halfords

FY17 Interim Results

Thursday 10 November 2016

Jill McDonald, Group Chief Executive

Good morning everyone, it's good to see you all again. It's now a year since I first presented my thoughts on Halfords and launched our Moving Up A Gear strategy. We did give a detailed report on this in June, and so today I'll give a brief update on progress. What you'll see is that momentum is building and sales are growing well. But foreign exchange has had an impact on our first half profits, but I am pleased with the underlying momentum of the business. More on this from Jonny later, together with the results and financial guidance, before we open the floor for questions. First of all though, I'll take you through a few of the highlights from the first half and give you an update on the two key markets in which Halfords operates.

So, service and services is a USP for us, providing a clear point of difference between us and much of our competition. We continue to focus and invest in this area. Last year we launched a new KPI, service-related sales. This comprises the income we generate from any service activities such as fitting or repair, plus the associated products sold with it. Our aim is to grow this element of sales faster than the total like for like growth, and in Half 1 our service related sales were up 14%.

On to motoring:- our sales grew by 1.1% in the first half, and excluding satnavs were up 3.2%. Dash cams, where we are the market leader, grew strongly along with travel equipment and child car seats as customers increasingly turn to Halfords for our product knowledge, fitting and overall service.

In cycling our like for like sales were up nearly 5% for the first half. The period from late July onwards was particularly strong, helped by new ranges, a competitive promotion, warm and sunny weather for once, and the success of Team GB cyclists at the Rio Olympics, and I am pleased that we saw market share grow over the summer and that our strong cycling performance continued beyond the end of the promotion, and the summer with double digit like for like growth in the final six weeks of the half.

Parts, accessories and clothing, which were excluded from the summer promotion, returned like for like growth for the first time in two years.

So momentum is building as we implement the Moving Up A Gear strategy, and good progress has been made to date. I'll go through each of our strategic pillars in a moment, but to give you a couple of highlights. We have made significant steps in improving our understanding of our customers and can now match 31% of sales to customers, compared to only 3% a year ago. Also, we've launched a number of really great new products and collaborations across motoring and cycling during the period. In May we acquired Tredz and Wheelies, and the business has grown 25% since acquisition on a like for like basis.

Finally, online performance. Group sales were up 30%. The acquisition of Tredz and Wheelies have step-changed our online sales value, and particularly our home delivery capability. But notwithstanding that, our retail like for like online sales grew 7%, and our Autocentre web bookings grew 35%.

So, as you will know Halfords principally operates in two broad markets: motoring; and cycling. Around 70% of our Group sales are generated from products that are principally motoring related, with the remaining 30% of our sales coming from cycling. The motoring market continues to grow solidly. The number of cars on the road is increasing, reflecting growth in both new and used cars. The strong growth in new car registrations in 2015 and 2016 to date provides a good pipeline of cars coming into our target market, which is what we call the second life of the car, and that's essentially cars that are three or more years old.

We continue to see two key trends play out. Firstly, the move from do it yourself to do it for me, and secondly the increasing complexity of cars and car parts. These trends lead to customers needing more on demand services, reflected in the continued increase in the proportion of products that we sell that are fitted onto customers' cars.

Another feature of the motoring markets in which we operate is that they continue to be very fragmented, particularly in the aftercare market where Autocentres operates. Autocentres is the largest chain offering a full suite of services, yet has just 1.5% market share. We continue to anticipate that the motoring market will grow at a rate of 2% - 3% per annum on average over time, and we will strive to beat the market growth rates, and are confident that there is more to go for.

Moving on to everybody’s favour subject cycling 2015 was a soft year for the market in comparison to the preceding two years for reasons we've covered in detail previously. Now we've seen a gradual stabilising of the market since then, although the weather continues to bring volatility over short periods. After a weak start to the summer season and due to remaining high stock levels, there was heavier and earlier discounting in the market than in previous years. This, combined with favourable weather and Team GB's success at the Rio Olympics, helped the cycling market to pick up in the latter part of the season, reducing the levels of stock in the market.

With like for like growth of nearly 5%, and the acquisition of Tredz and Wheelies, our total cycling sales grew over 15% for the first half, strongly growing our market share. Importantly, for the market leading position of Halfords, the growing presence of Cycle Republic and the acquisition of Tredz and Wheelies, we can now meet the needs of all key customer segments in cycling. We continue to anticipate that the cycling market will grow at 3% - 5% per annum on average over time, driven by new customers entering the market and existing customers spending more.

Last November we launched our Moving Up A Gear strategy aimed at investing to modernise the business and drive sustainable long-term growth. Progress has been good and I am pleased with the moment that is building, and I'll step through each of the five pillars in turn.

