I think that is a really great statistic that encapsulates our ability to harness that growing do-it-for-me trend.

Our retail colleague turnover has improved during the year to record lows, and is now around 33%, down from 36% last year and 50% only four years ago. We were again listed in the Sunday Times Best Big Companies to Work For list, with Halfords' retail moving up from 18th place last year to 13th place this year, an achievement I am really proud of. Having more engaged colleagues helps to deliver better customer service and, in turn, supports our growth.

Our unique '3 Gears' training programme underpins our in-store retail strategy, and we have achieved our targets of colleague completion of the respected gear levels. We also introduced two new motoring services in the year, windscreen chip repair and motorcycle bulb and battery fitting, which both performed well.

We also introduced new services in cycling, including bike sizing using Smart Fit technology in our recently refreshed stores, together with Slime puncture proofing. We will be launching more unique in-store experiences in the months ahead. For example, on the motoring side we are introducing AdBlue top-up and car fob key repair, which will complement our existing offering.

Better shopping experience

Our second pillar is to create a better shopping experience for customers. After a successful trial, we are rolling out headsets for retail colleagues, enabling them to quickly communicate with one another wherever they are in the store, or when they are on a WeFit in the car park. That enables them to share expertise and better support each other. This means specific customer needs can be met quickly and more efficiently. I must say, the response from colleagues has been absolutely fantastic.

Our digital capability was enhanced by our switch to Agile web development. We complemented the core digital team at our support centre in Redditch with a team in central London, and this has really enabled us to accelerate web development during the year, deploying more frequent code changes. For example, we redeveloped our mobile checkout to provide a more seamless online customer journey, and have seen mobile traffic grow 31% in the year.

We opened five more Cycle Republic shops to reach 15 in total at the year end, and we launched a transactional website in August 2016. We are encouraged by the progress that Cycle Republic is making, with strong double-digit like-for-like sales growth. We plan to continue the rollout with around five additional stores in FY18, and we will further develop our online presence.

I said earlier how our stores are core to our service and services proposition, and accordingly, we continue to invest in our physical estate as well as our online infrastructure. During the year, we updated our store refresh concept, starting with Derby in November. This is an evolution of what was already a successful programme, updating it in line with our Moving Up A Gear strategy and incorporating advances in customer insight and technology, as well as placing greater emphasis on our services. I will now show you a brief video to bring the store refresh concept to life.

[VIDEO PLAYS]

The performance so far is above expectation, and the customer and the colleague response has been excellent. By the end of March, we had refreshed five stores in this new design, and we will refresh around 30 more in FY18. We are also developing a 'lite' version of the design, for smaller shops that do not financially justify a full refresh.

Building on our uniqueness

Turning to uniqueness. Exclusive products, relevant innovation and unique partnerships all strengthen our differentiation. During the year, we enhanced our range of parts, accessories and clothing for our Boardman brand, which itself won a host of coveted industry awards, including the prestigious BikeBiz 2017 Bike Brand of the Year. We launched a new range of motorcycling products and fitting services in our retail shops. We consolidated our position as a market leader in dash-cams, fitting five times as many dash-cams this year in comparison to last year. We grew our Tradecard offer through an enhanced central support team, and also enabling cards to be used online of the first time. We also launched an exclusive range of Bradley Wiggins kids' bikes in July, and more recently expanded our range of electric bikes and the number of stores we ranged them in. Another stat that I am proud of is that we have grown our child car seat sells twice as fast as the market.

I want to just briefly touch upon the complementary M&A and investments that we have made during the year. Through the acquisition of Tredz and Wheelies, we are uniquely positioned to serve all cycling customer segments, right through from kids and mainstream leisure customers at Halfords' retail stores, commuters at Cycle Republic shops and the fitness and enthusiast segment through Tredz. I am pleased that Tredz performed very well in FY17, with sales up over 20% since acquisition. You will recall that at our Q3 update in January, we also announced an operating agreement with tyresonthedrive.com, a UK mobile tyre-fitting business, alongside a minority investment. We are developing a number of projects together as we look to leverage each other's expertise, and we will give you an update later in the year. We will continue to investigate similar opportunities to expand our capabilities and strengthen our positions in our core markets.

