halfords

Halfords FY18 Interim Results

Thursday, 9th November 2017

Introduction

Dennis Millard

Chairman, Halfords

Good morning everyone, and welcome to the Halfords Group Interim Results presentation for FY18. It is really great to see you all again. Standing up here today is a little like déjà vu all over again; however, you can rest assured that I will not pull an Archie on you and hog the presentation. I can assure you, Jonny and Adam are more than capable of doing a better job than both he or I could have done. For those of you today when you get a chance to see Adam up on the stage, please take a note of his socks.

As you know, Jill McDonald left Halfords at the end of September, and Graham Stapleton joins us as CEO in mid-January. In the meantime, we are very fortunate to have Jonny in place to ensure there is a seamless transition, having stepped up as Interim CEO in addition to his CFO role. Jonny worked very closely with Jill in developing our strategy which we set out in November 2015, so is ideally placed to continue its delivery. In the process of seeking Jill's replacement, we were looking for someone who had the relevant and proven leadership experience but, importantly, someone who will continue to build on the current well-embedded strategy and, off this platform, drive our next growth phase. He brings considerable retail, commercial, digital and services experience, which is directly relevant to Halfords going forward. We look forward to his arrival in mid-January.

As Jonny will set out, we have made further good progress with the strategy and are pleased with the results of the first half and look forward to and are well prepared for a busy second half as we enter the Black Friday, Christmas and winter peak trading periods. Importantly, today we have reiterated unchanged guidance for the full year and reiterated our confidence going forward. I will now hand you over to Jonny, thank you.

CEO Update

Jonny Mason

Interim CEO, Halfords

Introduction

Thank you, Dennis. Good morning, everybody. I am now just over two years into my Halfords journey, and I am extremely proud of what we have achieved in that time. We will show you today that the business has changed significantly over the last two years, and is now in much better shape to deliver future growth once we have got through the significant but temporary FX impact.

Today I will take you through, firstly, the operational and financial highlights of this half-year; then an update on our two key markets; a roundup of strategic progress; before handing over to Adam, who will describe the financial results; and then we will finish with Q&A.

H1 operational highlights

First, operational highlights. We are pleased with our trading performance in the first half. We grew revenue in both motoring and cycling, despite challenging market conditions. Most importantly, we continued to gain market share in both motoring and cycling. We continued to deliver good progress against our strategic objectives, across our customers, our colleagues, our shop estate and our infrastructure. I will give you an overview of progress under each of those five strategic pillars shortly. In particular, we were pleased to grow our service-related sales by nearly 20% year on year, and you will hear more about how we are doing that later on.

H1 financial highlights

First, let us go to the financial highlights. Group revenue was up 3.8% year on year, of which Retail was 4.5% and Autocentres was down 0.6%. Adam will describe the components of that later. The Autocentres' reduction was planned, because of our withdrawal from some low-margin business, specifically tyre sales through third parties. It was associated with an increase in margin and profit for the first half-year. The Retail like-for-like growth of approximately 2% in both motoring and cycling represented good steady growth in market conditions which were challenging because of inflation, consumer confidence and weather. This steady growth reflects the resilience of Halfords' sales over time.

Now, the impact of the weaker pound on our cost of goods was £15m year on year in the first half. However, our plans to mitigate that FX impact are in place and are working well. As a reminder, there are three parts to those plans: we work with our suppliers who support us; we improve our costs and processes; and then our last resort is price increases. Now, the first two of these opportunities arise because of our scale, which means that we do not need to increase prices by as much as other competitors who do not enjoy those same scale advantages. Compared to that £15m of gross FX impact, the reduction in our PBT was restricted to £4m.

You will hear later that this first half-year was the worst period of year-on-year FX impact. It will be less in the second half, and close to zero next year at the prevailing spot rates. PBT was £36.8m, and we remain comfortable with the market expectations of profit for the full year. Net debt at the half-year was flat on last year-end, at 0.8 times EBITDA, and the Board has approved an increase of 3% in the interim dividend to demonstrate the further progress of our strategy and continuing confidence in the future prospects of the business.

Motoring market update

The motoring market

Now we will move on to an update of our key markets. First, motoring, which represented approximately 65% of Group sales in the period. The market for our products and services remains strong. The number of new car registrations has declined this year for the first time for a few years; however, as we have explained previously, we predominantly support cars that are over three years old; what we call the 'second life' of the car. The total miles driven by cars in the UK continued to increase, the average age of the car remained at around eight years, and reductions in new car registrations are actually predicted to result in increases in the size of the second-hand car park, which is our market.