Our first pillar is all about service and services. In April we updated our pay structures to reflect the national living wage, at the same time taking the opportunity to make a few other improvements to our awards and benefits package. Colleague retention in retail has further improved with colleague turnover at a record low of under 35%. We are now at target levels of Gear I, II, III attainment in retail, with around 70% at Gear II, and the equivalent of two Gear III colleagues in most stores.

In Autocentres we have introduced a new technician grading pay scheme using similar principles the to the Gear's programme in retail and we are also introducing hybrid and electric car training to keep our colleagues at the forefront of technological capability, which is a key point of difference to many of the independent garages against which we compete.

We continue to invest and focus hard on our services, and we now have over 30 instore services across motoring and cycling. We added motorcycle bulb and battery fitting and windscreen chip repair earlier this year. Our expert colleagues and growing customer awareness helped lift service related sales by 14% in the first half.

Our second pillar is better shopping experience. We launched cyclerepublic.com in August, and also opened two new Cycle Republic stores during the first half: Purley in South London; and Birmingham, and we anticipate opening a total of up to five this financial year. Our Group cycling capability has also been boosted by the acquisition of Tredz and Wheelies, adding the top end cycling brands to the Group's portfolio as well as strong online and home delivery capability.

We have now rolled out contactless and mobile payments in stores, and in September around 20% of payments in retail were made using these improved payment options. We've also changed the way in which we develop our retail and Autocentre's websites, moving to an agile approach to web development, and that's enabling us to speed up improvements to our websites.

We've refreshed 12 retail stores in the first half, and our new Store of the Future concept is progressing, and a pilot refresh will be complete at the end of the month to test out various elements. We anticipate refreshing a further three stores in the new concept style by the end of Full Year 17, and then accelerating the rollout in Full Year 18. Some of the features that we'll be trialling in the first trial store will include a park up and relax lounge for customers using refit services and bike repair, with phone charging points and coffee; a dedicated hub for trade customers; and colleague headsets to support faster knowledgeable service. We'll also be introducing electric car charging points in the car park, and smart bike fitting technology to ensure customers get the most comfortable bike fit. We'll also be testing new in-store communication and design principles, including making more of a shop-in-shop shop feel in each of the motoring and cycling departments, and there will be updated external branding.

In Autocentres we have refreshed 12 sites during Half 1, and opened a further two new centres. The extended opening hours are embedded and have been positively received by customers. Our investments in online and in particular mobile have helped improve the customer journey online, driving that strong growth in web bookings. We are operating the same agile approach to web development for Autocentres as we are in retail, resulting in those quicker website improvements.

Our third pillar is building on our uniqueness. In recent months we have launched a number of new products and collaborations many of which are exclusive to Halfords. The new collaborations with Sir Bradley Wiggins and Laura Trott went live in July in readiness for the Olympics. Also within cycling we relaunched our Apollo and Carrera mainstream ranges for adults for the first time in several years, and these new ranges and collaborations performed well, contributing to the strong cycling sales.

In motoring we launched a new Orla Kiely range of camping and travel accessories, as well as a new motorcycling parts and accessories range. As market leader in dash cams we continue to bring new products to the market, often with exclusivity. Our dash cam fitting service is proving popular with customers, providing a differentiating factor between buying your dash cam at Halfords rather than an online-only retailer.

We've also increased our focus on Trade Card, adding new product ranges and enabling the cards to be utilised online. We've added thousands more customers into our Trade Card offer, and sales of products using Trade Card were up 9% in Half 1.

Our fourth pillar is about putting customers in the driving seat, and in June we launched our new brand positioning, Halfords 'For Life's Journeys' across multiple customer touch points. The new campaign has captured attention, particularly amongst younger consumers. Phase one of our single customer view project has been completed, linking our retail, Autocentres, online and multiple other databases, in fact 15 data sources in all. We've also added nearly two million customer email addresses, and in retail we can now match 31% of sales to customers, compared to 3% a year ago. This enables us to tailor our email marketing campaigns much more effectively, highlighting products and services that may be of relevance to them.

But it's not just about sales, it is also about building awareness of our service proposition. For example, if you buy a bike from Halfords and opt for the e-receipt, you will now receive a reminder email for your free six week bike check. We've also changed the way in which we collect our net promoter score feedback. We've increased the channels through which we gather customer views to ensure we gather as much feedback as possible, and this is giving us much richer customer insight into our service offering.

Our final pillar is fit for the future infrastructure. In June I highlighted the two major IT projects that we were embarking on. Firstly, the till hardware and software project which we've now called iServe. Secondly, our colleague resource planning system which is called Dayforce. Both are now in pilot stage, with full rollouts across the retail and Autocentres' estates commencing towards the end of the financial year and running through the early part of Full Year 18.