Putting customers in the driving seat

Moving on to putting customers in the driving seat. We have completed phase one of our single customer view, linking up 15 discrete separate data feeds from around the Group. At the same time, we have been adding to our customer database, collecting over five million email addresses within our retail stores over the last 18 months. We can now match 46% of retail sales to customers, up from 3% as of November 2015.

Now, this is a fantastic achievement. An investment in customer data has allowed us to move from generic email marketing to a much more personalised approach, which in turn is driving incremental revenue and awareness of our services. We saw sales attributable to email campaigns grow 19% in the year, and drove an incremental 1.2 million visits to the website.

Fit for the future infrastructure

We have continued to invest in ensuring that our infrastructure is fit for the future. After a successful pilot we implemented Dayforce, which is our colleague resource planning system, in March this year, removing 11 legacy systems and replacing them with just one tool. Colleagues and line managers can log into the system to view and change shifts, and the system also enables us to better optimise scheduling of resource.

As we explained in November, we have consolidated a number of external storage units into a third distribution centre in Daventry, adding to our existing centres in Coventry and Redditch. We also continue to develop the i-serve project, and that is to replace our till hardware and software. This is a major piece of IT change and we are now in pilot stage, including the testing of mobile tablets in shops. We anticipate rolling i-serve out to stores towards the end of FY18.

During the year, we also joined up our stock systems, giving us a single view of stock for the first time. This enables better fulfilment of online purchases and improved availability in stores. Finally, we remain focused on our successful 'We Operate for Less' programme, delivering cost and efficiency improvements across the Group.

Autocentres

Now, turning to autocentres. We see a presence in the car servicing and repair market as important for the Group, and a good growth opportunity. As a reminder, we currently have around 1.5% share of a highly fragmented market. FY17 was a year of long-term investment and training in skills, and improving our offers to customers.

To improve colleague retention and technician skills, we introduced a new technician pay grading system and bonus structure this year, to reward both teamwork and training. As a result, our colleague turnover has started to reduce, reaching the lowest level for almost three years. To improve customer convenience, we introduced Sunday and bank holiday opening. We also continue to invest in technician training and development, to keep pace with technological changes such as hybrid and electric vehicles, which are moving through the car parc and into the second life of the car.

These operational changes were made for long-term benefit but have been disruptive in the short term. Despite many positive developments and sales growth over a number of years, we are dissatisfied with profitability. Accordingly, we are taking a number of actions to improve performance, including a review of the operating model, and we will report our conclusions in due course.

Summary

In summary, we are pleased with a strong performance this year, with service-led sales growth across all areas of our business and market share gains in both motoring and cycling. Our focus and investment in WeFit and cycling services resulted in a significant growth of service-related sales, a key differentiator for us. I am also pleased with the momentum building as we implement our Moving Up A Gear strategy. There is demonstrable progress across each of the five pillars of the plan, and plenty more to come. Our priorities include growing and utilising customer data, building our service and services credentials, continuing to invest in our colleagues and further investments in stores and in our online platforms, to reflect the way our customers are shopping today. We have broadened our customer reach and developed our capability through the acquisition of Tredz and Wheelies, as well as the operating agreement and investment with tyresonthedrive.com.

To bring this all together, we have leading positions in the highly fragmented motoring and cycling markets, and offer a customer-driven, service-led proposition that differentiates us from competitors both physical and online. I am proud of what we achieved last year, and I know that when I leave in the autumn, I leave Halfords with a great team, clear direction and a strong plan for the year ahead. I will hand you over to Jonny to talk through the financial performance and prevailing financial guidance.

FY17 Financial Performance & Financial Guidance

Jonny Mason

Chief Financial Officer, Halfords

Introduction

Thanks, Jill. Good morning, everybody. I am going to take you through our financial results for the year, and I will say a few words about the outlook. The impression I want to leave you with is that the underlying performance of the business is strong. Absent the FX impact, we would be doing very well, and we have started to recover from the FX.

Group financial highlights

Let us start with the Group financial highlights. Group revenue was up 7.2% year-on-year, which was 2.7% like-for-like. EBITDA was down 5.1%, which was £5.9 million lower than the year before. There were various pluses and minuses in the year, which we will look at in the following slides, but the big one was the impact on our cost of sales of the weaker pound, which you can see on the bottom left of the slide cost us £14 million in the year.