Our research shows that 75% of customers have low or medium expertise in car DIY, or insufficient time or inclination to do car DIY. They are more inclined to pay for someone else to 'do it for me'. The proportion of do-it-for-me customers is set to increase as cars become more complex with hybrid and electric vehicles.

Halfords' position in it

Halfords is perfectly positioned to benefit from this do it for me trend. We are training and equipping our colleagues to deal with this increase in complexity, we are increasing the number of different services we offer, and we are growing our market share.

Cycling market update

The cycling market

Let us move on to the cycling market. Bike prices in the market have increased this year to offset the US-dollar-related cost inflation. We estimate that market prices have risen on average between 10–15%, although our prices have increased less than the average. At the same time, bike volumes in the market have reduced; imports were down by double-digit percentage in 2016, and are expected to decline further this year. This is the same trend that was observed over the last significant depreciation of sterling, but then volumes returned to growth after two years. This year the reduction of volume has been exacerbated by the poorer summer weather. However, the positive aspect of lower imports is that the market's stocks are in better shape, i.e. lower, than in previous years. These difficult conditions have made it hard for many bike shops, who sell mostly third-party brands. We have seen both independents and smaller chain operators closing shops.

Halfords' position in it

Halfords is in the strongest position to trade through these difficult market conditions by virtue of our scale advantages, including predominantly own-brand products with a direct-sourced supply chain, partner manufacturers and with increasing online and offline presence supporting our ability to reach all different types of cycling customers through our customer-facing channels: Halfords, Cycle Republic, Tredz and Boardman.

Whilst others have been forced to close shops, we have grown total cycling sales by 7% and we have grown market share. A particularly positive development in the market this first half has been the growth in e-bikes. From a low base, these are growing very quickly. This is especially encouraging because e-bikes attract new, different customers into the market such a wider range of commuters, older riders and mountain bikers who prefer the downhill thrill.

For the cycling market as a whole therefore, we are positive about the future prospects. UK participation levels in cycling are still much lower than in other comparable European countries. Macro factors such as the public authorities' investment in infrastructure, increasing health and environmental consciousness will underpin future growth in the market for years to come.

Moving Up A Gear strategy

Now let us move on to talk about the delivery of our strategy. We launched the Moving Up A Gear strategy in November 2015, and we have made excellent progress to date across the five pillars of that strategy, which are shown on the slide. I will now give you a brief update on each one of those strategic pillars.

Service in our DNA

The first is 'Service in our DNA'. The strengthening of our services proposition is key to positioning Halfords as a specialist service-led retailer, with clear differentiation from online and other competition. With our colleagues now trained to target levels, by continuing to grow customer awareness of our services and by adding new services, we grew our service-related sales in the first half by nearly 20%. Now, this service-related sales is a tight definition, and it includes only where customers specifically pay for a fitting or repair service. It currently represents about 10% of Retail sales, and about 15% of gross profit, but it is growing much faster than the total. If we include other sales with important components of service, such as the fitting of child seats and the building of bikes, which we do not charge for separately, then the proportion of Group sales associated with these services rises to over 50%.

These services are what makes Halfords special. They offer strong resilience against online and other competition. They are delivered by our friendly expert colleagues, who are now better trained than ever before as a result of our bespoke Gears training programme. That has also led to the lowest ever level of colleague turnover. In terms of the delivery of service to our customers, the capability of this business has been transformed from where it was two years ago. We now have a short video from Ian Carter, our Retail Director, to show this in action. Watch out for the headsets.

[VIDEO PLAYS]

Ian Carter (Retail Director): We now offer over 70 in-store services across motoring and cycling, which are key to our uniqueness as a service-led specialist retailer, setting Halfords apart from the competition. To put our performance into context, we completed nearly two million instore fitting and repair jobs in the first half. None of this would be possible without our trusted, friendly expert colleagues. A few years ago, we had just one trained fitter in every store, but now thanks to the Three Gears training programme, we have on average eight colleagues per store Gear-Two-trained, who can carry out around 80% of our in-store services. We are continually building on our colleagues' expertise; for example, this year introducing e-bike training as well as updated training in the fitting of dashcams to support these two fast-growing categories that are increasingly sought by our customers. In addition, new colleague headsets rolled out to every store help our service proposition even further, by enabling any colleague to contact and seek advice from the most experienced colleague in the store that day. All of this great progress combined together has helped us grow our important metric of service-related Retail sales by 19.3% in the half. This is a credit to our colleagues.