In retail, the benefits of iServe include mobile transactional tills, more automated in-store processes which free up colleagues to spend more time with consumers, and a booking system for our 'We Fit' and bike repair services. In Autocentres it will improve booking functionality, provide better control over part sourcing, and enable centres to hold and sell retail products.

Dayforce replaces multiple people management systems with a new cloud-based tool. For colleagues it gives the ability to access their shift patterns anywhere at any time, and swap hours or book holidays for example. For our store managers it reduces admin tasks, freeing them up for more value-added activities. It also enables us to more effectively match rotas to customer demand.

In supply chain we have a stable three day a week delivery to store transport model, and this has been in place for over a year now and is working well. We have since been reviewing our warehousing requirements and recently signed an agreement to consolidate numerous external storage warehouses into one site in Daventry and this will improve efficiency and customer service levels.

Now we've also been running a process efficiency programme called We Operate For Less for a couple of years now, and last year we talked about the changes to the bike building process. Since then we've landed a number of other improvements, including a stock put away process, that has saved 80,000 colleague hours in shops over a year.

Another initiative is the Click & Collect cabinet, and by installing these at the front of shops we have made Click & Collect quicker for customers and saves time for colleagues, a nice win/win.

So in summary then, a strong first half sales performance with growth across all of our businesses. Our focus on and investment in services was reflected in the strong growth in service related sales in the first half. We continue to gain market share in both Motoring and Cycling.

The addition of Tredz broadened our cycle customer offer and the business has performed very well since acquisition. And I'm pleased with the momentum building as we implement Moving Up A Gear. There is demonstrable progress across each of the five year pillars of the plan and more to come in the year ahead. I'll now hand you over to Jonny.

Jonny Mason, Chief Finance Director

Thanks Jill, good morning everybody. I've been with Halfords now for just over a year and I can certainly confirm my initial impressions which were that it's a great business with a wonderful team of colleagues, really engaged and passionate about serving our customers and evolving to meet those fast-changing needs.

So I'm now going to take you through the Group's financial results for the first half and then say a few words about financial guidance and targets.

So Group revenue was up 6.3%, based on like for like growth of 2.2% which improved steadily through the first half year, plus additional sales from the acquisitions of Tredz and Wheelies and new estate growth in Cycle Republic and Autocentres.

Now profit was lower this year than last because of a reduction in gross margin, so gross profit grew slower than sales at 1.5% because of a combination of FX impact, mix into the lower margin Tredz and Wheelies business and lower retail trading margin. So the FX impact was the biggest of those three, increasing costs by over £6m, and that's more than the reduction in profit year on year. And we'll look at FX more later on.

Operating costs increased 4.5% as we continued to invest in colleagues and infrastructure for sustainable long-term growth, and so PBT was down 12% at £40.8m.

So let's look at the retail business first. Like for like sales grew 2.5% which comprised 1.1% in Motoring and 4.6% in Cycling.

Car Maintenance was up 1.8% led by car parts, bulbs, blades and batteries, our famous three Bs, and the associated fitting services as well as new ranges of parts and accessories for Motorcycle.

Car Enhancement decreased by 3.5% with strong growth in dash cams, not quite enough to offset the continuing sharp decline in satnav. And then Travel Solutions increased 7% from higher sales of roof boxes and bars, cycle carriers, and especially, child car seats.

Cycling started the year weaker because of the adverse weather in the first quarter but finished with a strong performance. Sales were up 4.6% like for like and over 15% in total, benefiting from our unique and new ranges, our competitive summer promotion, a successful Olympics for the Team GB cyclists, and favourable weather in the late summer. And then the strong sales growth continued beyond the end of the promotion into autumn.

Cycle Republic delivered strong double digit like for like growth and the Tredz and Wheelies businesses have grown their sales by 25% year on year since acquisition.

Now looking at the Retail P&L. Revenue increased in total by 6.8% but, as with the Group numbers, profit was down because of the reduced gross margin. Gross margin was down in total 275 basis points and operating costs were up 4%. But excluding Tredz and Wheelies the Retail gross margin was down by a bit under 200 basis points and operating costs increased by 2.5%.

We'll look at each of those in turn now.

So the margin enhancing service related sales continued to grow faster than overall sales, however this was more than offset by a number of margin dilutive factors, firstly Tredz and Wheelies acquisition as I've mentioned, this has a higher transaction value and contributed good sales and cash to the Group, but at a lower gross margin rate. And this mix effect accounted for 78 basis points of the 275 year on year decline.

