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Presentation

Operator

Hello and welcome to the Halfords Group Plc Third Quarter Financial Year 2018 Trading Update Call. And of course, throughout this, all participants will be in listen-only mode. And afterwards, there will be a question-and-answer session. And just to remind you, this is being recorded as well. And today, I'm pleased to present Graham Stapleton, Chief Executive Officer; and Jonny Mason, Chief Financial Officer. Please begin.

Graham Stapleton

Good morning everyone. And thanks for joining the call today. I'm Graham Stapleton, new Chief Executive of Halfords. And with me is Jonny Mason, Chief Financial Officer. I'd like to kick off by saying that I'm delighted to have joined Halfords. Clearly, as I'm only four days into the role, I won't be commenting on any historic performance or future plans today, but I look forward to doing so in due course. I'll now hand over to Jonny, who, as you know, has been leading the business in the interim period since the departure of Jill McDonald in September last year. Thank you.

Jonny Mason

Thanks very much, Graham. I'll talk about our Q3 trading results for a few minutes and then we'll take any questions that you have afterwards. As you know, this quarter is an important one for us covering a 15-week period including both the cyber and Christmas peaks. Overall, it was a good performance against strong comparatives and what has been widely reported as tough market conditions for non-food retailers. We achieved best-ever sales for Black Friday and Christmas because of good planning and execution with great products and services. Group revenue was up 3.2% with retail revenue growing 3.3 and auto centres up 1.9. Group like-for-like revenue was up 2.7%, with retail like-for-like growing 2.9 and auto centres up 0.7.

So let's look first at retail motoring. Like-for-like sales was slightly up in the period against the strong comparative of 6.8%. Car maintenance sales were up 2.1% like for like. There was good growth in 3Bs fitting services and associated parts as well as workshop products, although there was a little bit less winter weather this year compared to last.

Our car enhancement sales decreased by 1.1% on a like-for-like basis, driven by a continued decline in satnav sales. Car audio products were also down, but this was offset by growth in dash cams and their associated fitting services.

In travel solutions, sales declined by 4.1% due to the annualising of last year's child car seat legislation changes. And that helped to drive 15% like for like for Q3 last year. So on a two-year basis, travel solutions has delivered growth of over 10%.

Now let's look at cycling. Good like-for-like growth of 7.8% reflected increases in bikes, cycle repair and PACs, which is parts, accessories and clothing. Particular highlights included adult mainstream bikes, electric bikes, and kids ride on toys. Our Christmas offers resonated well with customers. We saw good attachment rates of PACs to bikes and promotional activity was in line with our expectations. As we previously explained, bike prices across the market have increased this year in response to higher costs from the weaker pound. And we've increased our prices as well. Reassuringly, our volumes were marginally up in the quarter despite these prices changes. Indications from the market are that volumes are lower in general and therefore we are confident that we continued to increase market share.

Other key statistics included growth in services-related sales of 8.6% in the period from the fitting of the 3Bs dash cams and also cycle repair services. This was a slower growth rate than in previous quarters partly because of the milder winter weather in October and November reduced the job numbers. However, we are pleased that the penetration of fitting services has increased to 45% as customer awareness of our suite of services is growing. More and more customers prefer assistance service and advice for their car maintenance rather than doing it themselves, which is positive for Halfords future growth.

Group online sales grew by 13% and around 80% of Halfords.com online orders continue to be collected in-store, further evidencing the customer's preference for some form of service advice or assistance with their transactions.

Now turning to auto centres, like-for-like sales grew by 0.7% in the period. The reduction in sales from our planned transition out of low-margin sales via third parties was more than offset by increased service maintenance and repair work as well as direct tyre sales. And the implementation of the improvement plan following the operational review last summer is on track. And initiatives implemented last year such as the changes to technician pay grading continued to have a positive impact on the business, for example, improving colleague turnover.

Now, regarding the delivery of our strategy, we made further progress in the quarter. We now have 40 shops refurbished in the latest format. And we opened two new Cycle Republic shops in Derby and Canary Wharf which look great, taking the total to 19. We increased further the use of our customer data, for example, supporting our best-ever Black Friday sales performance with targeted email campaigns. We achieved our training targets in auto centres so that we now have hybrid and electric qualified technicians covering the whole of the UK. And as I mentioned previously, we make good progress on implementing the improvements from our operational review.

And, of course, our new CEO arrived. So a few words on outlook before I wrap up. Sales growth was slightly ahead of expectations for the period. And that was led by the lower margin cycling business. As a reminder, the weaker pound brings an increase to our cost of sales of about £25 million this year. Split 15 million in the first half and 10 million in the second. And this is on top of £14 million last year.

