halfords

FY16 Preliminary Results

Wednesday, 1st June 2016

Jill McDonald, Group Chief Executive

Good morning everyone. It's good to see you all again.

So I've now been in my role for just over a year and a lot has happened in the course of 12 months. I am thoroughly enjoying leading Halfords, and having spent my early days in learning mode, I now have my feet firmly under the desk and remain excited about the many growth opportunities we have to grow this business.

So, as to the order of the day, firstly Jonny will take you through our financial performance in Full year '16. I'll then take you through a brief operational review of the year, before focusing on an update of strategic progress. Jonny will then walk through the forward-looking financial guidance and the update on capital structure, and we'll then be happy to take your questions.

But before we dive into the detail, I will just share with you some of the highlights from full year '16.

It was a solid service-led sales performance and we grew market share in both Cycling and Motoring. And despite that being a challenging year for Cycling, we remain confident in the long-term growth prospects for the cycling market, and I'll explain more a little later.

I'm delighted with the strong improvements we have made in both customer satisfaction and key colleague metrics. However, the job to modernise Halfords is not yet done, and we are making good progress on our *Moving Up A Gear* strategy.

Finally, we announce today our debt target of 1x EBITDA, with a range up to 1.5x EBITDA for appropriate M&A. And we reiterate our capital allocation priorities.

I will now hand over to Jonny.

Jonny Mason, Chief Finance Director

Thanks, Jill, morning everybody.

For me it's been nearly eight months now and I've really loved being at Halfords. As well as learning my way around the numbers, I've been out and about in the shops, the Autocentres and the DCs, and the most striking thing about Halfords for a newcomer is what a fantastic set of colleagues we have up and down the country. Real passion for the business and for the developments we're making, in product innovation, and especially in the delivery of services.

Now let's have a look at the results for the year. So group revenue was up 1.7%, which was 1.5% like-for-like. And group gross margin was broadly flat, with the expected decline in Retail offset by a gain in Autocentres.

Operating costs grew in line with sales, and as such, EBIT was basically flat year-on-year. Now that included a higher depreciation charge from the capital investment programmes of recent years, so excluding that, EBITDA improved by 4.3% and margin was slightly ahead of our previous guidance at 11.2%.

Finance costs were a bit lower because of the reduction in average net debt and a lower interest rate. And the tax rate improved, resulting in an increase in earnings per share of 1.5%.

Now the comparatives that we're showing here, and throughout, are for the pro-forma 52-weeks to the 27th March 2015, because last year was a 53-week year, and they're also stated before non-recurring costs.

In FY16, we had £1.7m of one-off costs from organisational restructuring to align our team with the implementation of the new strategy *Moving Up A Gear.*

So for the Retail business, revenue was up 1.2%, and that was lower than the like-for-like of 1.3% because of the impact of the weaker Euro on Republic of Ireland sales.

The Retail gross margin fell by 30 basis points, in line with the first half year, and this was at the better end of last year's guidance of a 25 to 75 basis point decline, because the growth in the lower margin Cycling was less than the growth in Motoring.

Operating costs increased by 1% and we'll take a look at that shortly. And so EBIT of £81.8m was 1.1% below the prior year, again because of the increase in depreciation, and EBITDA increased by 3.5%.

Now Retail revenues. Like-for-like, calculated at constant exchange rate, was 1.3%, and in that, Motoring was up 2.5% and that represented two thirds of our Retail revenues.

Car Maintenance increased 3.4%, with the growth in sales of car parts and workshop products more than offsetting the decline in winter-related products because of the unusually warm weather in winter.

And the fitting of bulbs, blades and batteries, our famous 3Bs, continued to grow, helped by colleague training and new innovations, such as the 130% brighter bulbs.

Now Car Enhancement increased by 1% as dash cams and in-car connectivity grew strongly, reflecting Halfords' authority in these categories. And for the first time, those more than offset the decline in satnav sales, leading to the growth in the category overall.

And Travel Solutions grew by 2.8%, mostly because of child seats and camping equipment.

Now in Cycling, there was a decline of 0.9% for the year because of the weak summer last year.

In November, we explained the performance in Q2, but as a recap, the decline reflected particularly strong comparatives, exacerbated by poor weather, and there was discounting across the market, annualising against the Yorkshire Grand Départ of the Tour de France. And in the second half we've seen Cycling return to modest growth.

Now within Cycling, bikes' growth was positive. Cycle Repair grew strongly, but in PACs, Parts, Accessories and Clothing, sales did decline, as we said last time, this is an area of focus for us to improve in the medium-term. And the first next step is the launch of the Cycle Republic website in a few weeks time.

Now online sales grew in line with the like-for-like sales, remaining at about 12% of the total, and we continue to see around 90% of those sales collected in-store, emphasising the integrated nature of our offer.

And service-related sales, which includes the income from the fitting and repair services themselves, along with the product, grew by 8.5%, so significantly ahead of the total growth, and this is an area we will continue to push.