[VIDEO ENDS]

Jonny Mason: Thanks, Ian. The average number of fitters in shops has increased from one to eight, and the payroll increase for that is already in our numbers. These great colleagues are the ones who will continue to drive the growth in services sales going forward, and that is the strong competitive advantage for Halfords.

Better Shopping Experience

Our second strategic pillar is 'Better Shopping Experience'. Our shops are fundamental to the business model as the delivery point for our services. Of our online sales, approximately 85% are collected in shop, where our friendly expert colleagues can offer further advice or service. By the end of this month, we will have refurbished 40 Retail shops in our latest look and feel, which is on top of over 100 shops refurbished in the previous format over the last three years. These refurbishments have been delivering good sales uplifts.

We opened two more Cycle Republic shops in the period in Reading and Cheltenham, and we opened another one in Derby yesterday, to reach 18 shops in total. We are encouraged by the continued double-digit like-for-like sales growth, similar to the growth that continues to be delivered from our acquisition last year, Tredz. On our websites, we are developing them as well to catch up with other retailers, by introducing techniques such as guided selling, intelligent search, more personalisation and shifting presentation in favour of the increasing use of mobile phones. All of this has helped to deliver good growth in online sales, which was up nearly 11% in the half-year.

Building on our Uniqueness

Our third strategic pillar is 'Uniqueness'. Exclusive products, relevant innovation and unique partnerships all strengthen our differentiation as a service-led retailer. During the first half, we launched some new services: for example, in motoring AdBlue top-up, which is an essential fuel additive in some cars; key fob battery repair; and fuse fitting. In cycling, we launched the Electric Bike Care Plan. As Ian mentioned earlier in the video, we now have over 40 cycling services and over 30 motoring services on offer in our shops, which is entirely unmatched by anyone else in the market.

We continue to grow our own-brand bike sales, including the new ranges of e-bikes launched at the start of the year under the Carrera and Pendleton brands, which have contributed to the strong growth in e-bike sales as well as the increased sales of Electric Bike Care Plans. We grew our unique trade card sales by 21%, and we issued over 45,000 new trade cards in the first half. This is an important area of focus for us, because we know that trade card customers shop more frequently and spend more in each basket than other customers. We also grew our Cycle-to-Work sales strongly in the period. These sales relate to the government-backed scheme which allows employers to provide bikes and safety equipment to their employees as a tax-free benefit. We are gaining share very quickly in this important area because of the unique breadth of the cycling offer across the Halfords Group, serving all different types of cycling customers.

Then the most recent addition to our portfolio of products and services was the launch last month of Halfords Mobile Expert. On a trial basis initially, this enables the delivery of selected motoring services to a customer's home or place of work by a qualified Halfords technician, with the software and online platform powered by tyresonthedrive.com following our investment in that business last year. Watch this space.

Putting Customers in the Driving Seat

Our fourth strategic pillar is 'Putting Customers in the Driving Seat'. We have made great progress in getting to know our customers, and in communicating with them. After collecting 6.5 million e-receipts in our shops over the last 24 months, we can now match 54% of transactions to Retail customers, up from only 3% two years ago; a huge increase, as you can see from the slide on the top left there. Across the Group, we can match 67% of sales to customers, which is even better.

Now, communicating with those customers in a relevant and targeted way is just starting to drive increased frequency of interaction and higher spend. We are beginning to use sophisticated analytical tools to better understand shopping behaviour; for example, we have developed a recommendation engine and a guided selling tool. By identifying key milestones in a customer's lifetime journey, we will become increasingly relevant to their needs. Now, this area of customer contact is another one where Halfords has been fundamentally transformed from where it was two years ago. We now have a short video from our Chief Customer Officer, Karen Bellairs, to explain more.

