halfords

# Chief Financial Officer's Review

Halfords Group plc (the "Group")

"Group revenue in FY16, at £1,021.5m, ***was up 1.7%*** and comprised Retail revenue of £868.5m and Autocentres revenue of £153.0m.

**Jonny Mason**
Chief Financial Officer

**£81.5m**
**Underlying Group Profit Before Tax**

**+1.5%**
**Underlying Basic Earnings Per Share**

Read the **Chairman's Statement** on page 3

Read the **Chief Executive's Statement** on pages 4 to 5

## Reportable Segments

Halfords Group operates through two reportable business segments:

- Halfords Retail, operating in both the UK and Republic of Ireland; and
- Halfords Autocentres, operating solely in the UK.

All references to Group represent the consolidation of the Halfords ("Halfords Retail"/"Retail") and Halfords Autocentres ("Halfords Autocentres"/"Autocentres") trading entities.

The FY16 accounting period represents trading for the 52 weeks to 1 April 2016 (the "financial year"). The comparative period FY15 represents trading for the 53 weeks to 3 April 2015 (the "prior year"). We believe that the 52 week proforma results for FY15 better reflect the underlying performance of the business when compared to FY16. On this basis, all commentary included in this report is based on the 52 week period to 27 March 2015 unless otherwise stated.

## Financial Results

| | 52 weeks Ended 1 April 2016 £m | Audited 53 weeks Ended 3 April 2015 £m | Unaudited 52 weeks Ended 27 March 2015 £m | 52 week change |
|---|---|---|---|---|
| Group Revenue | **1,021.5** | 1,025.4 | 1,004.9 | +1.7% |
| Group Gross Profit | **543.1** | 546.3 | 535.1 | +1.5% |
| Group Underlying EBIT* | **84.5** | 87.6 | 84.6 | -0.1% |
| Group Underlying EBITDA** | **114.6** | 113.3 | 109.9 | +4.3% |
| Net Finance Costs | **(3.0)** | (3.5) | (3.5) | -15.0% |
| **Profit Before Tax and non-recurring items** | **81.5** | 84.1 | 81.1 | +0.5% |
| Profit Before Tax, after non-recurring items | **79.8** | 83.8 | 80.8 | -1.2% |
| Basic Earnings per Share, before non-recurring items | 33.2p | 34.1p | 32.7p | +1.5% |

* EBIT denotes earnings before net finance costs, tax and non-recurring items
** EBITDA denotes earnings before net finance costs, tax, depreciation, amortisation and non-recurring items

Group revenue in FY16, at £1,021.5m, was up 1.7% and comprised Retail revenue of £868.5m and Autocentres revenue of £153.0m. This compared to FY15 Group revenue of £1,004.9m, which comprised Retail revenue of £857.9m and Autocentres revenue of £147.0m. Group gross profit at £543.1m (FY15: £535.1m) represented 53.2% of Group revenue (FY15: 53.2%), reflecting a decrease in the Retail gross margin of 30 basis points ("bps") to 51.2% and an increase in the Autocentres gross margin of 90 bps to 64.3%.

Total Operating Costs before non-recurring items increased to £458.6m (FY15: £450.5m) of which Retail represented £363.0m (FY15: £359.3m), Autocentres £94.5m (FY15: £89.3m) and unallocated costs £1.1m (FY15: £1.9m). Unallocated costs represent amortisation charges in respect of intangible assets acquired through business combinations, namely the acquisition of Nationwide Autocentres Limited in February 2010 and Boardman Bikes Limited and Boardman International Limited (together, "Boardman Bikes") in June 2014, which arise on consolidation of the Group.

Group EBITDA before non-recurring items increased 4.3% to £114.6m (FY15: £109.9m), whilst net finance costs were £3.0m (FY15: £3.5m).

Group Profit Before Tax and non-recurring items for the year was up 0.5% at £81.5m (FY15: £81.1m).