Secondly, FX. Our hedged rate for US dollars this half year was 146 versus 156 in the prior year and this increased cost of goods by approximately £6m and reduced margin by a little bit over 100 basis points. Again, we'll come back to FX later.

So the remaining decline in margin of just under 100 basis points resulted from the ongoing sales mix into Cycling, which is growing faster than Motoring, but mostly it was because of the summer Cycling promotion. Now as previously described our competitors began discounting earlier and deeper this year than in previous years in order to clear excess stock. We didn't have a stock problem but we decided to follow the promotional stance in order to continue to offer strong value for money to our customers.

Now operating costs were up 4% in total or 2.5% excluding Tredz and Wheelies. Store staffing costs were up 7.1% reflecting increased pay rates including the National Living Wage, the annualisation of Gears training premia, increased sales volumes and the opening of five new Cycle Republic stores. Now we've now reached the target training levels for our store colleagues so this cost growth factor will be lower going forward.

Store occupancy costs decreased by 0.6% as negotiated rent reductions continued to offset inflation in utilities and rates. And warehouse and distribution costs decreased by 5.7% and it was around this time last year you'll remember we moved from an in-house five day a week delivery schedule to the more cost effective outsourced three day a week delivery schedule, and this has proved to be very successful. Availability and service from the supply chain has been good and at a lower cost. And finally, support costs increased by 7% which reflected mostly increases in marketing cost.

Just a few words on Tredz and Wheelies which we acquired in May for an initial cash consideration of £18m. As a reminder, Tredz is predominantly an online retailer of premium bikes and packs whilst Wheelies is the UK's largest provider of replacement bikes for insurance purposes. They sell, among other things, the major cycling brands, including Giant, Specialized and Cannondale and the sales are split roughly 70% bikes, 30% packs and 88% is delivered direct to home.

Now the performance since acquisition has been very strong, with sales growth of 25% year on year, so the company contributed £16.5m to revenue in the first half since acquisition and has been accretive to profit from the outset, so we're very pleased with Tredz and Wheelies.

Now onto Autocentres. Revenue increased by 3.6% year on year with a like for like increase of 0.9%, and online booking revenue was up 35%. Gross margin improved by 38 basis points. A slight increase in the mix towards lower margin tyres was more than offset by improvements in margin on service, maintenance and repair work.

EBITDA of £3.7m was 12.8% lower than last year as the improvement in gross profit was offset by higher operating costs and we continue to invest in the people, in training, in systems and in new and refurbished Autocentres to improve the customer proposition and to drive long-term growth.

Moving to cashflow. Free cashflow was £24m in the period compared to just under £20m last year. Working capital was adverse, and this is mostly because of an increase in stock. On a constant currency basis our stock was broadly flat, but the deprecation in sterling increases the cost of our stock in pounds, and this will continue as our hedged rate of pounds to dollars declines and so cash generation will be temporarily reduced until that impact has flowed through.

Capex was £15.5m, £2m down year on year due to the timing of projects and Group net debt finished the half year at £64.8m which was 0.6 times EBITDA.

For the interim dividend the Board has approved an increase of 3% reflecting the strong underlying performance of the business, the progress on implementing the growth strategy and continuing confidence in future prospects for the business.

So now a quick update on some of the specific current year pieces of financial guidance.

We continue to anticipate Group capex to average £40m a year over the next few years, however we now anticipate this year will be about £40m rather than the £45m we guided previously and this is just due to the timing of initiatives. And that means we anticipate that the Group's depreciation and amortisation charge will now be about £32m rather than £34m.

There's no change to the guidance on finance costs or tax charge and we anticipate PBT for this year will be in line with market consensus.

Turning to FX. So we purchase around $250m each year and about two thirds of that is for cycling products. We're now fully hedged for FY17 at a rate of about 141 and we're currently about 25% hedged for FY18 at a rate of around 137.

So this change in FX rate will bring a significant increase in costs for us, but as you would expect we've been working hard on mitigations and we're making good progress. So the opportunities include working collaboratively with suppliers to secure support, includes costs and process efficiencies such as near sourcing which are a longer timescale but nonetheless promising avenue and then of course price. The increased cost in pounds, especially in Cycling, will affect the whole market over time. We are better placed than most smaller players to manage these costs,

So we anticipate that the pricing the market will increase. The uncertainty is about when rather than if. So we'll monitor the pricing in the market very carefully and we'll continue to provide the very best value for our customs compared to competitors.

Now this increase in cost from FX has started to take effect in the first half and it will intensify into the second half. However, as I've just said, we're comfortable with how the market has assessed these impacts and therefore we're comfortable with the current market consensus for PBT.

