halfords

Preliminary Results FY15

Friday 5 June 2015

Dennis Millard – Chairman

Good morning everyone and it's very good to see you again. Now with Matt having just left Halfords at the end of April and Jill only joining about three weeks ago, I've had to come off the subs' bench once again and will be hosting the results presentation. But before doing so, I'd like to say how delighted we are to have Jill on board. Jill is with us today in the front row, and though she won't be presenting, which you'll go "Ahh", she will say a few words at the end of the presentation and will be around for coffee later.

As to the order of the day, Andrew will firstly take you through our financial performance for FY15 and also provide guidance for FY16. Thereafter, I will highlight the progress we have made on our Getting Into Gear strategy. Then Emma Fox, our Commercial Director who is in the front row, will review certain of the trading highlights for FY15 and share with you some of the new initiatives we have in place for the year ahead. So finally Andrew, over to you. And obviously at the end we will take questions.

Andrew Findlay – Chief Financial Officer

Thanks Dennis. Good morning everyone. I'll now take you through a review of our performance in the year. Before I start, it is worth noting that FY15 was a 53 week year for Halfords. However, in order to make more meaningful comparisons we have presented pro forma 52 week numbers to 27 March 2015, both in our preliminary announcements and in the slides I'm going to take you through now. Any references I make to the performance will be in respect to the pro forma 52 week number, unless otherwise stated.

Group revenue was up 6.9% and exceeded £1bn for the first time, a year ahead of our Getting Into Gear plan. The strong retail revenue growth is now starting to be reflected in profitability, with Group EBITDA up and EBIT and EBITDA margins increasing despite the significant investments in both retail and also centres.

Profit before tax was up 11.4% to £81.1m. Combined with lower tax charges this drove up underlying earnings per share by 13.8% to 32.7p. Net debt was £61.8m, down over a third from last year's £99.6m, with the strong operating cash flows offsetting the impact of the Boardman acquisition and the upweighted capex programme.

The Board has recommended a final dividend of 11p per share, this takes the full year dividend to 16.5p, an increase of 15.4%. We continue to look to maintain broadly 2x dividend cover over the medium-term. The split between interim and final dividend moved a step closer to a 30/70 ratio target that I have previously disclosed.

Before we get into the detail of the performance this year, I thought it's worth pausing for a moment to look at how sales momentum has grown and been maintained in the retail business. Our Q4 performance was the eleventh consecutive quarter of growth, despite a tough comparative of nearly 10% last year, although admittedly it was aided by the unexpected prolonged frosty conditions benefiting car maintenance sales.

So looking at the year. Like-for-like revenues were up by 7% and reflected a more broad based performance across the categories. Cycling was the highest growth category with sales up 11.4%. Every element of the category grew. Premium bike sales the stand out performer with sales up 25% following growth of 30% last year.

Cycle repair sales were up 18% for the year with second half sales up 27% as we rolled out our new operating model, including dedicated workstations, new tools, highly trained mechanics, to the majority of our stores.

Car maintenance performed strongly again in FY15 with growth of 8.5%, driven by parts and workshop sales in particular. The investment in gears training gives us more multi-skilled colleagues, which means we are better able to meet the demand for fitting of bulbs, blades and batteries.

Car enhancement sales were down 0.5% in the year. Satnav and audio sales continued to reflect the declining market, but car cleaning revenues grew by 12.6%, boosted by a focus on brands of choice and new gifting ranges.

Travel solutions delivered a growth of 5.4%. Sales of child safety seats were up 10%, helped by face-to-face training giving us nearly 3,000 RoSPA accredited colleagues. Travel equipment revenues grew by 5.6%, benefiting from compelling bundle promotions as well as favourable summer weather.

In the table at the foot of this slide you can see that our online retail business grew by around 14% in the year. Home delivery sales fell as customers continue to switch into the Click & Collect proposition, and also reflects the shift of product mix. Over 90% of our online sales are collected in-store, which gives us a great opportunity to showcase our colleagues' service credentials and expertise. We continue to improve and upgrade our online offer, and Dennis is going to take you through some of the changes later on.

Looking at the retail P&L more closely, total revenues increased by 6.8%, driving an uplift in the cash gross profit of nearly £26m. In line with guidance, the retail gross margin fell by 30bps, driven predominantly by the downward pressure of mix into cycling and third party branded products. Better buying, reduced royalties, some foreign currency exchange benefit, plus the income we derived from in-store services, mitigated some of the dilution.

Cycle repair and the fitting of bulbs, blades and batteries, or 3Bs, make up the majority of the services revenue stream. 3B fitting was up 14%,along with the previously mentioned growth in cycle repair, total in-store service income rose to early £27m. This is still a huge area of opportunity for us.

Operating costs increased by 5.4%, reflecting strong volumes, the logistics transition, and the investments made in the key areas of the business. Retail EBIT of £82.7m was 10% ahead of the prior year, with a focused measure of EBITDA up 9.4%. After three consecutive years of decline in EBITDA margin, FY15 saw an improvement to 11.9%. We continue to anticipate low double digit EBIDA margin in the medium-term.

Looking more closely at retail OpEx, the increase of 5.4% was nearer the lower end of the guidance given in January. Strong sales volumes, particularly in the more service intensive areas of bikes, cycle repair and parts fitting, resulted in an increased investment in store payroll hours in the year. This, along with the rise in minimum wage, was the main driver for the 7.9% increase in store staffing costs. The investment in the 3 Gears training programme also contributed as more colleagues progressed through Gear 2 and qualified for wage uplifts.

Store occupancy cost decreased by 0.3%. Rental charges were lower year-on-year due to successful lease re-gear and relocation negotiations. This was offset by increased depreciation expense and non-capitalisable store change costs including refreshes, space swaps and Cycle Republic openings.

W&D costs were up 29%, due primarily to the strong volumes, particularly in bulky items and online sales, driving up transport costs as well as the transition to more frequent deliveries. I'll talk through W&D in more detail in a moment.

Support costs rose by 2.1% due to increased depreciation from our IT investments, pay reviews and the one-off transaction costs and ongoing operating costs associated with the Boardman Bikes' business.