Now looking at opex, the increase was 1%, at the lower end of the guidance given in January. Store staffing costs did increase 3.3% due to the combination of the anniversary of the uplift in National Living Wage, and also the *3-Gears'* training premier. But these were partially offset by improvements to in-store processes, such as bike building, stock put-away and cash counting.

Store Occupancy costs decreased by 0.7%, as the increases from rates and depreciation and store development were more than offset by reduced rental charges from lease negotiations.

And then Warehouse & Distribution costs increased by 5%. The year began with in-house five-day-a week-delivery, before switching to the more cost efficient outsourced three-day-a-week schedule at the beginning of August. So after three previous years of double-digit increases in Warehouse & Distribution costs, we now have a stable solution that is delivering good availability at an acceptable level of cost. And following the change to three-day, in the second-half of the year, W&D costs were in fact down 11% compared to the year before.

And support costs decreased by 1%, reflecting lower bonus accruals, efficiencies in marketing, and that was partially offset by depreciation.

So now turning to Autocentres. Sales increased by 4%, with a like-for-like increase of 2.5%, and this was the tenth consecutive quarter of like-for-like growth since the current strategy was introduced.

Gross margin of 64% was an increase of 90 basis points, because of a mixed shift out of the lower margin tyres and an improved margin on Service, MOT and Repair.

Operating costs increased by 5.8%, and this was mostly because of colleague costs in new centres, pay rises and training premier.

So EBIT at £3.8m was flat because of the increased depreciation, with EBITDA, before non-recurring items, 13% higher than in FY15.

So finally, before I hand back to Jill, a few words on cash flow.

Net debt reduced by nearly £14m to £48m, or 0.4x EBITDA. If you add to that the recent acquisition, it would be 0.6x EBITDA. Now the reduction in debt was less than in FY15, mostly because of working capital. In the previous year, there were benefits from payment timing because of the change of the year-end date with a 53-week year. But in FY16, working capital increased slightly, mostly because of the FX impact on stock.

Now capex was £38.5m, similar to the year before, roughly double what it was three years previously.

And finally, the Board has recommended a final dividend of 11.3 pence, taking the total dividend for the year to 17 pence, which is an increase of 3% year-on-year, reflecting continued confidence in the long-term prospects for the business.

Back to you, Jill.

Jill McDonald

Thank you. I would now like to take you through the Trading and Operational performance in the year, followed by the progress made on the *Moving Up A Gear* strategy.

So, firstly, a very high-level summary of performance in the year. In November I talked about the importance of growing our *We-Fit* and Cycle Repair services and the sales of associated products. I explained that we would be focusing on a new KPI for service-related sales, and that we targeted it to grow by more than overall sales.

In FY16, these sales grew by 8.5%, reflecting good growth across the suite of our in-store services, and in particular by Cycle Repair. We will continue to invest in training equipment and people to grow our service income.

Sales of car parts were good with robust growth from bulbs, blades and batteries, despite the lack of winter conditions. This was helped by increased awareness of our on-demand fitting service, as well as new products and innovation.

Workshop products performed very well, with Halfords own-brand hand tools continuing to gain authority in this category. Sales of in-car connectivity equipment and dash cams grew significantly, helping to offset the market-led decline in satnavs.

On to something that didn’t go so well, and as we’ve explained before, cycling sales in Q2 were below expectation. Whilst our bike sales improved and were positive in Q3 and Q4, this wasn’t enough to tip the full year into growth. PACs’ performance improved from Q2, but remained slightly negative in Q3 and Q4, and I’ll talk more about the cycling market shortly.

At the Interims in November, we explained how we had recently transitioned to a three-day-a-week outsource delivery to store model, giving us a more stable medium-term logistic solution. This now has been operating for ten months and is working well.

Finally, whilst not taking place during FY16 itself, I do want to draw upon the acquisition of Tredzs and Wheelies that we announced last week. Although only a modest acquisition, this was a strategically very relevant addition to the Group, and again, I’ll talk more about this later.

Onto the Motoring market. The macro indicators for Motoring continue to look healthy. 2015 was a record year for new car registrations and industry predictions are for new car registrations to continue to be in growth, but at a more modest rate. Importantly, for Halfords, we expect there to be growth in the used car park and the average age of cars in the UK remains at around seven and a half years.

Going forward, we continue to anticipate the motoring markets in which we operate to grow at an average rate of 2%-3% per annum over the medium-term.

The growing complexity of cars and car parts, and the consumer trend away from do-it-yourself to do-it-for-me, both continue to present growth opportunities. Overall, we grew share in our key motoring markets.

So, as we've explained previously, the cycling market is not particularly well documented, with data difficult to come by, reflecting the fragmented nature of the operators within it. As such, we conduct our own extensive bespoke customer and market research.