At the interim results, we reported on how we were making good progress in mitigating the impact of this FX costs and these plans remain on track and are delivering as expected. The UK retail sales environment is subdued at present as has been widely reported. And we anticipate that this will continue for the rest of the financial year and that our group profit before tax will be broadly in line with current market expectations.

To summarise, it was a good trading performance in a difficult market. We did particularly well over Black Friday and Christmas with some well-executed plans. Service-related sales continued to grow at a faster rate than total sales. And there was further progress in delivering our strategic initiatives as we continue to strengthen Halfords credentials as a specialist service-led retailer. The results for our full year will be reported on the 22nd May. Thanks very much for listening and we'll now be happy to take any questions that you've got.

Q&A

Operator
Thank you. Ladies and gentlemen, if you wish to ask a question, could you please press 0 and then 1 on your phone keypad now to enter the queue. And then after I announce you, simply ask that question. And if you find that question has been answered before it's your turn to speak, just press 0 and then 2 to cancel. And there'll be a brief pause while the questions are being registered. Our first question is from the line of Charlie Muir-Sands, Deutsche Bank. Please go ahead, Charlie. Your line is open.

Charlie Muir-Sands
Yeah, good morning guys. Happy New Year.

Graham Stapleton
Hi, Charlie.

Charlie Muir-Sands
Hi. I've got a couple of questions on a couple of different categories. Firstly, on online, you said Halfords.com Click & Collect is now 80% of sales. I think for a long time it was over 90. I don't know whether that's a seasonality effect or there's been a category mix shift. But I wondered if you could talk about why you think that home delivery is disproportionately taking share of that channel at the moment. Secondly, partly related to that. The like-for-like sales in cycling clearly strong. I just wondered, I guess, Tredz and Wheelies are now within that like-for-like sales base, could you talk about the performance of the cycling category within the Halfords stores? And then, thirdly, I appreciate that this is new news this morning, but the news that the UK government has decided to stick with a three-year start to MOT testing rather than pushing about four years. Is that something that you think is, you know, materially positive towards the centres? Thanks very much.

Jonny Mason

Okay, Charlie, I'll take those in order. Online, yeah, so Click & Collect – the Click & Collect proportion has come down over time. I think that's a representation of our improved offer on homework delivery rather than the other way around. It was about six months ago, I think, that we moved towards next day delivery for orders placed by 20.00 the evening before. And so we've seen homework delivery grow rather than Click & Collect in-store decline. I'm very happy, you know, Click & Collect is 80%, still a very high proportion. No issues there. On like for like, you're absolutely right that the number includes Tredz and Cycle Republic in the like for like. We've always had the headline number. The performance in retail was good as well. Tredz and Cycle Republic are delivering higher like for likes. But there's still a very small proportion of the total. And so, you know, the retail like for like is strong, single digit as well. And importantly, the volumes of bikes in retail are also positive.

And then on the three-year MOT, yeah, we're, you know, we're pleased about that. Remember that our main population of customers is second life of the car, actually older cars. The average age of the cars we look at is eight years. So, if, you know, this is marginally positive but I don't think it would have been very damaging if it had moved because it's more of the new end of the car spectrum.

Charlie Muir-Sands

Great answer. Thank you.

Jonny Mason

Thanks very much.

Operator

We're now over to Peel Hunt, Jonathan Pritchard, please go ahead.

Jonathan Pritchard

Good morning, gentlemen. Question on the broadly in line delivery of consensus for the full year. Clearly, it's a beat over consensus in terms of like for like. I know that it's bikes and obviously I know that that's a lower margin category. But is that the only thing that perhaps is driving forecast down this morning? Clearly, it's a good like-for-like number. But was – is there anything else perhaps in the cost base or perhaps in the gross margin that is causing consensus to come down today or is it just purely that mix effect?

Jonny Mason

I think we just wanted to be balanced, Jonathan, and, you know, it's a tough retail environment out there. So we just want to – with the quarter to go, we want to be a bit cautious. There's nothing else in the margin. And our promotional activity was as expected and, you know, the FX mitigation plans are also going as expected. You know, we are expecting cost growth slightly higher than it was last year. And that comes back to the increase in homework delivery, you know, our supply costs will be higher than they were last year, reflecting those new fulfilment options for customers. So, you know, a non-jump on cost growth versus last year. But nothing else really other than caution around Q4.

Jonathan Pritchard

Okay. And just another two quick if I may. Just in the stores I've noticed you're pushing the credit offer quite hard. Is that just – have I just stumbled across a week when you were doing that, or has that been a bit of a factor? And then, Graham, when will we expect to hear from you in terms of strategic update. You probably give yourself six or nine months, would you or what's your thinking?

Jonny Mason

So let me take the interest re credit first. It's a very small part of the business in retail. We do go for offers every now and again. But there's no particular trend.

Jonathan Pritchard

Okay.