PBT was down for the same reason by £6.1 million to £75.4 million, and that was in line with market consensus. EPS was down slightly more by 8.7%, because of a small increase in the tax rate.

The final dividend proposed by the board is 11.68 pence, which would take the total ordinary dividend for the year to 17.51 pence, which is up 3% on last year and is covered 1.7 times. We are continuing to grow the ordinary dividend to reflect the good progress made on the delivery of strategy, the strong balance sheet and cash flow and confidence in our ability to recover the impact of FX over time.

In the bubbles at the bottom of the slide, you can see that the free cash flow in the year was £37.7 million, and we paid a special dividend of ten pence or about £20 million, paid in February. After that dividend and the M&A, net debt finished the year at £85.9 million or 0.8 times EBITDA, which was up from 0.4 times the previous year. That represented good progress towards our debt target of one times EBITDA.

Retails financial highlights

Let us now look at the retail business. Retail revenue increased by 8%, or 3.1% like-for-like. New sales growth came from the five new Cycle Republic stores, and the acquired Tredz and Wheelies business. Gross margin was down 260 basis points. That also was in line with expectations, and I will show you the components of that movement in a moment. Operating costs were up 4.6%, mainly from increases in store colleague costs and Tredz and Wheelies, which we will also look at shortly. This left both EBITDA and operating profit down by around £5 million on the year, but remember that is after an adverse FX impact of £14 million.

Retail sales

Here are the retail sales growths by main category. Towards the top left, you can see that motoring like-for-like sales grew by 2%, reflecting good growth in car maintenance and strong growth in travel solutions, offset by a reduction in car enhancement. In car maintenance, our core products of bulbs, blades and batteries, our famous '3 Bs', with their associated fitting services continued to grow nicely, along with workshop products.

In travel solutions, we saw strong sales of roof boxes, roof bars, cycle carriers and child car seat; all products to help customers with their journeys, and supporting our expectation that 'staycation' will be stronger this year.

The reduction in car enhancement sales of 2.8% reflected the continuing decline in the market for sat navs, but it was partially offset by excellent growth in dash-cams. Sat navs now represent only about 4% of retail sales, having been nearly 20% at their peak.

Cycling sales grew 5.1% like-for-like, and 18.2% in total. As you can see from the pie chart on the right, cycling sales increased to 38% of retail sales last year, from 30% five years ago. The like-for-like performance was strong across each of the subcategories of bikes, PACs and services. The Cycle Republic and Tredz and Wheelies businesses both grew sales by over 20%.

At the bottom of the slide you can see that online retail sales grew by just over 30%, which included Tredz and Wheelies, and by 6% like-for-like. Online now represents almost 15% of retail sales, and we continued to see over 85% of online sales collected in-store. Our service-related sales also grew by 11.1% in the year, reflecting our focus and investments in that area.

Today, we are talking mostly about the results for the full year, but I will also briefly mention the performance at the end of the year. The short 11-week fourth quarter had no Easter this year, and so we have also published sales for the 15-week period to the end of April, which includes Easter in both years; you can see that in the middle columns on the slide. The 11-week period showed a small sales decline, but the 15-week period is more representative of underlying performance, and delivered a retail like-for-like sales growth of 3.9%, of which motoring was up 0.9% and cycling was up 11.1%.

Retail gross margin – decline of 260 bps as expected

Now let us look at the retail gross margin. There were three main elements of the reduction. Firstly, about 80 basis points from the inclusion of Tredz and Wheelies, which operates in the lower margin percent but higher average ticket price category of premium cycling. Secondly, about 150 basis points, or £14 million, from the FX impact on cost of goods. Thirdly, about 30 basis points from the remaining factors, which include the continuing mix effect of faster cycling growth, the cycling promotion last summer, and partially offset by the early effect of FX mitigation plans.

So, our plans to offset FX are well developed, and started to take effect towards the end of the year. They include, as you can see on the slide, working with our suppliers to reduce costs, becoming more efficient in some of our processes, and inevitably there will also be price rises. The benefit from these plans was modest in FY17, but we are confident that they will allow us to recover all of the FX impact over time.