[VIDEO PLAYS]

Karen Bellairs (Chief Customer Officer): There are so many new ways in which we can harness the information and data we are collecting. We now send over 25 automated trigger emails individual to each customer, and based on past online and offline behaviour, as well as predicted future actions. We can identify individual milestones in a customer's lifetime journey, such as recognising when a car seat upgrade is necessary to keep a customer's child safe, or when a child is due their first bike or even subsequent upgrades. For example, up until Christmas, we will send emails to over 140,000 parents to remind them that their child may need a bigger bike. We are collecting 1,400 vehicle registration numbers from our Retail customers every day, providing wider Group opportunities such as MOT reminder campaigns from Autocentres, which in turn drive Group sales. We have also built a recommendation engine, which analyses millions of online and in-store baskets. This drives an email campaign that offers relevant additional products, and that is not all: the recommendation engine is also powering new 'frequently bought with' offers on each website product page. We know that our strategy to maximise lifetime value is working for our customers as well as for our business. Our helpful and timely personalised communications are resonating with customers, indicated by our record open and click-through rates, which are up significantly year on year; and our unsubscribe rates, which are significantly lower than the industry average.

[VIDEO ENDS]

Jonny Mason: Thanks, Karen. Both Ian and Karen are here with us today, so if you have any questions for them, grab them at the end. We now know who many of our customers are, which we did not know until recently. We are starting to communicate with them in a sensible way. This is a great platform on which to build future sales growth; the benefits are still to come.

Fit for the Future Infrastructure

Our fifth and final strategic pillar is 'Fit for the Future Infrastructure'. We have made good progress in this area too, and we have solved many of the difficulties which hampered our operations a few years ago. Our distribution network is now stable, with a settled three-day-a-week delivery rhythm, and we have opened a third distribution centre in Daventry, which has consolidated previous external storage to enable greater flexibility and stockholding and improved shop-friendly deliveries for no greater cost. The Single View of Stock project that was completed last year has delivered better accuracy of real-time stock availability across the estate, and in this half-year we have launched an improved customer fulfilment capability: next-day delivery for orders placed by 8pm. The next big project is the replacement of our till hardware and software in shops, to enable more customer-friendly functionality. This is on target for delivery next year.

Across all those five pillars of strategy, there has been lots of excellent progress in our Retail business, with more to look forward to.

Autocentres

Let us say a few words about Autocentres. In this half-year, the decision to exit low-margin third-party tyre sales, and instead to focus on service, maintenance, repair and direct tyre sales has worked well. Sales were down slightly, as expected, but gross profit and margin has increased. The changes to technician pay-grading, which were disruptive to last year's results, have now significantly improved colleague turnover by around 11 percentage points year on year, so it was the right thing to do. Our investment in colleague training has continued. We now have trained technicians for hybrid and electric vehicles in over two thirds of our garages, and all garages will be proficient by year end.

Now, in May we announced a review of the operating model of Autocentres, following the disruptions to results last year. We have learned some good lessons from that work, and we are implementing actions now to spread best practice across the estate. We will announce the outcomes of the review and those actions with our financial results next May.

I am going to summarise at the end the key points on what I have discussed: the trading performance, the markets and the implementation of the strategy. However, for now I will hand over to Adam who will talk you through the financial performance.

H1 Financial Performance & Outlook

Adams Phillips

Corporate Finance Director, Halfords

Introduction

There are the socks, by the way, that Dennis referred to. I am on brand here. Thanks Jonny, and good morning everybody. I am going to spend the next ten minutes talking through the financial results, looking at each of Retail and Autocentres, explaining the Retail gross margin in more detail as well as covering the movements in cash flow and net debt. I will finish with a few words on outlook.

Group financial highlights

Let us start with the Group financial highlights, and starting at the top of this slide here you will see Group revenue is up 3.8% year on year which was plus 1.5% on a like-for-like basis. Non-like-for-like revenue came from the performance of Tredz and Wheelies prior to the annualisation of the acquisition at the end of May, together with sales from Cycle Republic stores and Autocentre garages that have been open for less than 12 months.

Moving to profit before tax in the middle of the slide. As we have previously explained, the weaker pound brings significant input cost headwinds for the Group, because around half of what we sell in the Retail business is bought in US dollars. In the first half, the gross impact was around £15m of additional cost to sales. Now, our mitigation plans have been implemented, are on track and are taking effect, helping to reduce the overall year-on-year decrease in profit before tax to £4m.

Looking at the interim dividend at the bottom of the slide, the Board has approved an increase of 3%, taking it to 6 pence.