Our four medium-term financial targets are unchanged.

To recap:

- To grow sales faster than the markets in which we operate
- To maintain EBITDA margin broadly flat as we reinvest for growth
- To grow the dividend per share every year with a coverage of 2x on average over time
- And a debt target of 1x EBITDA with a range up to 1.5 to allow for appropriate M&A

But it's important to note that the impact of the FX movements will reduce EBITDA margins and dividend cover temporarily until those impacts are mitigated, which will take some time, but we're confident we can do it, and other than that temporary FX impact, there's no change to these financial targets.

Our capital allocation priorities also remain unchanged, as set out on the slide. And we continue to anticipate moving towards the debt target over time, but there's no rush, and our clear priority remains to invest to deliver the *Moving Up A Gear* strategy.

So finally, in summary good first half sales growth, in particular Cycling and Online. A decline in gross margin in retail caused by mix from acquisitions, FX impact, faster sales and promotion in cycling, but good cost control, whilst continuing to invest in colleagues, shops, IT and online to deliver the strategy.

Good cash generation with the interim dividend up 3% and net debt at the end of the period at 0.6x EBITDA, so a strong balance sheet.

The depreciation in sterling will increase cost of goods, which we've already started to see. However, we're making good progress on a number of mitigation opportunities and we're comfortable, therefore, with the consensus PBT.

And finally, we reaffirm the financial targets and capital allocation priorities that we've previously communicated.

Thanks very much for your attention and I'll hand back to Jill.

Jill McDonald

Thanks, Jonny. So, to wrap up, the sales performance in the first half was strong with growth across all of our businesses and market share gains in both Motoring and Cycling. And we continue to make progress in improving service and services. Whilst the movements in foreign currency impact on reported earnings, the underlying business performance is strong and we remain confident in the long-term prospects for the Group.

One year on since the launch of our Moving Up A Gear strategy and I am pleased with the momentum that is building. There is demonstrable progress across each of the five pillars and lots more to come.

So, overall, a solid step towards modernising Halfords and driving long-term sustainable growth.

So, thank you for your attention and Jonny and I will now take any of your questions.

<u>Question and Answer session:</u>

<u>Question 1</u>

Unidentified speaker

On cycling, 3% to 5% growth for the market, could you just give us a bit of granularity on that? Is that coming from bikes or packs? What are the building blocks to the 3% to 5%?

Cycle Republic, I seem to be guided to upping my spend to get on to finance. Could you tell us what the percentage of finance on the website is and just a few comments on that?

And just a bit of a cheeky one, where is the pilot store?

Jill McDonald

I'll do that one first, that's easy! Derby, opening towards the end of November.

If I take the first one and, Jonny, if you take the second one. The building blocks between 3% to 5%, we think there are some structural pieces in the market which will drive future growth, so just to try and disaggregate those. There's only around about a third of Brits that cycle, so we think that there is a penetration opportunity. We are also seeing that the more enthusiastic cyclists are cycling further and buying second, third or, in some people's cases, fourth or fifth bike, so we think that existing customers will buy more bikes.

What else is going on is investment in infrastructure, so you only have to drive around London and see all the cycle lanes that have been invested in and that is spreading to other cities as well. So the government are investing in infrastructure to support commuting to work. That also coincides with the growth of electric bikes. Now those are still small, as an overall proportion, but I think we're beginning to see a tipping point with more and more customers asking for those, both older customers, who are trying to get fit – and I would hesitate to say over 55s because I'm sliding into that category! – so it's slightly older, but still very young at heart consumers, wanting to get fit. But also commuters, because obviously you arrive at work a lot less hot and sweaty and bothered if you've been on an e-bike, so that's fuelling growth.

We're still underpenetrated with women cyclists compared to other markets in Europe, so we think that there is an opportunity there as well, so that is what is giving us confidence that in the long-term there are some really good structural reasons why cycling will continue to grow, and health being the other one. When we talk to customers, even if you're cycling just occasionally for leisure or commuting, there's still an element of people wanting to get a bit fitter and a bit healthier, and we all know that trend is going to be around to stay.

Unidentified speaker

So that sounds it's the pure volume of bicycles sold?

Jill McDonald

And a bit of value, as well, and a bit of value for sure. Do you want to answer the cyclerepublic.com proportion?

Jonny Mason

So the question was interest-free credit online?

Unidentified speaker

In Cycle Republic, yeah.

Jonny Mason

It's very early days for Cycle Republic, so we've not got a proportion at the moment. We've only just introduced interest-free credit on Cycle Republic. It was introduced only a few weeks ago.