Jonny Mason

It's not material to our sales growth there. And, Graham, yeah.

Graham Stapleton

Yeah, I'm obviously day – I'm on day four so I'm still really getting to grips with the business and in terms of timing, I think I'll make that decision when I know a little bit more about the business. And one of the things that is attracting me to help that is the logical clear strategy that we have for the moment and the progress it's making in delivering against that. That's what I would say. But in terms of timing, at this stage, I don't know.

Jonathan Pritchard

Okay, get yourself a name badge.

Jonny Mason

Well, that'd be sorted.

Jonathan Pritchard

Thanks a lot guys.

Jonny Mason

Thanks, Jonathan.

Operator

Okay, we are now over to the line of Dan Homan at Citi. Please go ahead. Your line is open.

Dan Homan

Yeah, good morning guys.

Jonny Mason

Good morning, Dan.

Dan Homan

A few questions from the – first of all, just on the gross margin, the negative impact that you're expecting from the mix in the second half, if you could just maybe quantify what you think that might be. And then also, do you think that will assist into next year? Do you think the trend of the lower margin cycling category is growing faster, it's something that you're factoring in over the next couple of years? And then, just on the cycling, you mentioned volumes are positive, I just wonder if you could tell us what you think your pricing has done over the period versus what the market has moved at.

Jonny Mason

Sure. Well, you know, when you do the numbers you'll see that the mix impact of the factor cycling growth in Q3 was about 50 basis points. And, you know, as we look forward into Q4, part of our caution is related to the fact that, you know, that that could well continue, you know, because the, you know, the cycling sales are growing whilst volumes are protected as we thought would be the case with our FX mitigation plans. So that dilution could well continue into Q4. For next year, there's not really any change on what we've – what we said previously. We're not signalling that today. I think all the growth factors from this year to next year remain as we previously said. You know, over the last five years, cycling has been growing faster than motoring consistently and therefore we've been guiding to a continuing reduction in gross margin based purely on that mix kind of year in, year out. And I suppose that long-term trend is likely to continue.

And then in terms of cycling volumes and prices, very similar to what we said at the half year, you know, we've seen cycling prices go up 10% to 15% in many areas this year. Tends to be an annual – excuse the pun – an annual cycle of price rises, so that hasn't changed. Our price rises have been a bit below the bottom of that range overall. Partly, it's purely mix because the price rises have been bigger in the premium end, less, I'd say, the kids end. So our rises have been, you know, a bit less than, I think we said high single digits at the half year and that's right. And that's – so a small volume growth plus those price rises is what has led to 8% like-for-like sales growth in this quarter.

Dan Homan
Okay. Thanks.

Jonny Mason
Thanks, Dan.

Dan Homan
And could I just ask one more question.

Jonny Mason
Cheeky.

Dan Homan
Just tell me – comment about the retail sales environment will remain subdued. I think that's the first time you've put it in those words and I was just wondering if you've seen anything in the market over the last 15 weeks that's making you, perhaps, more cautious than when we spoke to you at the interim results.

Jonny Mason
Only the market data. Only the, you know, BRC, everybody else. You know, we haven't seen any particular changes in customer behaviour as regards our trading to this point.

Dan Homan
Okay. Thank you.

Operator
Okay, we now go to the line of Matthew McEachran at N+1 Singer. Please go ahead, Matthew. Your line is now open.

Matthew McEachran
Thanks very much, yeah. Hi guys. A couple of questions for me. And I was wondering if you could just dance off with the – talking about price and margin. I mean, you know, the exchange rate obviously bottomed out at 120, I think, fallen from150 whatever it was, you know, previously. And we've now recovered a lot of that ground. I'm just wondering if, as you've seen that trend, you know, come through, whether or not you remained committed to the price increase plans that you put in place or whether or not anything has just been kind of, you know, moderated a little bit given where, you know, given the direction of the currency.

Jonny Mason
Well, you know Matthew that the impact of our FX hedge is to delay any impacts on our P&L from FX moves. So the movement in the exchange rate favourably is, of course, welcome news. But it won't help us until, you know, later into next year or – and then the year after. So, you know, we are expecting that the cycling market will move again on its prices at the beginning of this next season in March, April time. We've always been a bit circumspect about the timing of our FX mitigation recovery because we'll watch the market and we'll always insist on providing best value to our customers. But, you know, that said, we do expect the market to move because the market hasn't recovered the full cost – the input cost inflation yet and it needs to. Now, you only need to look at the cycling press about how many of our competitors are finding it really tough.

Matthew McEachran
Yeah.

Jonny Mason
To get that cost inflation recovered and we'll do so as well.