Looking specifically at recent market performance our analysis suggests that the market declined slightly in the last 12 months due to the reasons Jonny outlined, with Halfords making share gains. Since then we have observed a gradual stabilising of market conditions, notwithstanding that it may take some time to return to consistent growth, and the weather continues to have an impact on the timing of customer purchase. However, we remain confident in the long-term growth prospects of the cycling market, at around 3%-5% on average per annum.

Participation in the UK is still low, and there is large scope for new cyclists as well all as increased spend from existing cyclists, and this is supported by significant government infrastructure investment in London and in many other cities.

So, just to recap on the *Moving Up A Gear* strategy launched in November. If you remember, there are five key strategic pillars. Firstly, putting the customer in the driving seat. Secondly, hardwiring service into our DNA. Thirdly, we will build on our uniqueness. Fourthly, we will look to offer our customers a better shopping experience no matter what channel they choose to use. And finally, we will ensure that we have an infrastructure that is fit for the future and can support our growth.

I will now step through the progress we have been making on each pillar, and also give you some details on what we're working on in the year ahead.

In recent months we have been rapidly improving our customer data knowledge and capability. In January we started offering e-receipts to customers making purchases over £10, and since then we have collected over one million email addresses of which the majority are new contacts to the database. This, combined with progress in joining up our pools of customer data, means that we can now match 15% of retail sales to customers, up from 3% as of November 2015.

Prior to our investment in customer data, Halfords' email marketing was generic and not personalised. In recent weeks we have started our first tailored email campaigns. To give you an example, anyone buying a bike and agreeing to provide their email address, will for the first time receive an email reminder to come in to have their free six week bike check.

Also, after any purchase online or in store, the following day the customer will receive a 'we recommend' email containing six products relevant to their purchase; and this is driven by a bespoke recommendation engine built for Halfords, and we will develop more of these tailored campaigns in the months ahead.

In November we explained that we needed to improve our value perception. Now as you know, value is an equation of the right price, great service, and outstanding quality, and the relevant importance of each factor varies by category and we have assessed our products and services accordingly.

We have already introduced more opening price points, such as in PACs, in order to improve the value perception. We have done this where, for example, we are comparable on pricing of the better and best products in our range, but don't have a comparable price point at the good entry level that is equivalent to our competitors.

Another important part of putting customers in the driving seat is a new brand positioning. Over the past few years our messaging to consumers has centred on price and individual product spot buys, rather than creating a relevant relationship with the brand. In a few days time we will be launching our new brand positioning which has been committed to making customers' journeys better, and that will manifest itself in a new approach to advertising and a new brand look and feel, under the strapline of 'Halfords for Life's Journeys'.

This is a significant change of approach and is designed to create a more emotional connection to the brand. At this stage we are not embarking on a complete and immediate change to external branding of the stores, or a complete change of in-store point of sale collateral. Rather, these will change over time as an when they come up for refresh in order to provide a more cost effective rollout.

I am delighted that our customer service metrics continued to improve, with complaints down and positive praise up in the year. The net promoter score is at its highest recorded level and has increased significantly year-on-year. We have decided to continue to use net promoter score, but we have opened up more channels for customers to give us their feedback, including exit interviews carried out by an external third party.

We've recently introduced new services into our stores, including windscreen chip repair, and motorcycle bulb and battery fitting. Existing fitting services for dash cams, and audio products were also particularly strong in the year, and we continue to look to add to and enhance the suite of services that we offer.

Now, the profile of our colleagues in stores has changed dramatically in recent years. We have invested in more full-time colleagues and they are more highly trained. I'm really pleased, by the end of full year '16, 99% of all colleagues had successfully completed Gear 1, and over 70% of colleagues had qualified for Gear 2. We also have now around 600 colleagues qualified at our Gear 3 Guru level.

We have previously reported on the progress made on improving turnover of colleagues within three months of joining. This continues to be around 9%, having been over 20% three years ago. We have now turned our focus to improving the overall colleague turnover, and this improved from 50% in full year '13, to 36% in full year '16.

As of April 2016 we introduced the national living wage for our colleagues aged 25 and over, and at the same time introduced our 20p supplement for all colleagues upon qualifying for Gear 1. This, combined with other changes to our pay structures, lifted the pay of all colleagues of the Halfords Group to above the minimum wage.

We continue to build our pipeline of Assistant Store Managers and Store Managers through our Aspire programme, and in full year ' 6 all but two of our Store Manager roles in our Southern Division were filled internally.

We were pleased to once again be included within the Best Companies to Work For list, maintaining our 18th position. Similarly, our retail and colleague engagement score, surveyed annual each April, was maintained at 82%. Both of these are particularly strong results in the context of the more challenging trading conditions this year. Halfords also won the Mainstream Retailer of the Year at the annual BikeBiz Awards last September, and a few weeks ago was the winner of Best Partnership at the National CSR Awards for our work with the charity Re-Cycle.