Retail operating costs – grew as expected

Now, let us look at the retail operating costs, which increased 4.6% in the year, or 2.4% excluding Tredz and Wheelies. Store colleague costs increased by 7%, and that reflected changes in pay rates, principally from the National Living Wage and the Gears training premia, as well as some increases in hours in shops to support the higher sales volumes. Store occupancy costs were close to flat, reflecting some savings on rent and rates across the estate offset by the costs of the new Cycle Republic stores. Warehouse and distribution costs decreased by 0.7%, because of the savings in the first half of the year when the three-day-a-week delivery schedule was annualising against the less efficient five-day-a-week model of the previous year. Support costs increased by 1.8%, due to higher depreciation charges and a modest increase in marketing spectrum. Tredz and Wheelies at the bottom of the slide added £8.2 million of operating costs since acquisition, and going forward those costs will be allocated to the categories presented in the table above.

Autocentres financial highlights

Now, turning to autocentres. Revenue of £157 million was up 2.4% year-on-year, which was 0.6% like-for-like. Gross margin increased by 80 basis points, reflecting improvements in margin across all the major sales categories. Operating costs increased by 5.6%, mostly due to investments in colleague costs to improve the offer to customers, such as introducing longer opening hours, Sunday and bank holiday opening and rewarding higher colleague skills with training premia. These operational changes made in the year are in the better interests of customers and colleagues, but were disruptive in the short term. As you can see from the EBITDA by quarter chart on the right of the slide, the disruption impacted mostly Q3.

As such, cost growth outstripped the top-line growth in the year overall, and it resulted in a decline in EBITDA of £1 million to £7.6 million, and a fall in operating profit. As Jill mentioned earlier, despite many positive developments in autocentres and significant sales increases in the recent years, and the return to growth in Q4, we are not satisfied with the level of profitability. We are taking various actions to improve the results, and that includes a review of the operating model which we will report on in due course.

Another strong year of cash flow

Next is cash flow. We have made good progress in the year towards our debt target, moving from 0.4 times to 0.8 times EBITDA. The components of the move are shown on the chart at the top of the slide, with last year at the bottom for comparison. Working capital increased by £16 million, largely due to the FX impact on stock value, and we will talk more on that later. CapEx was £34 million, similar to last year and roughly double what it was three years ago, as we continue to invest to deliver our strategy. We continue to anticipate spending about £40 million a year for the next few years, and that includes the cost of the store refreshes which were described by Jill. After tax, interest and other costs, our free cash flow was £37.7 million. Dividends totalled £54 million, including £20 million of special dividend in February, and £22 million was invested in M&A for Tredz and Wheelies and the investment in Tyres on the Drive. That all led to an increase in net debt for the year of £38 million.

Stock increased because of FX and to support trading

Then on to stock. It increased by £33 million in the year to £191 million. The increase consisted of £14 million FX impact on stock valuation; £13 million stock build from the timing of Easter as well as new ranges and growth products, which included e-bikes, the Boardman Bike refresh, dash-cams, child car seats and motorcycling products; and then £6 million simply from the inclusion of the Tredz and Wheelies inventory in the total.

Outlook

Finally, a few words on outlook. We are not changing any of our financial targets. We will continue to grow sales ahead of the markets that we operate in, targeting a roughly flat EBITDA margin. We will also continue to grow the ordinary dividend, with a coverage ratio of around about two times, and we will continue to progress towards our debt target of one times EBITDA, with flexibility to 1.5 times for appropriate M&A. There is also no change to our capital allocation priorities, which as a reminder are, first of all, CapEx to grow the business; secondly, to pay and grow the ordinary dividend; thirdly, for appropriate M&A to support our strategy; and fourthly, any further cash would be available for distribution to shareholders.

The FX impact is a big increase in cost for us and, as previously guided, it will be bigger in FY18 than it was in FY17, roughly double. However, our mitigation plans are well developed. They are enacted, they are gaining traction and we are confident that they will offset this increasing cost over time.

I hope you have seen from today that our progress on implementing the Moving Up A Gear strategy is very good. That is what leads us, despite the increasing impact of higher costs from FX, to anticipate that our profits in FY18 will be in line with current market expectations, which is broadly flat. Thank you for listening. I will now hand over to Dennis, who will summarise and wrap up.