In total, retail operating costs as a percentage of sales fell 58bps in the year to 41.9%.

FY15 has been a year of transition for warehouse and distribution. Whilst we anticipated a significant uplift in costs, they have been higher than we would have liked. However, it is important to note that a change was necessary because of strong volume growth, the mix into bulkier products and channel mix.

The rise of online sales coupled with growing extended range resulted in a huge increase in the numbers and the volumes of Order & Collect which are items not held in-store when the customer places the order. In response to this, in October 2014 we in-housed an inflexible outsource network and moved to five day a week delivery schedule. Whilst customer service has been maintained throughout with no child going without their bike for Christmas, and service levels sustained through the cyber weekend peek, the costs were greater than anticipated. We have taken action and are in the process of transitioning to a more flexible three day a week outsourced transport network as the business assesses the wider end-to-end supply chain proposition.

So now moving onto Autocentres where revenues were up 7.6%, like-for-like sales grew by 5.3%, improving during the year from 4.3% in Q1 to 6.6% in Q4. Closing seven centres and opening a further nine in the year took the centre estate to 305. During the year we opened a Concept Centre in Croydon, the learnings from which we will be applying in the year ahead. Dennis will talk more about this later. We are committed to the continued investment in Autocentres to secure medium-term growth, and anticipate opening 10-15 centres in FY16. We will continue to close sub-optimal centres as a matter of course, but we anticipate this to be minimal in FY16.

Gross margins within Autocentres reduced by 109bps during the year due to sales mix, with tyres increasing from 16% to nearly 18% of sales. Core service, MOT and repair margins were marginally up in the year.

Operating costs increased by 6.7%, with a vast majority of the increase coming from centres opened since acquisition of the business five years ago, with the balance due to pay rises, enhanced training, investment in supporting functions and depreciation. As expected, EBITDA increased marginally in the year and we anticipate further EBITDA growth in FY16.

Halfords continues to generate significant amounts of cash. Strong operating cash flows in FY15 more than offset the acquisition of Boardman Bikes, the upweighted capex programme and dividend payments, resulting in a reduction of net debt of nearly £38m.

Cash capital expenditure increased to £39.6m versus the £26.7m in the prior year as we completed the second year of the Getting Into Gear programme.

After investing in stock levels in FY14, inventory levels fell marginally despite the addition of stock associated with the Boardman Bikes' business and a continued growth in retail sales.

With net debt falling to £61.8m, non-lease adjusted net debt to EBITDAR was 0.6x in the year versus 1x in the prior period. Our capital allocation priorities remain unchanged. We also continue to be well supported with the amendment of our bank debt facility to £170m, and its extension to November 2019 on more favourable terms.

Our performance in FY15 was in line with guidance. The only beat was sales growth which in Q4 was driven primarily by the favourable weather conditions. Whilst we continue not to guide on like-for-like sales expectations, I thought it would be useful to give some clarity on the impact of the role out of Cycle Republic, which we anticipate added around 1% of non like-for-like sales growth in FY16 on the basis of having 15 stores by the end of the year.

I anticipate retail gross margin declining by around 25-75bps, reflecting the ongoing mix effect from the growth of cycling and the increase in third party branded sales. An assumption of continued US Dollar strength against Sterling is also factored into the margin decline. I anticipate our retail operating costs increasing by 4% to 5%, and I'll take you through this in more detail shortly.

FY16 will be a significant period of activity for us. Retail capex guidance for the year is around £45m, taking the total to £100m over the three years of Getting Into Gear. Around half of the spend in the year ahead will support our stores' Fit to Shop initiative, with the rest being invested in projects such as more hardware and software replacements, electronic vehicle look-up screens and stock management and distribution software enhancements.

Autocentres' capex will be around £8m in FY16, and we anticipate Autocentres' EBITDA to be up on FY15 by a low double digit percentage. For the first time we have provided guidance on Group depreciation charge, which we anticipate being around £30m in FY16. Net finance costs for the Group are expected to be around £3m, whilst we anticipate our effective tax rate to alter to around 20%.

As I mentioned earlier, we anticipate an increase in retail operating costs in FY16 of 4% to 5%. Around 1% of this is driven by depreciation, with pay increases in the 3 Gears' pay increments adding a further 1%. Volume related cost growth offset by targeted savings drives a further 1%. This includes the costs associated with warehouse and distribution. Finally, we anticipate the costs of refreshes, space swaps and Cycle Republic to add between 1 and 2% to costs depending on the exact store numbers and timings.

So to summarise. FY15 has seen a continued momentum in retail top line flowing through to earnings growth with underlying earnings per share up 13.8%. Cash generation remains strong with net debt to EBITDA down to 0.6x.

We are pleased to announce a growth in the full year dividend per share of 15.4%, reflecting our continued recognition of the importance of dividends to our shareholders. And finally, FY16 will be a busy year of investment and activity with top-line growth remaining a key priority for us.

I'll now hand you back to Dennis.

Dennis Millard

And for the avoidance of doubt, that's not me, but I have got a bike exactly like that!

Thanks Andrew. Now I'd like to take you through the progress made in our Retail operations first on the Getting Into Gear strategy.

By now, I'm sure you're all very familiar with the strategy comprising of the three category pillars and the five execution priorities, with the aim of helping and inspiring our customers with their life on the move. We launched this strategy two years ago and remain committed to executing it.

There has been a huge amount of progress but there's still a lot more to do.

What I'd like to do now is to set out the progress we have made in each of the five execution priorities.

Turning first to the service resolution:

As we said at the outset two years ago, customer service is at the very core of our strategy and upskilling our colleagues' capability was essential to bring about a step-change in customer service. We believe we have made significant investment in our colleagues and we believe the benefits are starting to show.

Our colleague profile looks very different to that of two years ago. We now have 1,500 fewer people working in our stores, though the total hours worked has increased by 12%. This is evident in the average weekly contracted hours per colleague rising by nearly 50% and a much higher proportion of full-timers.

The three month new higher colleague turnover has dropped significantly, aided by the new recruitment processes introduced in FY14, enhanced career opportunities and the training made available to colleagues when they join Halfords.