Turning to uniqueness. Exclusive products, relevant innovation and unique partnerships all strengthen our clear differentiation as a retailer. Over the last few months in motoring we have launched the world's first 130% brighter bulb, introduced a lifetime guarantee on certain car batteries, and extended our range of motorcycle products to include a 2bs, which is bulbs and batteries, products and fitting service for motorbikes, as well as a range of consumables and accessories.

During the year we also commenced joint sponsorship with Yuasa of last year's winning team in the British Touring Car Championships, the BTCC. Halfords previously sponsored a BTCC team from 2004 to 2008, and our return to the circuit has been very well received.

Looking ahead, this year we will have our largest ever range of in-car connectivity products with an emphasis on design, colour and technology, such as solar powered devices and more branded items. We'll also be first to market with an exclusive launch of digital in-car devices, as well as having a number of exclusivity periods on new products.

Finally, we'll be developing our trade offer which I'll share more about this coming November. However, as a start we have last week launched the ability for the trade cards to be used online.

Turning to cycling and leisure. In March we unveiled to the press our new Wiggins and Orla Kiely collaborations, which were both well received. The partnership with Orla Kiely comprises a range of cycling and leisure products and accessories, and has recently launched online and in and around 250 Halfords stores.

The Wiggins range comprises bikes for toddlers to teenagers, and are priced at £99 to £450, and will be on sale from July. Take a quick look at what Sir Bradley has to say about the new range.

[Video clip]

So, looking ahead we have some big new news. An exclusive collaboration with Olympic Gold medallist and World Champion cyclist, Laura Trott, to create a range of new performance bikes for women under the Trott brand. Let's take a quick look.

[Video clip]

We are delighted to be working with Laura, and these fantastic new bikes will be launched in store and online in July in time for the Olympics.

So, over the last few years we have been working hard to improve the in-store and online experience for customers, but as we set out in November there is more to be done. We continue to make ongoing enhancements to our fulfilment proposition, such as adding delivery time slots and extending the online order cut-off deadlines. Since May 2013, we have refreshed 97 stores under the Getting Into Gear programme. Customer feedback has been positive, and the investments have justified themselves financially. As such, we remain committed to the continuation of a refresh programme and our creating a store of the future refresh concept.

The initial design principles have been agreed, and we anticipate trialling the first concept in the second half of this year. Store of the Future builds on many of the features of our recent store refreshes, and is building in technology to enable colleagues to better serve customers, create a hub for our WeFit services, and create more flexible spaces. We will continue to rollout a number of exiting refresh concepts during full year '17, and across both concepts we anticipate refreshing 15-25 stores in the year.

In November, we explained how infrastructure investment remains a priority, but that the type of investment moves from being about fixing the foundations to more customer and colleague facing enhancements. This change in focus began during full year '16 with projects such as the new online marketplace, new tills in stores, electronic number plate look-ups, and offering bike finance online.

There are also a number of developments that we've been working on in recent months that we'll launch in the coming weeks. For example, contactless payments in-store, and the ability to use trade cards online.

Looking ahead, our IT investment is focused on two key IT projects that we anticipate will be implemented over the next 12 months. A new electronic point of sale, or EPOS system, and a new people resource planning tool. The EPOS system will be rolled out across all stores, and also in Autocentres.

In Retail, there are many benefits including an e-diary with which customers can pre-book services such as 3b fitting or cycle repair. And there are opportunities to improve in store processes and eradicate many paper based processes. The new people resource planning tool removes 11 systems and replaces them with one tool that we will use across stores, garages, support centre and distribution centres. Colleagues and line managers will be able to log into the system to view and change shifts as well as optimise scheduling of resource.

Within Property we continue our strategy of reviewing leases as they become available for renewal, and either closing, relocating, right sizing or renegotiating in situ. During the year we closed one store, relocated two, right sized one and renegotiated the leases of 25 others.

Our supply chain infrastructure has undergone significant change over the last 18 months and in August 2015 we moved to a three day a week outsource delivery solution. As I've said, this is now embedded, stable and working well, providing the benefits of more frequent deliveries on a cost effective basis.

Availability has remained at strong levels through the transition and thereafter. Concurrently over the last few months we've been reviewing the long-term supply chain requirements. We have concluded that in order to support our future growth we will develop our warehouse infrastructure to improve customer service; but we do not anticipate such plans to cause any significant ongoing changes to warehouse and distribution operating costs, or to the capital expenditure guidance we have previously given.

The Autocentre strategy was launched in November 2014 and remains in place, with a focus on building trust with our customers. And just to briefly recap, the strategy contained four points: To be first choice for motorists; to give a service that customers come back for; to run a grand prix operation creating centres that we can be proud of; and leveraging the Halfords brand, exploring opportunities to cross sell, jointly source products and operate common offers across Autocentres and Retail. There remains much to be done but progress is good.

The standards in our centres continue to improve, evidenced in an improvement in customer retention and net promotor score. We have introduced a new quality team with the objective of continuing to improve the quality of workmanship.

