halfords

Chief Executive's Statement

Jill McDonald
Chief Executive

Summary of Group Results

Sales of £1,021.5m were up 1.7%, with like-for-like ("LFL") revenue growth of 1.5%. Group gross margin was broadly unchanged at 53.2%. Total operating costs rose by 1.8% reflecting volume-driven cost increases and investments made in key areas of the business offset by targeted cost savings. Investment in the expansion of Autocentres continued as the business added eleven centres and in Retail we opened six Cycle Republic shops.

Group earnings before non-recurring items, finance costs, depreciation and amortisation ("Underlying EBITDA") were up 4.3% to £114.6m. Group earnings before finance costs, tax and non-recurring items ("Underlying EBIT") were £84.5m, which compares with £84.6m in the prior year. Profit before tax and non-recurring items was £81.5m and earnings per share before non-recurring items was 33.2p, up 0.5% and 1.5% respectively.

The cashflow performance remained robust with operating cashflows more than offsetting the impact of our capital expenditure programme. Net debt at the end of the year was down £13.9m at £47.9m, with a net debt to EBITDA ratio of 0.4:1 versus 0.6:1 in the prior year.

The Board has recommended a final dividend of 11.3 pence per share (FY15: 11.0 pence) which, if approved, would take the full-year dividend to 17.0 pence per share, an increase of 3.0% on the prior year. If approved, the final dividend will be paid on 26 August 2016 to shareholders on the register at the close of business on 5 August 2016. The Board continues to target to grow the dividend every year with an average cover of around 2 times over time.

We have announced a target for debt of 1.0x EBITDA with a range up to 1.5x to allow for appropriate M&A. This is a prudent level for debt, taking account of our regular strong cashflow, no pension deficit and shorter, more flexible leases than many other UK retailers. Our priorities for capital allocation are explained later in this report.

Operational Review: Retail

Halfords Retail achieved a solid year of sales performance in the context of the trading conditions, with sales up 1.2% to £868.5m. LFL growth of 1.3% reflected Motoring LFL of +2.5% and Cycling LFL of -0.9%. The weather was not helpful, with both a wet summer and a mild winter, including the warmest December since records began. Despite this, the motoring side of our business, which contributes around 70% of Group sales, was resilient and reflected the healthy underlying market indicators and the service-led proposition.

Car Maintenance LFL revenues increased by 3.4%, driven by good growth in sales of car parts, workshop products and the fitting and sale of bulbs, blades and batteries ("3Bs"). The Halfords own brand oil further consolidated its number one market position and some of our innovations, such as 130% brighter bulbs, performed strongly. Car Enhancement LFL revenues increased by 1.0%, supported by exclusive products, innovation and expert service, and dash cams and in-car connectivity sales grew strongly. The growth in sales of this "new technology" for the first time offset the continued decline of sat nav sales; the latter continuing to decrease as a result of the structurally-declining market. Our We-Fit proposition drove an increase in sales of car audio products and services. Travel Solutions LFL revenues increased 2.8%, driven by growth in child car seats and camping equipment.

Cycling sales declined by 0.9% on a like-for-like basis. This was principally driven by the previously highlighted challenging July and August for mainstream bikes, due to a number of factors including particularly strong comparatives, poor weather and discounting across the market. Bike sales returned to growth in Q3 and Q4. Parts, Accessories and Clothing ("PACs") sales declined in the year and this is a focus area for us to improve over the medium-term.

Service-related sales increased by 8.5%, driven in particular by cycle repair and elements of motoring fitting, such as audio and roof boxes. We also introduced new services including "2Bs" (bulbs and batteries) fitting for motorbikes and windscreen chip repair for cars.

Online Retail revenues grew by 1.4% and represented 12.1% of total Retail sales (FY15: 12.1%). The importance of our store network and service overlay continued to be highlighted by the strength of Click & Collect, with around 90% of online orders picked up in store.

> In November we launched our Moving up a Gear strategy aimed at driving sustainable long-term growth, with good progress to date.

Operational Review: Autocentres

Total Autocentres revenues were up 4.1% and, on a LFL basis, up 2.5%. Gross margin improved by 90 basis points in the year, reflecting a lower tyre mix and an increase in service, MOT and repair margins. Operating costs increased by 5.8%, with the majority of the increase coming from new centres opened in recent years and the balance due to pay rises, enhanced training and investments in support functions. Underlying EBITDA increased by 13.2% to £8.6m.

Eleven new Autocentres were opened and two were closed, taking the total number of Autocentre locations to 314 at the end of the year. 24 centres were refurbished during the year, taking the total new or refurbished to just over 10% of the estate. 10-15 new centres will be opened in the year ahead and any sub-optimal centres will continue to be closed.