Now on the topic of training:

FY15 has been a year of real progress with 96% of colleagues having qualified in year one and 46% on year two. At the end of the year, we had over 300 colleagues who are qualified in year three, primarily as a result of our focus on cycle repair.

Our target for the year ahead is to have 80% of colleagues qualified on year two and two year three colleagues in most stores by the end of FY16. We believe that the increased number of multi-skilled colleagues is having a beneficial impact on sales. For example, the 3B fittings of car child seats, just to name a few, by enabling us to meet demand during peak periods.

Also during the year, 163 colleagues graduated from our store manager and assistant manager training programme, Core Aspire, enabling us to fill 60% of store manager vacancies internally.

Now Halfords is a somewhat unique retailer with an estimated 80% of customers requiring interaction or help or advice when they make their purchase. Our investments in the service revolution are already driving improvements in both service, with the Net Promotor score rising significantly above where it was two years ago, and colleague engagement, as demonstrated by both our engagement scores and in our ranking in *The Sunday Times* 'Best Companies to Work For.'

Simply put, engaged, well-trained, properly rewarded colleagues will inevitably lead to satisfied customers.

In summary, we believe we've made great progress but we know there's still some way to go.

Turning to the next strategic priority, stores fit to shop:

Forty five stores are refreshed in the year, taking the total to 72 in the last two years. Our experience to date has been encouraging, with customer feedback positive, and we have seen an uplift in sales performance and customer experience in our refreshed stores versus our control group comparators.

41 stores were space swapped during the year, which involved a partial relay of product and a reallocation of space across the categories. We are looking to rollout some of those successful elements during the year ahead. We remain committed to a total of 150 refreshed stores by the end of FY16.

In addition, we launched our new Cycling Only store chain under the Cycling Republic brand. So far, we've opened five stores: three in Greater London and two in the cycling-friendly cities of Norwich and Nottingham. We're encouraged by the performance so far, and in line with the previous guidance, as laid out by Andrew, we continue to anticipate having around 15 Cycle Republic stores by the end of FY16.

Now with regard to the fourth priority, the H Factor, we continue to make significant strides to strengthen our authority in both Auto and Cycling by working closely with our suppliers, our customers and our colleagues to ensure that Halfords has the products and services our customers want. Now in our presentation we'll provide a review of the strides we've made on that front and our plans in the year ahead.

But we've also expanded our involvement in the wider community to further extend our authority and credentials. During the year, as well as 57,000 children and their parents attending our free bike workshops in-store, we've taught many other thousands of children about cycle maintenance in schools. We continued our bike trade-in events, collecting 12,000 used bikes for our participation with the charity Recycle. And our cycle mechanic crew supported more than 150,000 cyclists at cycling events across the country, principally with our Sky Ride partnership.

Furthermore, we launched a new partnership with British Cycling's Woman's network Breeze and held our first woman's workshop last month with over 2,500 women attending.

And, following a successful pilot, we launched our first retail apprenticeship scheme in February. We already have a well-established programme with some 200 apprentices employed in Autocentres, but this programme is new and open to people not in education, employment or training. We plan to train 500 apprentices across Halfords Retail in both Auto and Cycling in year one and see huge potential for the programme to get people back into work and a new wave of talent into retail. Much achieved but much more to do.

And finally, the fifth retail priority, infrastructure in digital:

As Andrew explained earlier, it has been a challenging year for our distribution activities with costs higher than we would have liked. We have trialled a number of solutions, taken some considerable pain, but now have taken action and our new transport solution goes live in just a few weeks.

It has been a busy year building our IT infrastructure and online offer so that they are fit for purpose and we're able to grasp the opportunities that we see. Earlier in the year, we rolled out tablets to all stores and also became the first company in the UK to go into the Cloud with SAP as we concluded our core system upgrade.

Black Friday was our biggest ever online day with sales three times that of the same day in the prior year. Importantly, our investments and IT infrastructure ensured our website and our supporting systems were stable and secure throughout, as they were over the Christmas period.

Our social media presence has also been strengthened, including an in-house digital studio that enables us to keep our YouTube site well stocked with product reviews and 'How To' guides. And one of our campaigns, The Bike Whisperer, was an award-winning one during the year.

We're continuing looking at ways of upgrading our online offer and bolt-on use on new services. A few examples include the launch of Live Chat, Click and Collect in Ireland, an online number plate ordering service and a 360 degree rotational product display. We've also refreshed the website design in order to make the customer journey much easier.

Finally, we've agreed an arrangement with a major courier whereby parcels of other retailers can be collected in 120 Halfords' stores.

Now my review up until now has been focused on our retail activity, so I'd like to take some time on Autocentres.

Back in November, as you recall, our Autocentres CEO Andy Randall presented the strategy for the business. At the core is our ability to build trust - Trust with a capital T - particularly essential given the nature of the industry in which Autocentres operates. And this will be driven by focusing on the four execution priorities as set out in the slide, underpinned by investment in our colleagues. Working more closely with the Retail business is also a key part of the plan, both in terms of cooperating commercially and also sharing learnings.

In essence, Autocentres is on a similar path to that of our Retail business was in terms of customer service and colleague development two years ago, but in reality, Autocentres is about a year and a half behind Retail in that transformation journey. We're not content with the financial performance but believe we're now on the right path.

Now progress to date, the next slide with some of the initiatives Andy outlined include the launch of a mobile site and enhanced search optimisation. We are now consistently near or at the top of the relevant Google searches. This has boosted online traffic and conversion with online bookings up 21% in the year. Also we invested heavily in the Bosch diagnosis equipment across our network and the aim is to keep ourselves at the forefront of technical capability.

We opened a Concept centre in Croydon in October, which has had very good customer response, and there are some early customer service wins across the wider business with a rating now consistently around 8.5 on Trust Pilot, as well as a significant reduction in the number of complaints received.

Our Autocentres and Retail businesses are already working closely together with a consistent five-point winter check running both in the Autocentres and in stores across the whole of the winter. And Autocentres is now using Halfords' branded oil and batteries.

Now as well as generating purchasing benefits, this closer working relationship also helps sales, with a number of Autocentre bookings made through the Retail website up 25% on the year.