Retail financial highlights

Looking in more detail at Retail then: revenue increased by 4.5%, and 1.9% like for like. Gross margin was down by 182bps, and I will show you the components of that in a moment. Operating costs were up 2.6%, with increases in store colleague, store occupancy and warehouse and distribution costs offset by lower support costs. EBIT and EBITDA were down £3.9m and £2.8m respectively which, as a reminder, was after the adverse impact of about £15m from the weaker pound.

Retail sales

Now onto Retail sales by category, and overall it was a steady revenue performance in challenging conditions, with sales growth and market share gains in both motoring and cycling. Our cycling sales grew by 7% in total and 2% on a like-for-like basis, despite poor weather during the peak summer period along with the non-repeat of the deep promotion of last year, which was a significant volume driver at the time. This combination of factors meant that bike volumes declined in the first half, but this impact was more than offset by the increase in average selling prices. Sales of parts, accessories and clothing for cycling continued to grow, supported by higher rates of attachment to bike sales. Cycle Republic and Tredz continued to deliver strong LFL growth.

Motoring sales were up 1.9% like for like. Sales of car maintenance products and services grew by 2.2%, driven by good growth in sales of car parts and associated services, as well as tool sets. Car enhancement like-for-like revenues decreased by 2%, reflecting the continued satnav market decline, along with the decline in sales of in-car audio products, partially offset by growth in car cleaning products and dashcams. Travel solutions like-for-like revenues increased 7%. Sales of child car seats declined slightly, as we annualised the favourable impact of the legislative changes in this area. However, this was more than offset by strong sales of staycation products and services like roof boxes, cycle carriers and camping equipment.

Moving onto the bubbles on the right-hand side of this chart, and firstly online sales which grew by 8.9%. These represent just over 15% of Halfords' Retail sales, with over 85% of Halfords.com orders collected in store, reflecting the closely integrated nature of our on- and offline sales. Secondly, service-related sales, which are up 19.3% in the half.

Retail gross margin

Now let us look at the Retail gross margin movement, which declined by 182bps year on year. The main elements of this movement were, firstly, around 300bps dilution for the impact of the weaker pound before mitigation. Secondly, about 55bps negative from mix impact, including the first-time inclusion of Tredz and Wheelies in April and May prior to the annualisation of the acquisition. Thirdly, a positive 173bps from mitigation and other movements. As Jonny mentioned earlier, there are three parts to our mitigation plans: supplier negotiations, process and cost efficiencies, and price. The large majority of these manifest themselves in gross margin, and price is the largest single element. As we have explained before, the majority of the dollars that we buy are for cycling products. The UK bike market is predominantly sourced in dollars, with over 95% of the bikes sold in the UK being imported. Prices have risen across the market, and we have raised ours, but the other mitigation options that we have other than purely price mean that we have not had to increase our prices by as much as the rest of the market.

FX impact

To give you a bit more detail on the FX impact, have a look first of all at the top chart on this slide, which shows the year-on-year gross impact from the weaker pound. As you can see, the impact has worsened for each half-year period so far since the EU referendum. We are almost fully hedged for half two, which gives us good visibility that the gross impact will reduce in the second half of this year. Assuming that exchange rates stay roughly where they are, there is likely to be no further adverse impact year-on-year in FY19, which means that the peak of the FX headwind is now behind us.

Moving to the bottom chart, and despite the gross FX impact intensifying in each half-year period so far since the EU referendum, the year-on-year decline in Retail gross margin has improved in each half-year period. The largest factor of this improved trend against the growing FX headwind is the tangible significant impact that our mitigation plans are having. Looking further ahead, we continue to anticipate that we will recover all of the FX impact over time.

Autocentres financial highlights

Turning to Autocentres, and at the top of the slide you can see that revenues for the first half decreased by 0.6% in total, and by 1.3% like for like. This sales performance reflected the transition away from low-margin third-party affiliates' tyre sales and towards direct tyre sales and increased service, maintenance and repair work. This contributed to the improved gross margin, which increased by 270bps. At the bottom of the slide, EBIT and EBITDA were both £0.6m higher, at £1.5m and £4m respectively.

Cash flow

On to cash flow, we ended the half with net debt at 0.8 times EBITDA, and the chart on this slide shows the cash flow movements which I will walk you through. We had a net £3.6m cash inflow from working capital movements. Stock increased by nearly £15m from the year end, which was more than offset by movements in creditors and debtors. Capex was £14.8m, and after tax, interest and other costs, our free cash flow was £31.1m. This was £6.9m up year on year. Dividend payments totalled £23m, and there was a further £7m on M&A, comprising deferred consideration of £5m in relation to last year's acquisition of Tredz together with a further £2m investment in Tyres on the Drive as planned.