Summary

Dennis Millard

Chairman, Halfords

Thank you, Jonny. For those in the audience who are analysts and are used to looking at things very carefully, if you look at the picture on the screen very carefully, you will see a gentleman lying comatose who has obviously imbibed a little too much at the festival. Apparently, it bears a striking resemblance to me, but I can assure you it is not me. I would hide rather than that, and also I probably would not be with such an attractive lady. Right, okay, now we can get into the real stuff.

A few words from me just to wrap up, before we open the floor to Q&A. Also, before we do: at 11.00, as you know, there will a minute's silence throughout the country. We will be doing the same here, so if we are still in the middle of questions, I would just ask you if we can pause for a minute. Thank you.

As you will be aware, and as you have heard from Jill herself, earlier this month sadly, Jill tended her resignation to take up a senior role at M&S. We are grateful for the positive contribution she has made and will continue to make across the business, and when she leaves Halfords it will be with a clear direction to drive future growth.

Now, the search for her successor is underway and, to pre-empt any questions, I am not going to say anything more about that. We are at the very early stages in the process. Crucially, we have a very talented group of engaged colleagues. Halfords is a very special company, with a very special work ethic and very special culture, and we have 125 years of heritage. It is because of those colleagues and that special culture that we have such confidence in the future.

We have our talented group of engaged colleagues, as I said, who remain focused on implementing our strategy and providing customers with the very best customer service. In doing so, that is how we drive sustainable, long-term growth. The Moving Up A Gear strategy is delivering significant momentum and traction across the organisation, and the board is content with the progress that has been made so far.

As Jill and Jonny have pointed out, we have maintained our medium-term financial targets and are making good progress against them, and we also reaffirm no change in our previously stated capital allocation priorities.

Looking forward, our key objectives remain unchanged: consolidating our service and services credentials, and continue to invest in our colleagues, our shops and our online platforms. Thank you very much for joining us today. I know it has been a very busy morning for retail reporting fraternity, so thank you for listening and now we will be delighted to take questions. Thank you.

Q&A

Jonathan Pritchard (Peel Hunt): Two if I may. Firstly, on the refurbs, on Derby: what is the CapEx spend there, and what is the expected payback? Perhaps if you could give us the details of the lite one?

Then one for you, Jill: just looking back on your time, which bits give you the most pride, and which bits were the most frustrating of your time at Halfords?

Jonny Mason: I will do the first one. Derby, of course, is a trial store so it costs a bit more. We are not expecting the refurbishments in the new format to cost significantly more than they did in the 50:39 format, once we get up to scale and cost-engineer it. Those numbers were approximately £250,000 per time. We are not changing the payback criterion either, which was a payback within four years. Obviously, Derby cost a bit more because we were trialling things, but is very much steady as she goes.

The lite version, we are still experimenting with the format, but the idea is that we need to make the whole estate look brand-conforming and fresh. Some stores do not justify a spend of that level, so it would be less than half but we do not know exactly yet.

Jill McDonald: To pick up on your questions to me: I think the two things I am most proud about are, firstly, really around engaged colleagues. I have a fantastic senior leadership team, we have invested a lot in our colleagues and they are really stepping up to the plate and delivering great and improved service for customers. Firstly, it is about the people. I think often, when you work for a great company, it is about the people, and I am really proud that we have continued to invest and engage in our colleagues.

The second thing is customer. I am passionate about putting the customer genuinely at the heart of businesses. I am sure everybody would sort of say, 'Oh yes, we put the customer at the heart of the business.' We have done a lot to invest in customers, bring customer data into the heart of our decision-making and ensure that everybody has an understanding of what our customers really value, so I am very proud of that.

I guess the frustration would be about FX. I know we have talked about it a lot, and you have to get on with what the market throws at you and it has chucked at us FX. However, it is clearly frustrating that it has had the impact on profits. Although, as we have said throughout the presentation, we have put a lot of effort into mitigation plans, we have had great support from suppliers. We have moved prices slightly, but it is important that we continue to offer value, and we are making good progress.

Jonathan Pritchard: Thank you, best of luck.

Jill McDonald: Thank you.

Speaker: A couple of questions. You talk about a full recovery of FX: does that include a recovery of the £14 million that you sunk last year just gone, and therefore we should think about adding that back in to future forecasts, or is it recovering the amount from this year onwards?