Looking ahead for FY16 and Autocentres, we plan to use the learnings from our Concept store trial in Croydon and apply these to 10% to 15% new centres that we anticipate opening in the New Year. In addition, we have commenced a more light-touch refresh programme, whereby over the next three years we will roll out some of the low cost successful elements of our Concept trial to the rest of the portfolio.

As Andy explained in November, productivity and utilisation are two key priorities. We're trialling different opening hours and also looking at ways to ensure we have the right people in the right place at the right time.

Finally, customer retention, this has improved slightly in FY15 but remains a big opportunity.

So to summarise, it remains a challenging competitive environment for Autocentres and it will take time for our initiatives to take effect. Trust is not something you build overnight, but the early signs are encouraging and we believe we have the right strategy and, importantly, the right leadership in place. And as Andrew indicated, we anticipate EBITDA growth in the year ahead.

I'd now like to hand you over to Emma who will take you through some of our product and services progress this year and those planned for the year ahead.

Emma Fox – Commercial Director

Thanks Dennis. Good morning everyone.

I'd like to share with you some of the activity we have planned for the current financial year, but before I do that, I'll briefly talk through our FY15 performance.

As Dennis and Andrew have said, it's been another year of strong top-line growth, this time against some tough comparatives. Whilst weather conditions were certainly favourable, with the warm summer benefiting cycling and a cold Q4 helping our car maintenance sales, the main driver of the better performance has been the actions and planning taken by the management and colleagues.

Our product and brand offer is vastly improved from a couple of years ago, and with the customer at the front of our minds, we've increased the quality and range of what is available in our stores, as well as having more compelling offers and merchandising. This is supported by a colleague base that is becoming more skilled, more loyal and more engaged.

So I thought I'd pick out a few of the highlights from the year just gone. Firstly, an enhanced range, coupled with the successful 'Does anything beat a bike?' Christmas advertising campaign, drove sales of older children's bikes up over 40% in the year. Premium bike sales grew by 25%, and staying within cycling, the sales of parts, accessories and clothing increased by a healthy 8% in the year, although this was lower than we would have liked.

Within Auto, we ran free five-point car checks, as Dennis has just alluded to, throughout the winter, and this helped drive up sales of parts and consumables with our own-brand oil becoming the number one brand in the UK on both volume and value.

We also fitted a record number of 3Bs, including over 100,000 in our busiest week, which is equivalent to one every three seconds. And it seems to have been a year of breaking milestone sales records with both £1bn Group sales and £100m online sales in Retail, the latter growing over 14% in the year with around 60% of website traffic from mobile devices. Our investment in online content drove ten million interactions with product videos and spin-sets and five million views of our advice centre articles.

As Dennis mentioned earlier, we further strengthened our authority in key categories during the year. To name but a few initiatives, we launched Car Parts Direct, we introduced new products within technology and car enhancement, including Go Pro and Dash Cams. We introduced our own new premium bike brand, 13. We acquired Boardman Bikes and, of course, we launched Cycle Republic.

And finally, we've introduced new and different products into our stores this year. A good example being the flexible use of front of store space to drive impulse purchases. So, during the Christmas run up we successfully introduced a gift plinth at the front of store, selling new gift plinth ideas to cyclists and motorists, many packaged in our own brand designs.

So, looking ahead to FY16, and firstly I'll start with cycling where there's lots going on. We're really excited about the range changes coming up, including VooDoo in June, a re-launched kids' range in the autumn and Boardman in January. We'll also be adding depth to our ranges in key areas, with the launch of Carrera electric bikes; and you can see one outside, for under £1,000; and a number of new female bikes in the 13 and VooDoo brands.

We launched Boardman clothing this spring, complementing our existing helmets offer. And then Boardman mountain bike shorts are already our number one selling item of clothing by sales value.

During this year we will relay all of our cycle departments, at the same time rationalising the range and refreshing the merchandising. All cycling department colleagues will receive a two-day face-to-face training course throughout the summer, aimed at ensuring they're even more knowledgeable and better able to sell customers the right bike for their requirements, along with the right accessories.

The Cycle Republic store rollout will further enhance our credibility in cycling, as well as providing new space in the city centre locations where we have low market share.

A transactional Cycle Republic website will start to be developed during the year, giving us another sales channel in the medium term.

So, looking to Auto. We're launching loads of new products, including new tool sets, in-car connectivity. You will have found one of these on your seat; we launched these about six weeks ago, so no expense spared; you've got one to take back with you. And we've also got an extended range of in-car dash cams.

This week we actually began a new initiative for SatNavs and audio where we're trading in for customers, so it's an event where customers can bring in their old units in exchange for a discount off a new one.

And we're also about to launch a new marketplace initiative online. This will enable our customers to access thousands of additional auto and cycling products through our website. These products will be delivered direct from the vendor without Halfords needing to hold the inventory. And we can trial new product ranges and then bring the popular items in-house.

We're improving our merchandising within Auto, including a wider rollout of electronic vehicle registration look-up screens, and enhanced 3B displays, making product selection simpler for our customers.

We trialled festival pop-up shops last year, and with the success of that we will be at five large music festivals this year, enabling customers to order a tent for collection from our pop-up on site; which is a much more convenient way of enjoying the festival.

And we expect the trend in Do It For Me to continue apace as people move away from DIY. Through investment in the latest equipment and training for colleagues we believe we are well placed to harness that trend.

And finally, after the success in FY15, we will maintain and add bundle promotions and package solutions at seasonally relevant times, such as upgrading both light bulbs for £25, and a single price for combined roof box bars and fitting.

So, to sum up: FY16 will certainly be a busy year for trading initiatives, and it will arguably be our biggest year of activity under the Getting into Gear strategy. And we go into the year with a tailwind of momentum driven by a group of engaged, passionate colleagues.

Thanks very much and I'll hand you back to Dennis now.

Dennis Millard

Thank you very much Emma. So, just to summarise:

We're pleased with the results for the year; robust earnings and obviously strong dividend growth. It was great to exceed the £1bn Group revenues a year ahead of plan. But more importantly is the platform that we're building for future growth.