Following the trial of a new centre concept in Croydon in 2014 we have been rolling out some of the elements that have worked to the rest of the estate, including customer service pods, TV screens, Wi-Fi, coffee and large viewing windows. In the year all 11 new centres were opened in the new concept style and we also refreshed 24 centres. And we will continue to refresh centres during full year '17.

During the year we've increased the number of services you can book on the web and added timeslots and this helped grow online booking revenue by 19%. We have trialled more customer focused opening hours, such as Sundays and weekday evenings and we are rolling this out on a gradual basis.

We also trialled interest free credit during the year and we've rolled this out now across the business in February 2016. In terms of leveraging the Halfords' brand, for the first time we've started to send emails to the retail customer database to promote Autocentre services. We've also continued to invest in our people, training around 750 technicians in the year and continuing to invest in our apprenticeship scheme. Our training programmes are now externally recognised by the Automotive Technician Accreditation. We're also introducing a new technician pay grading to suitably reward technicians and provide a clearer career development path.

The EPOS project is a joint Retail and Autocentres initiative, and for Autocentres the benefits will include having an e-diary capability and also the addition of a stock management system enabling our centres to sell retail products.

So as you know, last week we announced that the Group had acquired Tredz Ltd and Wheelies Direct Ltd. Tredz is a UK-wide online retailer of premium bikes and cycling parts, accessories and clothing, and it also operates four stores in South Wales. Wheelies is the UK's largest provider of bicycle replacement for insurance companies and collectively these businesses generated revenue of circa £32m for the year ended 29th February 2016; up from circa £24m in the prior year and they have an EBITDA of £2.4m.

From a customer and supplier perspective the businesses will continue to trade on a standalone basis and will continue to be led by the existing management teams. The businesses have strong web development capability and are supported by office and warehousing premises in Swansea. The majority of sales are fulfilled from the warehouse operation where a team of highly skilled and experienced bike technicians build bikes which are then very carefully boxed and delivered direct to customer's homes. The acquisition is a strong and complementary addition to the Group, extending our presence in the online market for premium bikes, parts, accessories and clothing.

Now, in November I said I would give an update on Cycle Republic performance at this meeting. It has been 18 months since the first Cycle Republic store opened in Euston Tower, London, and since then we have opened a further five stores in London and four in other cities across England, taking the total estate to 11 as of May of this year.

The performance across the stores has varied, with some encouraging and others taking longer to mature than we'd hoped, albeit it within the context of a softer cycling market.

Cycle Republic sales equated to 0.5% of Group sales in full year '16 and this is in line with our guidance. And we expect that this proportion will reach approximately 1% in full year '17. The total store and online investment in respect of Cycle Republic for the three years between full year '15 and full year '17 will equate to circa £5m which is 4% of Group capital expenditure in that period.

Now where we have opened Cycle Republics we have grown market share and this is because the target markets are different between Halfords and Cycle Republic. This is evidenced in the average transaction value of bikes, which is almost double that of Halfords, as is the average value of the basket of accessories sold with bikes. PACs and cycle repair form a greater proportion of the sales than within Halfords' cycling category, reflecting the different customer base and also the greater allocation of space and resource to repair technicians and workshops.

Now at the moment there is no standalone website for Cycle Republic, so in order to create a better shopping experience for Cycle Republic customers in the next few weeks we will be launching a dedicated and transactional Cycle Republic website. Initially the website will give customers online access to the existing range of Cycle Republic products and brands, plus 2,000 additional skews that are not currently available through either Cycle Republic or Halfords. And over time we will be adding to the products and brands that are available.

So, I will now hand you back to Jonny to talk about financial guidance.

Jonny Mason

In November we issued some new guidance to explain the implications of our new strategy for opex, capex and profit; and this medium term guidance still stands, there's no fundamental change to what we talked about then.

Let's quickly recap on the medium term financial targets before moving on to explain the new debt framework, the priorities for capital allocation and then finally some guidance for this year.

So these were the targets that we shared last time. Firstly, to grow sales faster than the markets in which we operate. We continue to anticipate that motoring market will grow on average 2% to 3% per annum and the cycling market on average 3% to 5% per annum over the medium term and we will aim to beat whatever those growth rates are.

Secondly, to maintain EBITDA Group margin roughly flat over the next few years at around 11% as we continue to invest the benefits of operational leverage in sustainable growth.

Thirdly, to grow the dividend every year with a 2x cover on average over time.

And fourthly we said that we'd announce a debt target and we've settled on a target of 1x EBITDA with a range of up to 1.5 x EBITDA for appropriate M&A.

Now this target has been set in consideration of our regular strong cash flow, no pension deficit and shorter, more flexible leases than many UK retailers. And we stress tested this target against downside scenarios and we believe it's a prudent level of debt which leaves us with a strong balance sheet. Now the target and range are intended as a guideline rather than a hard and fast rule, and we expect to move towards the target over time.