Now, this is not on the slide, but I also want to remind you that during the half-year we took the opportunity to extend the term of our revolving credit facility from 2019 to 2021, and amend it from £170m to £200m, whilst at the same time securing lower pricing. We continue to target net debt of 1.0 times EBITDA, which we will arrive at over time by continuing to consistently apply our capital allocation priorities.

Financial outlook

Moving on to outlook. As I explained earlier, the gross FX impact peaked in half one and recedes from here, assuming current exchange rates. At the same time, our mitigations remain in place and will continue to drive benefit in half two. At current exchange rates, we do not anticipate further FX headwind in FY19. There is also no change to the FY18 financial guidance that we issued earlier this year, and we are not changing any of our capital allocation priorities or financial targets. As a reminder, our financial targets are, one, to target to grow sales ahead of the markets; two, an EBITDA margin that is roughly flat on FY16 after fully recovering the impact of the weaker pound; three, to grow the ordinary dividend with a coverage ratio of roughly 2.0 times after excluding the impact of FX; and four, to continue to progress towards our debt target of 1.0 times EBITDA.

The final point before I finish is that we continue to anticipate FY18 profit before tax to be in line with current market expectations. Thanks for listening, and I will now hand you back to Jonny.

Summary

Jonny Mason

Interim CEO, Halfords

Thanks, Adam. I will now wrap up and we will move on to Q&A. In summary, it was a good trading performance in the first half. Against a challenging retail sector backdrop, we demonstrated resilience in Halfords' sales, much of which is needs-based. Even in our discretionary categories, we can perform well in times of lower consumer confidence; for example, we planned and implemented well for staycation this year. We continued to gain share in motoring and cycling, in markets where some of the competition are finding it tougher than we are.

The underlying business performance was strong. Without the FX impact, we would have been reporting profit growth for the first half. Assuming exchange rates stay where they are now, we have now faced the worst of the FX headwind which will recede going forward, whilst our mitigation plans will continue to drive benefit into the P&L. We remain confident that we will fully mitigate the FX impact over time.

We continued to make strong progress in delivering our Moving Up A Gear strategy. In particular, we strengthened our services and our customer credentials. We are a cash-generative business with a strong balance sheet, as demonstrated by a prudent net-debt-to-EBITDA ratio and a growing dividend.

We have exciting plans for the second half as we go into our cyber, winter and Christmas peak trading periods. We have planned well, we have some fantastic offers for customers, and we are confident that we will deliver a good performance. Thanks for listening; Adam and I will now be delighted to take any questions you have.

Q&A

Charlie Muir-Sands (Deutsche Bank): Three questions please, as is traditional. First one, online: I think you said in the statement like-for like online excluding the acquisition impact was only up about 5% in the Retail business. I wondered, given what you are doing with personalisation around email, which seems to be quite compelling, whether you are a little bit disappointed by that?

Second one, I wondered if you could just remind us how much of your sales now are on trade card?

Thirdly, can you just remind us whether you felt that last winter the weather was normal, helpful or unhelpful? Clearly, you cannot forecast this year, but just trying to understand how challenging or not the base might be for the second half. Thanks.

Jonny Mason: Okay, I will take a couple of those. Online, first of all: it was not a super performance on online, but what is important to note is that those benefits that we described, in terms of the new techniques and catching up with other retailers, we are at a very early stage on those. Those like the customer data, we have developed the platform and done the technological work, but the benefits from them are still to come. Cycling, remember, is over indexed online, and the Retail cycling was a bit weaker than the Retail motoring through the summer because of the weather. That mix will have impacted online sales growth as well.

Last winter, I would say, was warmer than average. We are planning this year on fairly prudent average winter weather. If we get lots of nice frosts, that will be good for us, but we are not building our expectations on any unusual weather for the second half.

Adam Phillips: Just to take your trade card point, Charlie, this has been growing quite nicely over recent periods. We have invested fairly recently in this with a new enhanced team in the support centre, and then enabling these cards to be used online. It is a relatively small proportion of sales, but growing quickly, and it is good margin. We got 40,000 new trade card members in this first half, which supports the future growth of this area.