Now, this will be the last Halfords results presentation that Andrew will be making. I don't know if that makes you upset, makes you sad. So, what we could do is those people that are sad you can clap; those people that are glad you can clap. He's still with us for a few more months, but obviously I'd like to thank him for all the support he has given me. We've been together through three chief executives.

Andrew Findlay

What does that say about us, Dennis?

Dennis Millard

I'd like to wish you all the very best in your new job at that place that copied our colour of the logo. Thank you very much.

Now I did promise that Jill would say a few words. Jill, over to you.

Jill McDonald – Group Chief Executive

Thank you very much, Dennis. Good morning everybody. I am in week four of the new role, so I'm delighted to have taken over as Chief Executive, less delighted that Andrew has decided to leave, but we are in the middle of our recruitment process to find his replacement.

I'm particularly delighted to have found a business that I can take over that's in good shape, and importantly for me one that puts customers and colleagues at the heart and that was something that was important to me as I went through the recruitment process, and is certainly a focus that I see is alive and well as I go through my induction period with Halfords. And just to give you a flavour of what I've been up to over the last three weeks: I've spent most of my time out in stores. So I've spent several days working in our retail store in Bracknell. I've spent time with Andy Randall out in Autocentres. And I'm due to work in an Autocentre, not in the workshop but in the reception area, in a couple of weeks' time. And I've also visited our Cycle Republics in the London area.

So, I'm not going to pontificate and share any grand views on the business at this early stage; but rest assured that when I present the interims in November you'll hear more about my views.

So, I look forward to meeting many of you over the coming months and having a quick coffee with you this morning so thank you.

Dennis Millard

Thank you very much, Jill. It's that time where we field your questions.

Q&A

Question 1

John Stevenson – Peel Hunt

A couple of questions, starting with PACs. Obviously you talked about the 8%. I'm interested in what's happened because I think clothing has done particularly well, I think it was up 40%; so maybe you can explain in what way PACs aren't working and what are the opportunities going forward?

Second question just on bikes. You mentioned about rationalising the space or relaying the space for the year ahead. If you could give a bit more information there in terms of what you're wanting to achieve and where ranges can be improved or what you mean by rationalise effectively?

Dennis Millard

Let me start with PACs and Andrew will chip in as well. I think we've got to put everything in perspective I s that 8% growth is still pretty good but it was disappointing relative to the high standards we set ourselves. So, that's the first thing.

Clothing isn't the biggest part of the PACs mix, so it's a bit of what I wouldn't call the law of small numbers but the law of relative numbers. So there wasn't areas in which we felt we dropped the ball, I think there's no doubt that in that area that's probably the most competitive, particularly online, and that's where we're building our credibility, our ranges etc. So, it isn't like it's broken; it's just that we are going to work harder at growing that side of the business by extending the ranges; and importantly as well looking very carefully at some of our good, better, best price points as well and building on our brands. So there isn't any magic silver bullet as such; it's just getting better at what we do, both in-house and online.

John Stevenson

In-house are people actually shopping in store? Has it been online where the growth has been coming through or are people actually stopping the range in store when they're buying bikes, using their better research?

Dennis Millard

If you look at a traditional purchase of a cycle, and that's why there's a large proportion of people who are online and then come into the store to have the bike fitted, to hopefully sign up to a bike care plan etc., that's where we get the opportunity to upsell and to sell them all the components.

There was a good example of this in that I bought my granddaughter her Apollo Cupcake for her birthday and by the time I got out I'd spent double the amount on the bike on accessories and you try stopping a four year old from grabbing the accessories. And that's up to us as store colleagues to actually create theatre and make sure that people do walk out, not just with things that are impulse, but also the safety features as well.

John Stevenson

And on the relaying of the bike?

Dennis Millard

Yeah the relaying, as we said, in a number of stores we've been doing it and we've been trialling whole different ones in different stores. And we've probably found that, as we go through the analysis of what is working – it's only a very short time period as well so we are feeling our way through this, number one. What we have found is on the flat stores those are working probably a little bit better, so we're going to trial some ideas there as well.

And if you look at what we're doing to the estate it's a sort of menu from pure space swaps, which isn't much to do with the appearance to the customer of the store, other than making it more shopping friendly; but all the way up to a full 50:39. And that's what we're working on: seeing what works best for us. At the same time you don't want to attack too many stores in one year because it's disruptive, as we all know. So, we have to plan those very careful.

<u>Question 2</u>

Jonathan Pritchard – Oriel Securities

Three from me. Medium-term steady state capex, I know there's a bit of a peak this year, but what's the underlying capex number?

How comfortable are you with very low debt ratios or even net cash on the balance sheet? The level of comfort with that?

Cycle Republic, have you done a piece of work to examine the ultimate potential of that?

Dennis Millard

Right I think as far as capex is concerned I'll kick that into the long grass, so to speak, because I think when Jill gets up in November and gives a more considered view on where we are on the Getting into Gear strategy and then beyond that, give some indication beyond that we'll be in a better position. But I think you should look at pretty solid state. We're going to continue to invest in our stores, as we said. That programme isn't over yet. We'll be investing in new Cycle Republics and obviously the same with Autocentres. Without giving you the actual number I think it gives you a sense of where we're at.

If you'd asked Andrew a question on low gearing, how comfortable does he feel, every accountant feels comfortable with low gearing, of course. Whether that's the most efficient balance sheet structure or not that's something for the future. Once again I'd like to move that question on to November when Jill has had more opportunity to look at the business and where we want to take it into the future.

Then lastly was the Cycle Republic. Matt threw out a figure of 100 stores or we call it the grenade: he rolled across the room and then walked out of the room. And so, it's stuck a little bit. Let's just to say that we want to have a national chain that gives us that authority. As to whether it's 100 or not timeout on that.

<u>Question 3</u>

Michelle Wilson – Berenberg

Firstly on your logistics and the distribution network that you're now rolling out, could you just go into a bit more detail of what it is that you're rolling out now? I think previously you talked about five-day a week deliveries; I think you mentioned going down to three-day a week.

Dennis Millard

That's right.

Michelle Wilson

So, just your plans and what impact that will have on product availability?