So the capital allocation priorities based on that strong balance sheet just described will use the cash generated first of all to invest for growth in capex within the guidance we've already provided. Secondly, to pay and grow the dividend, the ordinary dividend. Thirdly, for any appropriate M&A opportunities that may arise. And thereafter any excess would be available for additional distribution to shareholders.

And then I'll just end with a few words on financial guidance for the year ahead. So in November we said that profits in FY17 were expected to be broadly flat on FY16, now this guidance was issued with a US dollar planning rate of 1.5. There's no change to the profit guidance other than to the extent the US dollar impacts as the year goes by.

We don't know what the US dollar rate will be, but to give you a sense of the sensitivity each year we buy goods worth about £200m denominated in US dollars and about half of that, a little bit more than half of the year ahead is hedged at any one time. So the impact of a move in exchange rate by five basis points say from 150 to 145 would be an impact net of hedging of about £3m in a full year, and that's the impact on the cost of goods sold.

Now consistent with that expectation of profit we expect retail gross margin to continue to decline gradually as cycling grows faster than motoring over time; and operating costs will grow because of depreciation, annualisation of Gears Training Premier*,* National Living Wage, but that will be partially offset by continuing cost efficiency programmes.

All of that will be within the target of an EBITDA margin flat over the next few years and then the depreciation charge will continue to increase, reflecting the investment programmes of recent years. And we expect about £34m for the year ahead. Finance costs will remain around about £3m and the tax rate will be around about 20%.

Now we said that we expected to spend about £120m of capex over the next three years and we still do; but that will be slightly front end loaded and we're planning on £45m for FY17. This will include 15 to 25 store refreshes which will evolve towards the store of the future design as that is completed through the year. About five new Cycle Republic shops because our current priority is to complete and deliver the new website first. More new Autocentres plus a continuation of the refresh programme in the Autocentres roll out; and of course further improvements in delivery, fulfilment and IT systems, especially with the new EPOS and store productivity tool.

So that's it, thanks very much for your attention. I'll hand you back to Jill to summarise.

Jill McDonald

Thanks very much, Jonny. So, to summarise, this was a solid performance in a challenging year for the cycling business, but we remain confident in the long term growth prospects for the cycling market. I am really pleased with the improvements we have seen in customer and colleague metrics and we have made good progress against the *Moving Up a Gear* strategy.

However, the job to modernise Halfords is not yet done. We've explained how our capital allocation priorities remain unchanged from November and have announced a new prudent debt target. I would like to finish by thanking our 11,000 colleagues for all their hard work, commitment and support and welcome Tredz and Wheelies to the Group. So thank you very much for your attention and we will now take questions.

Q&A session

<u>Question 1</u>

Michelle Wilson, Berenberg

Just a quick one from me. Does the 2017 guidance include Tredz and Wheelies or is that excluding those businesses?

Jonny Mason

It's excluding, do the flat profit that was described in November was obviously excluding.

<u>Question 2</u>

David Jeary, Canaccord

A couple please. One, could you help us to gauge in a slightly more quantified way the improvement in customer service perception, maybe actually telling us what movement in your net promotor scores has shown.

And secondly, probably one for Jonny, I just wondered what the average decrease on lease renewals had been that you'd seen this year from the 25 negotiations that you had.

Jill McDonald

Okay, so on the MPS question, MPS at the end of full year 2015 was 78 and at the end of full year '16 was 85.

Jonny Mason

And then on the rent question, rather than a percentage I think it's better to talk about pound notes because often the rent reviews last for many years and you get a new slug in. So we benefited last year from a few million pounds' worth of past rent rebates on the basis of reviews. The reviews themselves, the retail estate that they're on, it depends on the comparative rents nearby so we get small percentage reduction on some sites.

<u>Question 3</u>

Charlie Muir-Sands Deutsche Bank

Sorry just following up on that last question first, are you getting significant landlord contributions though within that or are you just going for straight rent reductions?

Jonny Mason

There are landlord contributions but it really depends on what the plan is. So for the lease regears landlords are normally adding a bit of rent-free rather than cash. If we are relocating or resizing then the landlords will contribute some cash to development but it's not big numbers.

Charlie Muir-Sands

Great thank you. Secondly, you said you're now capturing email addresses on 15% of the value of the transactions. That does seem surprisingly low if you're trying to get email addresses on anything over a £10 transaction value, I mean are a lot of people buying very little or are a lot of people refusing to give their email addresses?

Jill McDonald

No it's more about being in early days of rolling it out so we've only started collecting email addresses in January so we've moved from 3% to 15% in a matter of a few months. So obviously the ambition is to increase that significantly and we are getting a good take-up and opt-in which is in line with what we hoped for at this stage. But there's more to do.

Charlie Muir-Sands

Sorry but the 15% is since you introduced it or that's for the full financial year?

Jill McDonald

It was 3% as of November 2015 and then in the intervening time period it's moved to 15%.