Charlie Muir-Sands: Sorry, how many trade cards are currently active in issue, do you know?

Adam Phillips: Active users are about 200,000.

Charlie Muir-Sands: We are still talking less than 10% of Retail sales then?

Adam Phillips: Yes, single digits at the moment.

Charlie Muir-Sands: Thanks

Kate Calvert (Investec): Thank you, two for me. Could you talk about which operational initiatives in store probably had the biggest impact on your underlying performance in the period?

The second question is: in terms of your service-related sales growth being up 20%, can you give an idea of how much of that was from new services, and how much of that was from the traditional three Bs[1]? Thank you.

Jonny Mason: The real great winner in our in-store improvements was the headsets; these transformed the lives of our colleagues in store. Colleagues used to spend quite a bit of time wandering around trying to find keys for cupboards, or asking advice of more experienced colleagues. You saw them in action on the video, the headsets are truly transformative in terms of quick conversation, immediate access to parts or spares or keys and, from the car park to in the shop floor, sharing knowledge among all the colleagues. That has been a very good one.

[1] Three Bs refers to bulbs, blades and batteries

That came out of a programme that we have referred to before here called 'We Operate for Less'. The We Operate for Less team are a continuous improvement team that go around the shops looking for efficiency improvements. We have previously described how we took eight minutes out of the bike build time using that same technique. We have had other projects including stock put-away trolleys, specially designed toolboxes with the most frequently used parts to go into the car park, and tool chests that are located in the car park. All of these things save minutes off each hour of each day, and accumulate up into our colleagues being able to spend more time with customers, which is the important thing.

Adam Phillips: Yes, service-related sales. The large majority of our service-related sales are our core three Bs, and the big suite of cycling repair services. The new ones that we have added certainly help, but we are seeing good growth still in our core thee Bs service, which we continue to grow and also in the penetration of those parts that get fitted onto people's cars.

Tony Shiret (Whitman Howard): Just continuing on the service, the 10% of Retail sales represented by service and product together, I think is how you define it: how much of that 10% is actually service, and how much is product? When you described the gross margin on services: the actual service element, is that 100% gross margin, or do you expense some of the labour against it, in your definition? That is the first question.

I apologise if I missed it to start with, but did you tell us what the price rises were that you put through in bikes? If you did not, could you?

Jonny Mason: Service-related, it is roughly evenly split between the service and the product. What we think is most important, though, is that customers think about a fitted price, and that is why we do not split it out so much. Splitting out the difference between the product itself and the fitting cost is somewhat arbitrary. You are right that in that tight definition of service-related sales, it includes the price paid for the fitting and also any parts used with it. What we were trying to describe today was that it represents, though, only a relatively small proportion of the service-enabled sales in the Group. The two examples we used were car seats and bike building, which our colleagues are trained to do, customers love to come to the shops for them but we do not charge for them separately.

The 15% is not after charging any labour cost, so that is the margin itself.

Then on bike prices, we did in fact mention in the presentation that the average rise in the market is between 10–15%, and we are less than that because of our other mitigating opportunities. We are below the bottom of the range.

Tony Shiret: Are you aggressively below the 10–15%, or how much are you trying?

Jonny Mason: It is a dynamic thing, and it varies by SKUs[2], but high single digits is where we are.

Tony Shiret: Thanks.

Matthew McEachran (N+1 Singer): Three questions from me as well, if that is okay. Probably start off with the pricing in the cycling category. Obviously, you took the commercial

[2] SKU refers to stock keeping unit

decision to wear a little bit of the margin hit from FX, from that raw material input price increase, and becoming less aggressive in terms of the price increase versus the peer group. Asking it in a different way, is there anything that you would look to tweak? Do you think that you can go for more market share, or do you think that you would rather relax the prices and float prices up a wee bit as you move into next year and not be so aggressive? That would be the first area.

Jason Mason: Most important to us is providing great value to our customers versus the competition, and so we are trading dynamically in the market. We are gaining share already, and I think that we will just continue with that approach. We will watch what everyone else is doing, and we will trade competitively against them and continue to gain share.

Matthew McEachran: Okay, thank you. Next question was in relation to the period that you had not reported earlier, on the Retail like for likes so the six stub weeks at the end of the period. It looks like there was a weaker trend generally; obviously, there was poor weather, unhelpful weather, but there was also a very tough comparative. Was it just those factors, or was there anything else? Are you happy to have put that behind you, or is there something else to talk about?