Andrew Findlay

So effectively we were tied into a very inflexible logistics network. As you've seen from the graph we've got to do something, it's a quality problem to have, given our sales performance and the volume of products coming out of the door, so we came in house thinking to create flexibility, moving to five days, got through peak and cyber weekend very well, put the customer first, and frankly it cost us more than we anticipated, we've now moved to a more flexible outsource model and we're consulting with our colleagues to do so. And effectively three days, we sense that's the better balance because you're going from one extreme to another in five day and frankly that's the balance we want to look to.

The whole aim is to alleviate the variability of cost in the business associated with order and collect in the business. From the point of view of availability we don't anticipate huge impact on that, availability's good and we'll flex our store stock holding accordingly. From the point of view of when that's going to happen, that's timed for the summer this year. All of the costs associated with it are included with the guidance that we've given for '16.

Michelle Wilson

Great, thanks. And then just on the Cycle Republic stores, have you done any work or do you have any figures around what cannibalisation impact that's having on nearby stores in terms of their cycling sales?

Dennis Millard

Yes, I mean that's something that obviously comes up, if you look at we have stores in Norwich and Nottingham, they've been open, well Nottingham's been open for about a week so it's hard to say. We have views on that and we're obviously tracking, it's always hard to completely track that as a retailer, and as far as the London stores, well we're not cannibalising anything because we just were not represented in inner London. Twickenham is a store that was a Halfords Metro equivalent that we've now converted to Cycle Republic, so there's nothing to track there.

Michelle Wilson

Okay, in your roll out of Cycle Republic stores though do you have a kind of figure in mind where you think is an acceptable level of cannibalisation or an expected level?

Dennis Millard

Yes we have an idea and we'll obviously take that into account when we look at each area that we're going into, but bear in mind Cycle Republic stores is extending our authority into areas that you wouldn't traditionally find in the Halfords BikeHut, so it is in some ways creating a new market, so we would hope that the cannibalisation isn't that great, but our authority in people will then feel comfortable going into other stores as well.

Andrew Findlay

I think we should remember, there's so much to go for in the high street market a bit of cannibalisation, it's better us getting it than somebody else getting it, so as far as I'm concerned moving into that market where we've got low market share, forcing out the IBD and the other competitors in that market…

Dennis Millard

Don't use that word, 'forcing out'.

Andrew Findlay

Sorry.

Dennis Millard

You've already got into the EasyJet mould.

Andrew Findlay

Grabbing that market share. If there's an element of cannibalisation I'd rather it was in our till than somebody else's.

Question 4

Matthew McEachran - N+1 Singer

Yes thanks, Matthew McEachran from N+1 Singer. Could we just go back to the warehousing and distribution plan and to move it more to an outsource model? So you're going to have a three day programme. Is that a sort of fixed and permanent stance or do you think that over time that can then improve to stores that would need a more frequent distribution model?

Andrew Findlay

We're moving to a fully flexible model, so move to three day. In tandem with this we are looking at the source to shelf supply chain end to end proposition as well. So as far as I'm concerned it's the right thing to do, we've got full flexibility, we're not tied in. And the key thing for us is to manage our peaks and troughs in a very efficient way. What we've found by coming in sourced during the peak periods, we didn't have that flexibility, we've gained it, and that was to leverage it.

Matthew McEachran

So if we go back to some of the original, if you like, reasons for changing that programme some of the opportunities were controlling and containing the career costs and perhaps eliminating them, reallocating warehousing space in stores to more productive areas, particularly cycle repair, and then the third area, pushing stock out of the business altogether. Does this kind of make a step back in terms of the opportunity there or do you think it just postpones?

Andrew Findlay

No, because I think versus one day definitely there's still a big opportunity, and as you've seen we've already created some space in stores so in over 300 of our stores we've put the repair area at the back, and we're seeing benefits from that as you've seen from the numbers in cycle repair and that's increasing productivity.

So with all of these things there's a balancing act and that's the art of good logistics and supply chain. And over time can I see some stores being delivered more frequently than others, particularly during peak? Yes, I can. And this model will let us do that. So from that perspective it creates that flexibility, more efficient, better cost management and balances out the customer proposition as well.

Dennis Millard

Yeah in hindsight if you think about it we introduced this in November and it was just before the Christmas peak, just before the Black Friday, and if you look back we would probably have done it slightly differently and maybe timed it differently, we didn't have that flexibility so therefore the costs rose during that time as we had to make sure that we didn't disappoint customers, and that was critical.

And as far as availability in store is concerned actually the customer probably wouldn't notice the difference we do, obviously for margin and during the peak periods, so this has given us the flexibility to be able to flex it accordingly.

Matthew McEachran

Okay, thanks for that. Another question was just on Cycle Republic, just thinking about the sort of net P&L of Cycle Republic, I mean you've got stores now in there in year two or in the first full year, will the contribution from those stores offset the new opening and preopening costs from this next phase?

Dennis Millard

We look at these stores, we reckon that it's got about a four year payback, that's what we're modelling. You know, we're in this slightly new area because these are new stores, but we've obviously got some idea of how it should be performing, so in the first year and the year ahead, as much as it's going to add a little bit to the top line you've got to assume that these are not going to be contributing much to the bottom line.

And so it'll take some time for them to mature and some will take longer than others. If you think about the inner London stores the one big extra cost you've got say in comparison to Norwich is rent, it's obviously much more expensive in London, yet you have got pretty much the same 3,000, 4,000 square feet type stores. So those will tend to kick in earlier, so a lot will depend on the next two.

<u>Question 5</u>

Tushar Jain – Bank of America Merrill Lynch

Just three simple questions, in terms of your store refurbishment when you look at it what's the sales uplift when you do a store refurbishment, just so we can get a little bit of an idea on that?

The second question, in terms of your staff, how many staff do you want on a Gear 3 programme? You said it's 80% on Gear 2, if you can give a little bit of an idea of the staff costs that might go into the next year as well?

And finally, on car enhancement, just looking at it is it fair to assume that the category might bottom out in the current fiscal year, given the fact that car cleaning is now picking up the slack from the SatNav? Thank you.