Unidentified speaker

What about including the stores then?

Jonny Mason

What we've got is across all of the Tredz, Autocentres, Halfords and Cycle Republic, interest-free credit is increasing as a proportion. It's not a big proportion at the moment and it's well below half, below a quarter. I haven't got a precise percentage for each of those channels. We can get back to you with that, but it is something that we are seeing growing.

<u>Question 2</u>

Anita, Citi

Firstly, just on the FX, so a £6m hit this year, can you just remind us what the hedging rates are comparable in the second half?

Secondly, I'm not sure if you'll be able to give any details on this, but if I've understood correctly, you probably have ordered for next year's cycling peak by now, or close to what have been your thoughts around thinking about what the UK consumer demand might be like?

And maybe just anything in the past of what you've seen with this kind of lag in terms of pricing inflation in the market in general and across your competitors.

Jonny Mason

So to your first question, for this year – I think that's the best way to answer it – we are expecting our hedging rate to be 141 and that compares to full year, last year, of 155.

In terms of impact on margin, what we anticipate is that the reduction in margin in the second half will be roughly equal, year on year, to the reduction in margin in the first half. We don't anticipate a similar impact from a cycling promotion in the second half, but on the other hand, the FX delta will accelerate, but all of that is within the context of we do think the market consensus for profits is about right.

And then in terms of pricing, I think I said it's a question of when and not if. When there was a substantial depreciation of sterling against the dollar previously, which was eight years ago or so, it was the case that cycling prices increased in the market. And they sort of have to because all of our competitors have no balance sheet to absorb anything.

Anita, Citi

Do you have anything on how long it took for that, of that's what you think?

Jonny Mason

I don't think the last time is necessarily a good indicator of this time and we are living in a competitive retail world. We don't want to be too specific about timing. We do think it will happen, but we'll play it tactically and competitively in terms of timing.

Jill McDonald

To your question on how we're thinking about customer demand over the summer coming up, so we haven't quite got a crystal ball – it would be handy at the moment! – but we think that with all the discounting that has gone on over the summer that the stock is in a better position across the market than it was a year ago. So I would hope that the discounting will not be as heavy next summer and we're certainly not planning, at this moment, a 20% off deal next summer, and Jonny's articulated some of those cost challenges that are coming through on the cycling side.

So we're not planning on a 20% off deal and we have looked back at what has happened in cycling, when there have been previous recessions. As Jonny said, it's not the best guide because life is a bit different now, but actually cycling volume held up. And I think that there are, for the reasons I was talking about earlier, some strong structural reasons why the outlook for cycling is good. However, we will see how those cost impacts play through in terms of what competitors will do, but we are better placed to withstand the pressures.

<u>Question 3</u>

David Jeary, Canaccord Genuity

I just wanted to ask a question really around the CRM and the piece and how that's playing going forward. You've obviously made good progress 3 to 31 and a couple of questions around that. How much faster is that going to go, going forward, and when and how, when will we looking in from the outside, will you be able to see what impact that's having on the business?

Jill McDonald

I'm not setting an absolute target on what I'm aiming at. Some retailers are up at 80%, so I think there's still plenty more to play for in terms of gathering email addresses and contact details for customers, so there's still growth to go for.

We are already seeing incremental sales come through on different marketing campaigns. So to give you some examples, we now offer, once you have given your email address, we've been able to obviously then analyse what you've bought with that, once you've handed that email address over. And we then have a recommender engine, which is very clever algorithms that other people do, that can then predict what an appropriate next purchase would be for you, so we can offer that proactively to customers and we're seeing an incremental sales benefit off the back of that.

We are looking at when we recognise you, because we have your email address, and you are, for example, online and you're putting in your vehicle registration number, that enables us to understand when your next MOT is due, so we can do a Halfords prepare for your MOT, make sure your bulbs and blades and batteries are up to snuff, we can provide a deal on that or just as a prompt. And then Autocentres can follow up with, 'And here's a deal on your MOT.' So as well as there being opportunities within Retail, there are opportunities across the Group that we are already seeing generate incremental sales.

Question 4

Matthew McEachran, N+1 Singer

Can we just go back again to the FX headwinds and your mitigations; you've got a three-pronged approach to dealing with those mitigations, at this stage, do you have a sense of how much of the headwind you can mitigate with the first two, i.e., how much is left to deal with on price?

Jonny Mason

Not really at the moment. It's a long way out, FY18, still, and we're working on the plans very hard and we're starting to see benefits, but we haven't got specifics between those three buckets how it will play out.