Charlie Muir-Sands

Very clear. Sorry to hog the microphone, one final one. You've alluded to the mixed performance around Cycle Republic and obviously you we're only guiding to five openings in the year ahead; can you talk about what you've learnt in terms of the kind of locations that are or are not working or what is it that needs to fine-tuned before you push ahead because previously all your previous management have indicated quite ambitious long-term targets for the number of stores that could be opened?

Jill McDonald

Well it is early days in the life of a new brand and a new retail chain, and it wasn't the most brilliant year to open up a new cycling chain. So we need to give it some time. And the stores that we have got open are in a variety of different locations. Some start at a commuter route, some right in the heart of central London, and some partway along the cycle routes.

In addition to that we've got different format stores, some with very large basements and small shop frontage, some with big shop frontage and smaller square footage. So what I don't want to do is chase a number of we are going to open x number of stores whatever, I want to make sure we are giving the time to learn about what is working best from that different mix, and it is quite a different mix of store types. And we've also got the inside London and outside London dynamic as well.

So we will continue to open stores this year but as Jonny said we are going to focus some of the capex on really building a rounder shopping experience, if you like, with the transactional website which is a missing component at the moment.

Question 4

Simon Denison-Smith, Metropolis Capital

A couple of questions if I may. First on capex, in a hypothetical scenario where you weren't investing for growth what percentage of your capex would be required just to keep the business on an even keel?

Jonny Mason

Well next year we are guiding to 45 and in the good old days before getting into gear it was around about 20 and that wasn't quite enough. So maintenance only I think about half.

Simon Denison-Smith

That's useful thanks. And could you maybe give us a bit more colour on the strategic rationale for your acquisition, where you see potential synergies between the two businesses, I understand that you're keeping them separate but there must be something that's a bit more than just a good return on the capital?

Jill McDonald

So we think we can learn from Tredz in particular. They are a premium, very high-end, vastly predominantly online seller of bikes and they also ship an awful lot of bikes to home, so we have a very high proportion of click and collect in core Halfords and we will see how the Cycle Republic proposition works with customers.

So we think we can learn a lot from them in terms of their online capability and expertise. They code in-house, which is interesting and they also have a particular way of, I've been to the warehouse myself and see how they deal very expertly with packaging very high-end bike brands and sending them to customers' homes. So we think we've got a lot to learn about from them.

For the Tredz business and brand, they are looking at warehousing capability. They've been very successful and grown, so we will be looking at how we can support logistics and infrastructure to have an investment for growth strategy for them as well.

So we think it's very much a two-way piece. And it's been performing very well so we do want the existing management to continue to operate the businesses as they have been doing because they've been very successful at doing it.

Question 5

Matthew McEachran N+1 Singer

Could I ask a question around price and volume in relation to the year just finished both in terms of the Motoring like-for-like which was 2.5% up, and specifically in Cycling where the like-for-like was down 0.9%, could you give us an approximate split of price and volume within the two?

Jonny Mason

Yeah so in the Cycling the average price was impacted by the heavy promotional season in summer last year and so the volume was relatively flat versus prices going down. In Motoring it was more balanced between the two.

Matthew McEachran

And presumably now you've had a chance to look at the last FX cycle and what impact that had on the business, how much of the price increase you were able to pass on, could you maybe just give us a bit a the flavour as to what you did back then and what you might do differently this time?

Jonny Mason

It’s mostly in Cycling, some of the FX denominated goods are in Motoring as well but it’s mostly Cycling, and the market has changed quite a bit since last time. So I'm not sure how good a guide that is. What we know is that all of our competitors will be impacted by the same adverse cost pressure that we will. There's a lot of competition out there still some stock overhangs from the weaker year last year.

Jill McDonald

Not for us.

Jonny Mason

Indeed, indeed, in the market. And so we do think there will be an ability to pass on prices to customers but we don't think it will be immediate. And so we’d expect, if there's an adverse move in the US dollar rate this year that we won't be able to pass all of that on immediately.

Matthew McEachran

Okay thank you. And then the last question was on working capital, you’ve got obviously some pressure from FX building on the inventories, you’re looking like you’re going to build up on your stock and your range within Cycling, in particular Cycle Republic; could you give us some idea as to whether or not you've got offsetting factors around working capital, for example, the releasing of in-store stock runs sufficient to be able to counterbalance the working capital pressures?

Jonny Mason

Yeah we’re improving processes in the supply chain, just like in-store. And so last year despite expanding the range and introducing a lot of innovation and new things stock was very close to flat, other than the FX effect. And I think that would be our planning assumption going forward as well.

<u>Question 6</u>

Kate Calvert, Investec

A question on PACs which has been an area of underperformance for a while, when do you think we should see a step change in performance, some sort of range improvements etc. that could be coming up?

Jill McDonald

So we said we're not happy with the PACs performance. The changes will take time. So we're looking at a medium-term improvement. There are three areas that we're focusing on to improve that performance. The first is looking at our own range and opening price points, and we've already made some changes to ensure that we are sharper on the opening price points. And we obviously look at range on an ongoing basis.