Andrew Findlay

Yes, so refurbishment, we have a range of expenditure that goes from very little to a full refurb and we flex it on the basis of the size of the store, the feedback from the retail colleagues, the demographic of the location, whether we'll get the payback etc. So it absolutely varies depending on what stores. The targets we set ourselves from a payback perspective we're hitting, so as far as I'm concerned I'm happy with that. So by store it very much varies, we've got a huge range of results as a result of what we'd say is the investment programme we set for each store.

Needless to say the uplift that we anticipate from the investment is targeted on the individual stores as the investments are made, so we have to get full buy in from every area of the business to ensure we get that return, and so far we are.

Dennis Millard

So we set the target, we set the bar higher, they've got to sign into that as well. And so when we make these investments it isn't something sort of delivered from up on high, we get buy in from everybody.

Yes, as far as Gear 3 is concerned, I mean Gear 3 lends itself to specialisation, so ideally in each store you want to have a specialist in each sort of area in each store, so the idea in the year ahead of having two in each, you know, somebody in Cycle who's a Gear 3, really highly, highly trained and also in automotive as well. So that's the kind of the model, we'll see how it pans out over time, but that's what we've got for the year ahead, to have pretty much two in each store.

Car enhancement, I think the one side we have SatNavs and audio which are in structural decline, I mean retrofit structural decline, everybody gets a SatNav when they get a new car but there's still opportunity for people who retrofit their SatNavs. And we've got the dash cam as well which is flying off the shelves and it's hard to keep up with it, so that's selling very well. So there are sort of pockets of our technology offer that are actually looking pretty good and cars now it's not just about the unit it's about the connectivity and actually that's where we see sales growing as well.

If you balance against that you've got the car cleaning, car cleaning's a good result and it's a strong growth area, so arithmetically they probably balance each other out, but having said that – he was about to kick me – we don't give any guidance on like for likes. Correct?

Andrew Findlay

Correct.

Dennis Millard

Thank you.

<u>Question 6</u>

Sanjay Vidyarthi – Redburn

Just coming back to distribution, can you give some idea of the additional or fractional costs that you incurred in the last financial year in terms of that move to five days a week deliveries? And are we talking about additional costs as you move to three days with potentially savings coming through in future years as that all kind of drops out?

And the second question is just can you talk a little about availability levels in stores, where are you now?

Andrew Findlay

Distribution, I think pure true one off was around £800k to a million. With respect to ongoing, we've got a quality problem, our sales are doing that and volumes are doing that, so from a point of view of distribution we've got to set ourselves a solution that's fit for purpose with a full flexibility.

So do I anticipate reductions in cost from a warehouse distribution? No. Do I predict better efficiency? Yes. So that's what we'll see in the numbers going forward.

Dennis Millard

And I think that is included in your guidance as well.

Andrew Findlay

Yes, absolutely.

Dennis Millard

And availability, I mean as I said if you were a customer and walked into store you wouldn't find that as an issue, I think as far as the distribution's concerned it was more on the click and collect side of things where it stressed the system, but in store the availability's still good. And so the proof of the pudding's in the eating, when you walk around stores it's good.

<u>Question 7</u>

Adam Cochrane – UBS

It's Adam Cochrane at UBS. I almost daren't ask one on warehousing, but in terms of the offer, just to clarify it, when you have click and collect product in store does some of that come direct from warehouse via a courier and some is picked from shelf?

Andrew Findlay

Yes, so 90% of online is click and collect, and the remainder is home work delivery. Within that click and collect offer you have some, so from a customer perspective as far as that customer's concerned that product's there but some of it has to be delivered into store and internally we have reserve and collect and order and collect which makes up the customer proposition of click and collect.

Dennis Millard

Yes, so some of it will come in store if it's already there.

Andrew Findlay

And some of it's direct from vendors, so it's back to back direct from vendors.

Adam Cochrane

Okay, in terms of the sort of bike repair, I remember sort of last year you pulled back a bit from the advertising etc. because you were being slightly overwhelmed in terms of the amount of custom compared to the staff and the training that you had available, is it something you can push a bit harder now you've got 300 repair centres in store and you can start to put television advertising or something around that?

Dennis Millard

Yes, I mean as Andrew mentioned in his presentation that's a real priority and if you want to establish your credentials and your authority if you're really good at repairs that's where it counts and if you look at the Cycle Republics, the way we've laid them out and that's where that part of their business is growing very strongly and slowly but surely that will be the thing that will get the enthusiast into the Cycle Republic stores. In the second half we grew 27% which is where we wanted to be because we think that that can grow at about that level. A big investment in it, yes.

Andrew Findlay

We did the advertising in Q1 last year but two reasons why it didn't work, the weather wasn't great and when you throw advertising about cycling when the weather's not great it doesn't work.

Dennis Millard

Nothing happens.

Andrew Findlay

And secondly, we frankly weren't ready, the roll out of our equipment and training and into the back of the shops happened mostly in half two. So it's something to consider, but so far, so good and it's taking traction and we see that in the numbers in the second half.

Adam Cochrane

Okay, you've preempted my third question, you mentioned weather being good and different weather patterns between two different seasons. Would you be able to sort of quantify roughly what the weather benefit would have been?

Andrew Findlay

Well my view is the beat on profitability in the year a lot of that came from Q4 and as a result of the better car maintenance. Car maintenance in Q4 was better than we anticipated – much better. And I was saying to Nick earlier that all you need is a hard frost in the morning, hard frost in the morning, sun in the afternoon, that's bang on for us. It's bang on and hands up it was great. So we were sitting there popping champagne corks when that happened. So a lot of that came through. With respect to underlying weather, you know it's very difficult to.

Adam Cochrane

But the sun that you had obviously in Q2 I suppose last year…

Dennis Millard

Yeah that helped us and at the interims that's what we said it did help us, the summer was good, strong, it helped cycles sales.

Adam Cochrane

What's your forecast for this year?

Andrew Findlay

We always assume though to be fair…

Dennis Millard

I'm going on weather we assume an average.

Andrew Findlay

Average. So winter average, you know.

Dennis Millard

These were better than average.