Matthew McEachran
Understood. That's very clear. Thank you. Second question was in relation to the kind of the ebbs and flows in the car maintenance side driven by what was clearly the ebbs and flows in terms of the wintery or, you know, actually very mild weather in October. How did your – or did your labour scheduling, your new labour scheduling system and your supply chain actually

allow you to respond to that efficiently? Or, will you kind of have any inefficient for the start of the season and then struggling to keep up at the end of the season?

Jonny Mason
No, I think generally, through Q3 our execution was great. You know, we traded through the peaks of Black Friday and Christmas without problem. You know, the website stayed up the whole time unlike some of our competitors. You know, it is – anyone who visited shops early in the winter season will have seen that we do tend to load the shops up with winter product ready for a quick, unexpected cold snap. And so, they were heavy with winter stock for a bit longer than we wanted them to be because of that mild patch in October and through November. But, you know, it came late. It came in the end. We were very happy with it. And I think the colleague scheduling worked according – worked well according to the sales wise.

Matthew McEachran
And the – in terms of the delivery of the wefit service, you know, when that cold weather and the snow really came, you know, came through pretty quickly and pretty intensely, were you able to back that up with the labour hours on the shop floor and in the car parks?

Jonny Mason
Well, we certainly try. You know, our colleagues in shop have – are all – are largely multi-skilled now and can turn their hands to whatever the customers want them to be doing at that moment.

Jonny Mason
So when the frost arrives we'll have more colleagues out in the car park changing batteries than on other days when they might be inside selling satnavs.

Matthew McEachran
Yeah, understood.

Jonny Mason
The colleague is working well. We look at the weather forecast. We try and we adjust our labour schedules every week to try and take account of anticipated demand. There will be sometimes where, you know, we do get overrun because the frost is colder or less well-predicted. But, you know, we do our best to respond to that.

Matthew McEachran
Understood. That's great. Okay, thanks very much indeed.

Jonny Mason
Thank you.

Operator
To reconfirm if anyone has any further questions at this stage, please do press 0 and then 1 on your phone keypad now and there'll be a further pause while any further questions are being registered. Okay, we have one that's popped up. And that's over to Michelle Wilson at Berenberg. Please do go ahead. Michelle Wilson, you might want to take your phone off mute.

Michelle Wilson
Sorry. Good morning. Thanks for taking my question. I just got a follow up on the gross margin comments around the mix effect. If I do a kind of quick back of the envelope calculation on a negative 50 bps mix effect, I don't think that fully offsets the like-for-like benefit that you would get from the like-for-likes that are coming through. So, should we assume, given your kind of cautious comments on Q4 within your guidance you're assuming this slowdown on the top line in Q4 in a retail business?

Jonny Mason
Well, I mean, the calc, you know, what – remember, we are anticipating that the dilutive effect will continue through Q4. So it's not just the Q3 effect you need to do your calcs on. I recon they're pretty close in terms of, you know, up and down. You know, the other things that we're thinking about for Q4, we're not thinking of a slowdown versus Q3 overall. But we are expecting that

that mix effect to continue into Q4. And then as, you know, as we indicated to Jonathan as well, we are thinking that cost increases for the year will be a little bit ahead of what it was last year based on these new fulfilment options we've got going to home and work. And so, the, you know, the combination of those factors plus the negativity in market measurements around customers is just making us a bit cautious as regards how this year might turn out.

Michelle Wilson
Okay. So we're going to assume, I guess, kind of flattish on a two-year stack on a like-for-like is what's gone in to your assumptions.

Jonny Mason
Well, we're not being precise about like-for-like sales. We, you know, we never have and we don't want to do that. But, you know, we are cautious that sort of, you know, current growth rates are about right. But that's a diluted mix.

Michelle Wilson
Okay, great. Thank you.

Jonny Mason
Thanks.

Operator
Okay. We now go over to the line of Georgina Johanan of JP Morgan. Please do go ahead. Your line is open.

Georgina Johanan
Morning guys. Thanks for taking my question and perhaps a silly one but just perhaps a clarification. When you're talking about OpEx growth being a touch ahead of last year, can you perhaps just remind us what underlying OpEx growth was in the retail business last year? Presumably, you are talking about it being ahead on an underlying basis rather than the 5% increase that you saw as Tredz and Wheelies OpEx came in.

Jonny Mason
Yeah, it's not a silly question at all. You're absolutely right. So underlying last year it was 2.4%.

Georgina Johanan
Thank you. Thanks very much.

Jonny Mason
Yeah.

Operator
Okay. That was the final question in today's queue. Can I please pass it back to you for any closing comments at this stage?

Jonny Mason
We'll just say, thanks very much for taking the time to listen today. Obviously, we'll be very happy to field any follow-up questions that you have. You know where to find us. And we'll look forward to talking to you on 22nd May.

Graham Stapleton
Thank you.

Jonny Mason
Bye for now.

Operator
This now concludes today's call. Thank you all very much for attending and you can now disconnect your lines.