Matthew McEachran

Thank you. And, Jill, just going to the rebranding or the brand repositioning efforts, obviously the capabilities of the business are improving and increasing, what have you done so far? What is the timing, what are the milestones going forward and when will customers really be encouraged to visit to see all of the new services and capabilities? Presumably it's been more of a soft start, so if you could just give us a time frame.

Jill McDonald

Yes, that's a good question. So what we haven't done is, in our stores, rebranded everything. That would not be a great use of capital. So we will be, as we refresh the stores – akin to the Story of the Future that I outlined – that is how customers will see some of the tangible touch and feel elements of the new branding.

All our advertising and marketing comms have been developed around the proposition of Halfords for Life's Journeys, and that's against a purpose of helping our customers make the most of their journeys, which is a good unifying thought across the Group. And that's already been executed in our marketing and getting good feedback from our customers.

But the most important thing, I think, that we can invest in to ensure that customers day-in and day-out get a great experience from Halfords is the colleagues and the training. So as we look out next year and we look at the cost mitigations that Jonny was talking about, one thing I'm absolutely committed to is ensuring that we continue to invest in colleagues and the training and the service that they give our customers, because that's our USP and that is really the most tangible way that our customers will see the manifestation of the brand.

We've just actually gone onto television with three different TV spots – I think they were playing actually in the coffee room – which talk about and support our wefit services. So, we know we've still got opportunity to build awareness particularly amongst women that we offer those services.

Question 5

Simon Denison-Smith, Metropolis Capital

On PACs you state in the past that your market share is lower than your cycling market share. What's the progress being made in addressing that and what plans do you have in the future?

The second question is, could you comment a bit about Halfords' marketplaces, how it's doing and what the strategy is there?

Jill McDonald

On PACs really pleased to see for the first time in two years PACs' sales growing and growing profitably. So, that has really been as the result of two things: firstly a lot of work on range and ensuring that we've got the right range in store for Halfords' customers. But also we have been more actively price matching on branded products online. PACs' customers are much more price conscious, even the higher-end PACs' customers it's very easy to go online and look at branded products and price match. So, that has been part of the strategy and that has been working well for us, so we'll continue with that approach.

Simon Denison-Smith

Sorry, just on that, do you see it possible to get up to the 25% ((0:46:52?)) cycling within PACs?

Jill McDonald

There is definitely more to go for. I'm not going to set a target of 'I'm going to go for the same market share on bikes', but we are making good progress. And I'm pleased particularly that it's been built and building over the last few months as well, so I'm not going to set a target on it, but I clearly see opportunity to grow.

And on marketplaces, Halfords' marketplace what we're really using that channel for is a way of testing out new products from different suppliers before potentially bringing them into shops. So, it's a really nice way of almost doing live market research. And we've probably brought in about 20, 25 products in the last few months that have done really well online in terms of marketplace and brought them into shops. That's really the key role that we see for the marketplace channel.

<u>Question 6</u>

Toni Shiret, Haitong

Excuse me if these are dumb questions; I don't really know you as well as some of the experts in the room. A couple of things. The labour scheduling day force is it fully in place at the moment? And when it is fully in place what sort of cost savings do you think you'll be able to get through that versus the service increases you're putting in?

Secondly on buying on bicycles: first of all I don't really know how you buy bikes. Do you buy the whole lot in one go or is there some sort of flex in the operation? Do you have like an open-to-buy system? And if there is no flex in the system can you tell us, in answer to the previous question actually, what your volume buy is for next summer, because you've probably done that already?

Lastly, in terms of the type of positioning you're looking for in bikes next year versus this year, bearing in mind there might be some impact on consumer demand, are you going for a lower market positioning in terms of your bikes or not?

Jill McDonald

Labour scheduling is in pilot at the moment. We're in about 20 shops and that is performing well, and Autocentres as well. So, so far so good, and we will be rolling that out, all being well, from January. So, we're not putting a quantification externally on that; it will be hopefully over £1m worth of cost savings, but we need to see how that actually plays through in reality. But it's certainly something I've seen play out very well in a previous role so high hopes for that.

Jonny Mason

Then on the bike purchasing we do have some flexibility; we do operate open-to-buy. But there are lead times in the system. Our bikes are coming from Asia so there is a certain lag to the time through which we can apply that flexibility. We are in a better position than most others in the market because we have the capacity to talk directly to the factories that are making our own-brand bikes, and most of our bikes are own-brand; and also we have the capacity to hold stock should there be short-term fluctuations because of weather or whatever other factor. Many of the independent bike shops, which comprise the majority of the market, just don't have that same capacity to manage volumes.