Andrew Findlay

And that’s what we do and our job is to trade into whatever weather throws at us, that's our job and our job is to maximise when the weather goes our way, which we were very good at in FY15. So where the weather came good in the summer we maximised it. When the weather came good in car maintenance in Q4 we maximised it.

Andy Cochrane

And structurally do you think that's something that's changed within your business model to enable you to be more flexible to either take advantage?

Andrew Findlay

Online helps. So you can punt out an offer online very quickly when the weather changes and that's our job that clearly it has an impact.

Question 8

Charlie Muir-Sands – Deutsche Bank

One technical question and two more generic ones. The first one was could you just give us the net debt at the 52 week stage or clarify whether the extra week made a big difference in terms of net working capital?

Dennis Millard

Same number.

Charlie Muir-Sands

It was the same number?

Andrew Findlay

Exactly the same

Charlie Muir-Sands

Okay great. And then secondly, still on cycling, you talked about rationalising cycle ranges, can you just clarify what you mean by that in terms of the reduction in range you're talking about and where that comes in?

And then the third question is you said also centre retention rates was still a big opportunity I wondered if you could give some numbers around where you are and where you think's realistic to get to in the medium term? Thanks.

Dennis Millard

Emma do you want to talk about cycle ranges so you get a holistic view of it?

Emma Fox

Yeah so in terms of range rationalisation what we've done is a full analysis of all the bikes that sell, both online and in store, and equally where our gaps are. So we can see a big growth for example in women's and 8+ kids, what we'd call 'Junior' so we're putting more of those ranges into store and to do that we need to rationalise some of the ranges that weren't selling. And that's effectively. It so it's just a constant review really.

Dennis Millard

Sorry and the other question?

Charlie Muir-Sands

Auto centre retention rate.

Dennis Millard

Yeah I'd rather not share the number, that's a more commercially sensitive number, we just feel it can get better but it won't happen overnight, you won't jump overnight because it's all about trust. And bearing in mind that a person probably only comes in once a year, so they remember the last time and so you have to get them the next time around, really wow them with the service and quality that you've delivered for them to come back the next time. So it's a more slower thing that we have to build but we're very focused on it.

And it is an output, it's not an input. It's all about building trust and getting better at it.

Andrew Findlay

A couple of years ago, this one was a bit of a drive of discounting MOTs and really dropping the price down and up and down to bring in. As a result of that you get in customers who might come in for an MOT once and never come back again as a result of the price. What Andy's doing is slowly standardising that price across web and in centres so you'll see now there's a consistent price across all channels - £35 for an MOT – and all of that is about building transparency, trust and that customer who will come back again and again. And it's proven that as you build that retention and that return spend the expenditure goes up and is on that journey now. So you go online you'll see it's a consistent price.

<u>Question 9</u>

Ben Hunt – Espirito

You've mentioned four-year paybacks for your Cycle Republic, it strikes me as quite a long time. You've mentioned the rents so I guess the missing number we're all looking at is the sales densities, do you see yourself having sales densities significantly below your peers, your nearest rival as it were, and if so why?

Dennis Millard

No we don't and when you say our peers who are you measuring us against, the independents, Evans?

Ben Hunt – Espirito

Evans.

Dennis Millard

Cycle Surgery, whoever. No, no we don't and in fact helping us develop these models was Peter Kimberley who actually runs the Cycle Republic business, came from Evans, he was their retail director, so he understands what the competition will look like and what it needs to get to where we've got to get to. We opened up and we're now selling stuff, so we're likely that with some of it's to do with the market and some we're also taking from our competitors so we can't be doing altogether a bad job.

As far as the four years is concerned we'd obviously like to do it quicker than that and I think that's probably on outer edge of what we'd expect, for example in our 50:39s we would be looking for much shorter payback – you'd expect that from an existing business. But we think that that's realistic. We're starting this from nothing and what we're trying to also do is we were hoping that as we stretch more into the enthusiast market, as we broaden our credentials it will have the halo effect on the rest of the Halfords organisation as well which is difficult to quantify.

<u>Question 10</u>

Mark ((?)) – Canaccord

Just on the Autocentres can you maybe talk us through the thoughts on the Croydon trial, what's worked, what hasn't worked?

And you mentioned sub-optimal stores, I think you closed about seven in the year, what proportion of the 305 currently do you think are sub-optimal?

Dennis Millard

Okay on the concept store, I don't know if you've been there, but we tried a number of concepts and you've seen that for example the cubes, the idea that you're not behind a counter, that you're actually interacting with the customer, we believe has worked well. Customers like that. They like the transparency. It takes away a little bit of the fear they have when they take a car into the garage. So that's number one.

Number two is the fact that you can watch your car being worked at, particularly within MOT where you're there, you bring it in, it doesn't take that long to do. Those worked.

The Wi-Fi works and the things which perhaps didn't work was – here's a desk and a laptop for you to work on – most people bring their mobiles in with them so it wasn't needed. The childcare area probably we don't need that, that's a bit of waste of space.

So those are something to do with the customer facing, the fact that you go in, it's clean, it's tidy, it's not over the top but it's somewhere where it's warm and you can sit, read a book, have a cup of coffee, so there'll be a coffee vending machine there that doesn't poison you and so those are the sort of things that work.

Also the colleagues like what they're seeing, the fact that we've got the customers looking, they actually like that. You always worry that they might feel, oh these people are snooping, it's exactly the opposite, actually the opposite. And it makes us raise our game internally. If you know your customers are watching you on the shop floor you've got to make sure that your standards are pretty good. So these are the things that we're going to push in and we'll come up with new ideas as we go along. So we think those are working.

What was the second question sorry?

Andrew Findlay

Sub-optimal. Do I answer that one?

Dennis Millard

Yeah you try that one.

Andrew Findlay.

So yeah we've closed one this year, we anticipate not closing hardly any more this year. So it was a bit of a clean out really of some of them. And that was a combination of where we had the opportunity from a lease perspective, profitability and frankly was it worth the investment to bring it back into standard? No. So net/net we should be between the 10 – 15 and 16 from a net growth perspective.

Dennis Millard

Thank you very much for coming and thanks for attending.