Market Update

A full review and update of the markets in which we operate is set out on pages 8 to 9.

Halfords Business Review

Our goal is to be customers' first choice for their life on the move and we will achieve this by being Committed to Making Customers' Journeys Better.

In November we set out the evolution in strategy from Getting Into Gear to Moving Up a Gear. In Retail this new strategy has five key pillars:

- **Putting Customers in the Driving Seat** — investing in customer data and insight capabilities to maximise the lifetime customer value
- **Service in our DNA** — embedding the focus on customer service
- **Building on our Uniqueness** — exclusive products, relevant innovation and unique partnerships, such as our new collaboration with British Olympian and Tour de France winner Sir Bradley Wiggins
- **Better Shopping Experience** — a seamless customer experience, online as well as in store
- **Fit for the Future Infrastructure** — moving from fixing the basics to improving efficiency and fulfillment

On pages 14 to 15 we have set out a more detailed explanation of the Retail strategy and on pages 16 to 19 we have explained in more detail our progress on each of these pillars. On pages 20 to 21 we have explained our Autocentres strategy and progress during FY16.

Financial Targets

In November we set out four key financial targets, which we reaffirm and update below:

- **Grow sales faster than the markets in which we operate**. We anticipate that the motoring market will grow at an average rate of 2–3% per annum and the cycling market at an average rate of 3–5% per annum over the medium-term. We will aim to beat whatever those growth rates are.
- **Maintain Group EBITDA % margin roughly flat** over the next few years as we continue to invest for sustainable growth.
- **Grow the dividend per share every year** with coverage of around 2 times underlying earnings on average over time.
- **A debt target of 1.0 times EBITDA** with a range up to 1.5 times to allow for appropriate M&A. We have set out below some important principles in this regard.

Capital Structure and Priorities

Our top priority will be to maintain a strong balance sheet. The debt target has been set at a prudent level, taking into account the strong, regular cash flow generation, no pension deficit and shorter, more flexible leases than many UK retailers.

Our priorities for use of cash, based on the balance sheet described above, will be firstly capital investment to grow the business in line with previous guidance, secondly to pay and grow the ordinary dividend every year within a cover ratio of 2x on average over time, thirdly for any appropriate M&A opportunities which may arise and thereafter any excess cash would be available for additional distribution to shareholders.

The debt target and range is intended as guidance rather than a hard and fast rule. We anticipate moving towards the debt target over time. Our clear priority at present is investment to deliver the Moving Up A Gear strategy and for growth.

Acquisition of Tredz and Wheelies

Subsequent to the year end, on 23 May 2016 the Group acquired Tredz Limited ("Tredz") and Wheelies Direct Limited ("Wheelies"). Tredz is a UK-wide online retailer of premium bikes and cycling parts, accessories and clothing. It also operates four stores in South Wales. Wheelies is the UK's largest provider of bicycle replacement for insurance companies.

Collectively, these businesses generated revenue of circa £32m for the year ended 29 February 2016, up from circa £24m in the prior year, and EBITDA of £2.4m. The initial cash consideration is £18.4m and has been settled from the Group's existing borrowing facilities. Dependent upon the financial performance of Tredz in the year ending 28 February 2017, there will be an element of deferred consideration payable in 12 months.

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 carefully boxed and delivered direct to customers' homes.

This acquisition is a strong and complementary addition to the Group, extending our presence in the online market for premium bikes, parts, accessories and clothing.

Current Activity

As we look ahead there is plenty to do as we implement Moving Up a Gear and we've already built good momentum. The year ahead will be a busy one, both for product developments and strategic progress.

In Motoring, we are embedding our new motorcycle product and service offer, building our new windscreen chip repair service, launching exclusive in-car technology products, further expanding our ranges and developing our trade offer. In Cycling we have just launched our Orla Kiely collaboration and there will be a refresh of our Apollo and Carrera bike ranges, the launch of the Wiggins and Trott ranges and extended online PACs range through Cycle Republic.

The key focuses under the Moving Up A Gear plan include building relationships with more of our customers, growing more service-related revenue, continuing to improve our colleague training and retention, implementing transformational colleague and customer-facing distribution and IT development and improving on our successful store refresh programme with the Store of the Future concept.

In Autocentres we remain committed to new centre openings, along with the continuation of a roll-out across the wider estate of the refresh programme. We are also investing in a new electronic point of sale system, which will enable us to stock and sell Retail products in our centres, jointly source parts with Retail and implement an e-diary.

I would like to thank all colleagues for their fantastic contribution, support and commitment to the further progress and performance made in Halfords this year.

Jill McDonald
Chief Executive
1 June 2016

See more on **Our Retail Strategy** on pages 14 to 19

See more on **Our Autocentre Strategy** on pages 20 to 21