Secondly: you talked about autocentres, but I do not really understand what has gone wrong. Because the concept seems like it should be quite good, but it never quite delivers as well as we are hoping. Could you give us a little bit on that?

Finally, on the service element split, would you be able to give a proportion of your revenues, which are not just from the services as you book them, but the products attached to those services? I suppose to cut a long story short, how much are you selling with the services that someone like, let us call them Amazon, might not be able to access? Thanks.

Jonny Mason: FX recovery, we do mean it all, including the £14 million. We are not specific about timing. The reason we are confident along those lines is: just think about the structure of the market. It is mostly in cycling; there is a little bit in tech and in workshop, but the FX exposure is mostly in cycling. Our competition is comprised of many independent bike shops and they just cannot absorb input price inflation, so there is an inevitability about the fact that bike pricing is going to have to go up in the market.

Now, it will be traded dynamically. We will always insist on best value for our customers, and that is why we do not want to be prescriptive about timing. However, given that prices will have to go up in the market and given that, compared to the competition, we have additional benefits of cost and process improvements, and also supplier support, that is what leads us to the confidence that we will eventually get it all back.

Jill McDonald: On the second two – and chip in if you want – in terms of autocentres, it is a profitable business, it has been growing sales strongly. However, as we said, we think there is more that can be done to drive more profitable growth. The areas that have not performed as well as we would hope is productivity. We have invested a lot in colleague training and colleague pay, and that is partly because we need to stay in tune with how cars are developing and ensure our technicians have got the most up-to-date skills. However, also, turnover is really high in the industry, and there is a shortage of qualified technicians. So, we are having to ensure that we are competitive, and we want to be competitive, in terms of wage structure for colleagues.

The other thing when we dissect the sales side of the mix: we have been investing in, for example, selling autocentre tyres through affiliates. Now, that is quite a low-margin business, so one of the things we are doing in the short term is coming out of some of that lower-margin tyre affiliate business. There is some work to do that we are doing at the moment around the sales mix, to ensure that we are optimising the productivity of our centres with the right mix of business. I think those are really the key factors.

In terms of your question around product and the attachment of services: on the motoring side, we have about 41% penetration of services alongside the related product fit. That is growing; our penetration is growing, the volume is growing. That is because customers increasingly cannot fix things themselves; you cannot fit a stop/start battery without very specialist equipment, and actually, even changing car bulbs is becoming increasingly tricky. The complexity of car is very much playing into that trend; plus, also, just time-poor customers not wanting to spend the time themselves doing it, never mind having the ability.

The other piece to mention is around own brand. Halfords has a number of very strong own brands, and we do on the '3 Bs' side as well, of the business. When I look at it, I see this service and services as being our key differentiator versus the online players like Amazon, for example. 80% of customers want some form of help and advice, and this growing penetration of service is aligned with that do-it-for-me trend, and that is what is giving us the differentiation.

Speaker: It is not that 41% of product sales have a service attached to them, is it? Because I presume that there are whole loads of bits where people do not – if that is just in motoring, is that true across the site? What portion of Halfords' retail sales only sell because they are getting fitted by you?

Jonny Mason: Yes, so that figure is, of things that can be fitted, how many are. However, as a proportion of our total sales, service-related sales are roughly 10% at the moment, but growing faster than the total. What is interesting: now that we are getting to know our customers much better, what the data is revealing to us is that people who come into Halfords for a service-related sale, of course, they also buy other stuff. This is a uniqueness of Halfords which gives us defensive characteristics against online and other bricks-and-mortar retailers. If you were to take everything that people buy who also buy a service, it would be a bigger number than that.

Matthew McEachran (N+1 Singer): Can I just come back to the service question as well? You have made a lot of investment, both in the training side but also deployment of hours. Is there any confidence you can give in terms of the full profitability of that piece of the business? Once you have costed everything in, is it more profitable? It feels like it should be, but can you quantify the profitability of service-related activity compared to product sales?

Jonny Mason: Yes, we are very confident that it is profitable, and it is growing faster. The gross margin on fitting services is much higher than on a normal branded item, for example, and it comes back to what I just said, the uniqueness of Halfords. This is what draws our customers in. We have not distilled down the return on investment on any particular fitting service because, when you train a colleague, that is to train them to do lots of different things. We look at the overall NPS scores and colleague engagement scores; we have the lowest ever turnover of colleagues in the business. All of that is adding up to an improvement in performance which, if you took the FX out, would have been really good.