Adam Phillips: Looking at our sales, particularly the cycling sales over a really short period like that, can be not particularly meaningful. Certainly, last year in that September period we had great weather, versus quite poor weather this year in September. We had the tail end of a promotion at the end of September last year. What is more meaningful is looking at the cycling performance over a longer period of time, when you iron out those impacts of promotional patterns and weather year on year.

Jonny Mason: We are not seeing that as any sort of trend.

Matthew McEachran: Great, thank you for that. Then the other side of that was, if I am right, your service income growth rate actually accelerated in that six-week period to get a higher number for the overall half. You have already talked about the headsets and various other factors; could you give us a sense of the run rate? It sounds like you have stepped up quite a bit in terms of service income growth rate.

Jonny Mason: Yes, I think it is adding the new services as well that has helped that. We used to be more reliant on three Bs fitting than we are now. Three Bs fitting is still incredibly important, but we have seen dashcam fitting growing, we have seen cycle repair growing really nicely, and we have added these new services that we talked about such as AdBlue top up which is relatively new in the market, key fob repair and fuse fitting. We will continue to add new services on the back of fabulously trained colleagues now. However, 19% is a pretty fast growth rate. We would be happy for that to continue; I do not think we will see that accelerating.

Matthew McEachran: Okay, that is great, thank you. The third question was in relation to your very clear outline of the moving parts on FX and mitigations. Looking at FY19, no further headwind based on current exchange rates and your hedging policies and so forth; when do you expect, based on the current mitigation actions, for the benefits of mitigation to have fully annualised through? There is obviously a lag effect; is it that there is a lag still of at least 12–18 months still to come before they fully annualise through, or is it more short-term than that, please?

Adam Phillips: By the end of this year, we will have had about £40m of impact on our cost of sales from the weaker pound. Only a small part of that was mitigated last year. That is growing this year, as you will have seen in the first half, and we will have that in half two. There will be a leftover unmitigated amount, which we are confident we will recover over time; we are just not being precise about timing, partly because we will trade tactically next year on the bike side.

Matthew McEachran: Okay, thank you.

Andy Wade (Numis): Slightly similar to Matthew's questions to be honest, but in a slightly different way. I am just interested why you decided to increase your prices by less than the market overall; did you feel like your price position needed improving? It just feels like it would have been the natural thing to do to increase prices in line with the market, and therefore mitigate away all of the impact, not part-mitigate it and then have to work very hard to get the rest of it back. What deep data, what details did you have that made you confident that it would be the right thing to do to increase prices by less than the market?

Jonny Mason: We are looking at it very carefully week-in, week-out, and trading dynamically to offer the best value to our customers. Headline price increases can be a bit misleading, because you have mix factors going on as well. I think it is fair to say that the price rises in the market so far have been greater at the premium end, and not quite so large at the family/mainstream/kids ends. So, some of our headline price being lower than the market differential is down to mix. However, we are keen to provide best value to the customers on an ongoing basis, and that is what is enabling us to gain share so well. This for us is a long-term game.

Andy Wade: Okay, thanks. Then the other one, you used this phrase that, 'We are going to fully mitigate the FX impact over time.' This is a phrase that you have used consistently over a period of time. I am just not quite sure what we are supposed to take away from that; are you saying that gross margin is going to get back to the levels of 2015 and 2016, before we had the referendum? Is that what you are saying with that, or is there some other message that I am not quite getting? Or is it more a broader, 'We are working hard, and we can do a good job on it'?

Jonny Mason: There are other factors going on in gross margin as well. What we are saying is that the impact of FX will wash through gross margin, and we will get back to where we used to be, all other things being equal. We have had other impacts on gross margin, such as the mix effect of the acquisition of Tredz.

Andy Wade: Yes. They are relatively small, aren't they?

Jonny Mason: It will not be the same as it used to be. Back in 2016, we set out an EBITDA margin target, and we have deliberately relaxed that target whilst the temporary FX effect flows through. However, that we believe is still the right target for the time when the FX has flowed through. So, back to similar EBITDA margin targets is what we are aiming for here.

Andy Wade: Okay, very helpful, thanks.

Jonny Mason: Thank you very much for your time, everybody. Any other questions that you have afterwards, you know where to find us.

[END OF TRANSCRIPT]