In terms of bikes next year versus this year, we're not planning for a significant change in volumes. The work that the cycling teams are doing is to evolve and improve the bike ranges with we saw the innovation of new bike ranges this year: Boardman's going very well; Wiggins is going very well; next year we expect to see more e-bikes than we saw last year. So, there's a lot of work and a lot of changes reinforcing our uniqueness and the newness of the ranges. But we're not planning on significantly lower volumes.

Toni Shiret

But trading up the overall range?

Jonny Mason

Well working on up and down. Not a conscious trading up; an improvement.

Jill McDonald

One of the features of the Group, which the acquisition of Tredz & Wheelies has enabled us to do, has now being able to meet the needs of all cyclists, whether you're coming into the market for the first time, possibly inspired by the Olympics, possibly just because you want to get healthier, fitter, and I want us to be competitive at that end. But we have got, through the acquisition of Tredz & Wheelies, through the deployment of Cycle Republic, we can meet the commuter as well as that high end.

So we have been seeing this year premium bikes doing particularly well. Over the summer mainstream really started to get going again. So, we would anticipate we would be competitive in each of those customer segments.

Toni Shiret

And just finally the rough proportion of open-to-buy in the total buy?

Jonny Mason

We don't get into that. We are planning on the same sorts of volumes as we had this year, and we have the capacity to manage it flexibly.

<u>Question 7</u>

Andy Wade, Numis Securities

Probably going for boring question of the day award here: 100 basis point due to FX on just under £500m of sales, how do you get to six million?

Jonny Mason

Well, it's half a year.

Andy Wade

£500m sales in the half year then, and you said there was a 100 basis point impact on gross margin.

Jonny Mason

That's right. First of all you've got to look at how many dollars we bought, which was in the first half just over $100m. And if you apply a ten basis points move to $100m of US dollar purchases then you'll find that the margin impact on the 487 or whatever it is of sales is about 100 basis points.

Andy Wade

It is 100 basis points on £500m; I don't see how you work back to… anyway, okay. If we look at the core business, strip that out, you said that's obviously been a big impact in terms of where the half has gone, that FX number, and I can completely appreciate that; something which is largely outside of your control. Even if you add that all back and give you the benefit of that, once you strip out the benefit of Tredz & Wheelies, a million and a half or whatever that was, you're sort of flat to slightly down year-on-year anyway. Why is it we're not seeing a little bit more progress, because it wasn't a bad half in terms of the backdrop of decent weather for cycling, why are we not seeing a bit more? You talked about building momentum on the sales side; why are we not seeing that come through?

Jill McDonald

Do you want to talk about costs in the first half, because we're still annualising over investments in colleagues basically? So, there is an element of cost in the first half as we continue to invest in the Gears programme and the number of colleagues we have at higher Gears levels, so that is building in more cost in the first half than we'll see coming through in the second half and actually beyond that.

We've also had to implement the national living wage. So, there have been a number of cost pressures that have been built into the numbers.

Andy Wade

And looking ahead, the Gears element rolls away somewhat, but you are introducing Moving Up A Gear, aren't you, so there's still going to be inflation coming through from that, isn't there?

Jill McDonald

Yes, there will be some inflation coming through. But in terms of the big impact it's really forex looking out.

Question 8

Simon Denison-Smith

You talked about the rollout of the wefit booking service; could you just elaborate a little bit more on the timing of that? And what you think your turn away rate is currently from people not finding access to the staff that actually do the services?

Jill McDonald

The online booking will probably come in towards the middle of next year because we need both the workforce scheduling and the iServe pieces to join up; although in store in the future we have actually got a little test of that going on so we can see what customer demand is.

It's difficult to accurately say, put a figure on what the turn away of service is. Actually I'm not sure that's the issue really, the opportunity is really around growing awareness rather than we're not meeting the demand that's through lack of colleague availability. I think it's more about stimulating demand and being able to offer the customers the choice of 'turn up on demand' and hopefully you only have to wait ten, 15 minutes at the most – but that's still quite a lot of time for some people. So, if you can book a slot, if you like, to come and visit us that might appeal to other consumer groups.

Jonny Mason

Just coming back on the basis points question, it's just the arithmetic you're asking about?

Andy Wade

Yes.

Jonny Mason

We were using broad numbers. I think what I said was that the FX impact was the biggest: it was more than half of the 200 basis points, so it was a bit more than 100 basis points, and the other commercial margin was a bit less. And the six is a rounded number.

Simon Denison-Smith

125, 75, that sort of thing?

Jonny Mason

Yeah, around 120 or thereabouts. It was meant to be indicative.

Jill McDonald

Any more questions? Thanks very much for joining us. We'll pop in next door and have a coffee if anybody wants to carry on the discussion. Thank you very much.