Matthew McEachran: Yes, okay. Thanks very much. Can I ask a question on e-bikes? You have drawn it out in the presentation, and it would appear that maybe cycling performance in that 15-week period may have benefited from e-bikes really starting to gain some traction. Is it substitutional, or is it an incremental type of customer coming in? What proportion of cycle revenue do you think it represents at this point?

Jill McDonald: It is still small; it is around 4% of sales. The reason for the strong performance, not just in the last Easter period and 15 weeks of the year, but over the course of the year, has not just been down to e-bikes. That is really growing super, super fast, but it is a relatively small percentage of total sales. What has been driving cycling has been a re-launch, particularly of our Carrera brand, and Carrera has the highest value of any bike brand in the UK. We had a very successful re-launch of Carrera. We have also done very well in terms of PACs; we have had really strong growth in our PACs business. We have also continued to see good growth in our premium brands. So, one of the pleasing things about the cycling performance is it has been across all of the subcategories and PACs.

With electric bikes, it feels like it has hit a tipping point, as more people understand that actually, it is not like a little moped; it is pedal-assisted. It is appealing to two particular groups of consumers: one is commuters, and the second is slightly older customers who want to have an easy way back into doing more regular exercise. They are higher average ticket price than a regular bike, so some might be substitutional, but we do think there is incrementality, particularly on those older cyclists coming back into the market.

Matthew McEachran: Okay, thank you. Then just one final question for Jonny on depreciation in the retail division. It looked like depreciation – correct me if I am wrong – was actually flat in the second half, despite acquisition and a lot of investment. Could you maybe just help us understand that, and give some guidance on the new financial year?

Jonny Mason: It was broadly flat, that is right. Nothing magic about it. We have looked at the asset lives of the refurbishments and, in fact, what you saw from the CapEx is that, whereas we had guided to a small increase in depreciation in the year, actually our CapEx undershot. That is just about timing; there were some delays, principally in IT projects. That caused the depreciation to level off a bit. We do expect to still spend roughly £120 million over three years. We will catch up on the phasing, and so we do expect the depreciation level to tick up in future years.

Charlie Muir-Sands (Deutsche Bank): Thanks very much. The first one, on the new Derby fit and the plans to do 30 in the year ahead. I appreciate you said you are not going to do all as full-fat refreshes, but is 30 the kind of maintenance level that the scale of your estate needs? Put another way, is £40 million per annum the new normal for CapEx for this business?

Secondly, the pace of rollout of Cycle Republic has been perhaps towards the lower end of what previous management thought might be feasible. Can you just update us on paybacks on those stores as well please, and some of the economics there? Thanks.

Jill McDonald: I think we need to kick up the pace of store refurbs. Over the last year, we have really been focusing on getting that design right, and cost-engineering it and customer-testing it to make sure that we have got that balance right. So, I think the ongoing rate needs to be more like 40 a year. Now, that is built into our CapEx guidance, so you have not got any surprise on the amount that we want to invest in new stores. However, it also explains why we need to create a lighter version, because we have 30 high street stores, as an example, that cannot take that big refresh, so we need to cost-engineer and come up with a lighter version. Looking ahead, and in the plan, is more like 40 beyond this year.

Jonny Mason: Yeah. Then, is £40 million the new norm in terms of CapEx? Well, what we have in our current plan of £40 million clearly includes some catch-up CapEx. It is not on the store side, as Jill said; that needs to continue. However, on IT in particular, we are catching up, we are continuing to catch up. We have landed a couple of great projects recently, and we have one or two more big ones still to do and they are in the pipeline. It is conceivable that CapEx could drop a bit thereafter, but it will never get back to the £20 million a year that it was in previous lives. That was too little.

Then on Cycle Republic: we cannot talk for what previous management might have said, but we started with some experiments in terms of Cycle Republic store layout; there were a few different locations and formats that we tried. We are very happy now that we have a model that works. As you have seen, the like-for-like performance is very good, we have some stores that are performing very well. So, we plan to continue to roll out, and we think five stores a year is not a bad pace, actually.