Secondly is the Cycle Republic website that will launch in a few weeks time.

And then thirdly there is the acquisition of Tredz. I mean they are predominantly bike but the proportion of PAC sales are higher attached to a bike than at Halfords. So we can learn from them as well.

So those are really the three areas that we're looking at to drive improvement in the PACs performance.

Kate Calvert

Thank you. And in terms of acquisitions you hint that you might consider further acquisitions in the future, can you give us a rough idea of are they likely to be bolt-on, what sort of areas you might consider, and would they be UK or international?

Jill McDonald

I think to say on M&A it would be appropriate M&A and it would be very much in our strategic heartland, we're not going to go off and do something a bit weird and whacky. So it would be very much to accelerate or enhance one of our existing strategies than going off in a different direction.

<u>Question 7</u>

Adam Cochrane, UBS

A couple of questions please. In terms of the acquisition that you've made you've given the EBITDA number but it sounds like there's a lot of warehousing, IT processes, what's the depreciation attached to the Tredz and Wheelies business if you can please? Or does that £34m guidance include it?

Jonny Mason

The £34m guidance doesn't include it, that's about another million I would guess, including amortisation that would be.

Adam Cochrane

Okay in terms of the online performance the 1.4% growth is the sort of comment you're making around PACs the main reason or the lower growth in online than across the retail estate?

Jill McDonald

So yeah. Obviously online we sell a higher proportion of cycling and PACs, so it has been impacted by that performance, but there's two other factors around online. So 80% of our customers want some form of assistance and also the click and collect part of online sales is very strong at around 90%. So we do feel that unlike other retailers we're not going to see massive double digit increases on the website. So the performance at 1.4% is a reflection of the cycling performance in the year because it's about 50% of our online sales are cycling.

Adam Cochrane

Okay thanks. And then finally you talked about the Store For The Future concept, does that all fit within the £120m of capex?

In terms of when you look at your whole store estate you've obviously had quite a lot of refitted stores over the last maybe three to four years, is this Store For The Future refitting stores that were refitted three or four years ago or is this the 150 that have never been touched?

Jill McDonald.

Yeah so we've refurbed 97 stores and we've got an estate of 463, so there's a lot more to go. So it's not going back and redoing the ones we've only recently done because those are performing well, it's building on the design learns we've had from those refreshes and then just nudging it forward. So it will continue to iterate but it's going to stores that haven't been touched for seven to ten years.

Adam Cochrane

Okay great and then in terms of Formula One when you think about your capital returns for our modelling purposes do we sit there and think okay you're currently at either 0.4 or 0.6x net debt to EBITDA, if you make no acquisitions in the next year do we then assume you will do a capital return in order that the net debt to EBITDA doesn't fall or how do we think about it? Is it possible for us to model it or do we just have to wait for you to tell us?

Jonny Mason

I think the modelling is that it will get to 1x EBITDA over a few years potentially; and it will get there by a mix of either appropriate M&A which will bring with it obviously EBITDA-associated or else returns to shareholders. And at the moment we don't know what that mix is going to be. Our mind is open to appropriate M&A but there's nothing on the block and that's why we just wanted to be a bit cautious and keep our powder dry for the time being.

Adam Cochrane

If 1x is the right number you might as well be 1x now rather than 1x in two years' time, because you've given yourselves that half a turn of EBITDA for an acquisition, so call it 55 million quid and you're talking about bolt-on acquisitions, so it seems like you have enough capacity to do it now and then keep the scope for acquisitions as well?

Jonny Mason

Well as I said our mind is open to other acquisitions at the moment, although there's nothing on the blocks. And there's also quite a lot of uncertainty in the air with Brexit, FX, consumer confidence, and so it felt more appropriate just right now to keep the powder dry rather than do any sort of big gear up special dividend. But over time we will get to the 1x.

Question 8

Simon Denison-Smith, Metropolis Capital

You talked about how you can gain share in motoring, you grew motoring revenues by 2.5%, obviously you haven't quantified what you think the market did last year, you think the market growth was 2% to 3%, how can you be confident you actually did indeed gain share and if so in what areas do you think you specifically outperformed?

Jill McDonald

So we think we have grown share from the data we have available in areas such as dash cams and car connectivity, those have been performing extremely strongly, double digit growth. We have also been growing, we think, within areas such as car cleaning and also within those fitting services, so the bulbs and blades and the batteries, the actual products themselves. So those are the areas that we've outperformed quite significantly.

Simon Denison-Smith

And just for completeness, what do you think the bike market did last year, clearly it was quite tough?

Jonny Mason

Yeah it's very difficult with the bike market to be precise because the data is so spread and dispersed among all the independents; but all the evidence we have is that we did gain share and our sales went down 0.9%. So our best guess is small single digits.

Closing Comments: Jill McDonald

Any more questions? No? Great. Thank you very much everyone, thank you.