Jill McDonald: Clearly, if anything super dropped on our laps, we might –

Jonny Mason: Yeah. We are picky about locations, we are not in a rush. It is very important to get the right location, but modest pace is fine.

Charlie Muir-Sands: Relative to the three- to four-year payback you are talking about on refits, are you talking about the same ballpark from these new stores?

Jonny Mason: I would say it is a bit longer, because they are new stores so they need to ramp up from nothing, whereas a refit already has an existing sales base to build from.

Charlie Muir-Sands: Okay, thanks.

Kate Calvert (Investec): Can you just tell us what the big IT projects are that you still have to do?

Jill McDonald: The biggest is the change to till hardware and software, and we have talked about it a couple of times. That is by far the biggest IT investment. It is replacing an old system that needs to be updated, but it also enables us to, as we saw briefly on the video, test some quite exciting developments like tablets for colleagues in-store, which means that we can also take payment away from the hub area. Yes, mobile tablets will be part of that, which enables us to take payment on the floor. That is a big chunky project, because it is hardware, software and requires colleague training.

The second one is really around digital, and continuing to invest to keep pace – not lead, but keep pace – with how customers are shopping through online. Those are really the two big ones.

Andy Wade (Numis Securities): The first one, on Q4 cycling sales: you have talked about some of the elements within, and you did mention a bit of pricing amongst it. I cannot remember, plus 11%, was it, like-for-like?

Jonny Mason: That is in the 15 weeks to the end of April, yes. Plus 11, yes.

Andy Wade: What was the volume like-for-like there, and what was the pricing?

The second one: on the store element of the OpEx, it was slightly down. Jonny, you mentioned that there was – I cannot remember the exact number.

Jonny Mason: The store occupancy, yes, down 0.7%, yes.

Andy Wade: Down 7%. Presumably, you would have had some rental uplifts within there, so I am just interested as to how overall, you have got it to a slightly negative position? If you can go into a little bit more detail on that, that would be helpful.

Jonny Mason: Sure. Shall I do that one first?

Jill McDonald: Yes.

Jonny Mason: We are continuously reviewing our rental deals. As you know, we have a portfolio of leases which is relatively short maturity, gives us a good opportunity to negotiate. First thing to say is business rates do not really affect us very much. It is pretty flat, because we have pluses and minuses. So, that line reflects a small increase in rent from five new Cycle Republic stores, but it is offset by the rental deals we have been able to do on lease renewals across the patch. We have 460 leases in retail on an average lease length of just under seven years. There are 50 or so every year that we are doing hard deals on, and getting good rent incentives on the new leases.

Andy Wade: Interesting. So, I am presuming there is no reason why we should expect that to change in the near future, so a line which we might expect to be sort of flattish?

Jonny Mason: Absolutely, yes. We have previously guided that roughly flat for that line is a good expectation, yes.

Andy Wade: Alright. Sorry, and then the cycling one.

Jill McDonald: Yes, the cycling one. We increased volume as well in that Q4 period. I am not going to say exactly how much was through price, just because that is commercially sensitive. However, to give you a sort of flavour, in the marketplace we have seen price rises from 5% up to 10–15% at the higher end. We have not put our prices up at that higher-end level, because it is really important we retain our value credentials, but we have moved price in that quarter. However, we have grown volume as well. When we talk about the confidence in our ability to mitigate FX over time: even though we have moved some prices, we have not seen a significant impact on bike volume so far.

Andy Wade: Okay. So, in short, we are already starting to see that come through?

Jill McDonald: Yes.

Andy Wade: Yes, okay. The other one: you were talking about recovering all of what will ultimately be £50 million of FX headwinds. That could put you a very long way ahead of where consensus is now in terms of those outer years, FY20, or am I looking at that completely the wrong way?

Jonny Mason: First of all, it depends where spot settles. So, at 1.30, it would be less than £50 million, it would be closer to £40 million. We will not recover all of the hit in this year that we are just going into, so it is still a cumulative negative in FY18. However, as we recover into 2019 and 2020, we would expect the benefits to come back, yes.

Andy Wade: Okay, thanks.

Jill McDonald: Any other questions? Great. Okay, thank you very much for joining us today.

Jonny Mason: Thanks for coming.

[END OF TRANSCRIPT]