Non-recurring costs during the year represented organisational restructuring costs of £1.7m across Retail and Autocentres. Net non-recurring costs in the prior year were £0.3m and are explained later in this report. Group Profit Before Tax in the year after non-recurring items was £79.8m (FY15: £80.8m).

## Halfords Retail

| | 52 weeks Ended 1 April 2016 £m | 53 weeks Ended 3 April 2015 £m | 52 weeks Ended 27 March 2015 £m | 52 week change |
|---|---|---|---|---|
| Revenue | **868.5** | 875.1 | 857.9 | +1.2% |
| Gross Profit | **444.8** | 451.1 | 442.0 | +0.6% |
| Gross Margin | **51.2%** | 51.5% | 51.5% | |
| Operating Costs | **(363.0)** | (365.7) | (359.3) | +1.0% |
| EBIT before non-recurring items | **81.8** | 85.4 | 82.7 | -1.1% |
| Non-recurring items | **(1.2)** | (0.3) | (0.3) | |
| EBIT after non-recurring items | **80.6** | 85.1 | 82.4 | -2.2% |
| EBITDA before non-recurring items | **106.0** | 105.4 | 102.4 | +3.5% |

Revenue for the Retail business of £868.5m reflected, on a constant-currency basis, a like-for-like ("LFL") sales increase of 1.3%. Non-LFL stores, including 6 new Cycle Republic store openings since the prior year, contributed £5.2m revenue in the year.

Motoring sales represented 66% of Retail sales and grew by 2.5%. Car Maintenance LFL revenues increased by 3.4%. Growth in sales of car parts and workshop products more than offset a decline in winter-related products. The fitting and sale of bulbs, blades and batteries ("3Bs") continued to grow, helped by new innovation in the year such as the 130% brighter bulbs, and our Halfords branded oil maintained its number one market position. Car Enhancement LFL revenues increased by 1.0%. Dash cams and in-car connectivity sales grew strongly, reflecting Halfords' authority in these categories, supported by exclusive products, innovation and expert service.

Audio sales increased, driven by good growth in fitting services. Sat Nav sales continued to be impacted by structurally-declining markets, with sales down in the year. Travel Solutions LFL revenues increased 2.8%, driven by child car seats and camping equipment.

Cycling sales declined by -0.9% on a like-for-like basis, driven by the -7.6% LFL recorded in Q2 offsetting positive or flat LFL performance in each of the other quarters. Q2's performance reflected particularly strong comparatives exacerbated by poor weather, discounting across the market and annualising against the Yorkshire Grand Départ of the Tour de France. Since then, bike sales have been in growth in each of 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, beginning with the launch of the new Cycle Republic website in a few weeks' time. Cycle Repair sales grew strongly in the year, reflecting our investments in equipment and colleagues, along with our focus on driving service-related sales.

Revenues for the Retail business (including Boardman Bikes) are split by category below:

| | 52 weeks Ended 1 April 2016 % | 53 weeks Ended 3 April 2015 % |
|---|---|---|
| Cycling | **34.3** | 34.7 |
| Car Maintenance | **32.9** | 32.4 |
| Car Enhancement | **21.6** | 21.8 |
| Travel Solutions | **11.2** | 11.1 |
| **Total** | **100.0** | 100.0 |

# Chief Financial Officer's Review continued

Gross profit for the Retail business at £444.8m (FY15: £442.0m) represented 51.2% of sales, 30bps down on the prior year (FY15: 51.5%). The margin-accretive factors principally comprised the mix benefit out of Cycling into higher margin Motoring along with the strong growth of service-related sales. These were more than offset by greater promotional activity in Cycling during the summer and increased third-party-branded product mix.

Operating Costs before non-recurring items were £363.0m (FY15: £359.3m). The breakdown is set out below:

| | 52 weeks Ended 1 April 2016 £m | 53 weeks Ended 3 April 2015 £m | Change |
|---|---|---|---|
| Store Staffing | 103.0 | 99.7 | +3.3% |
| Store Occupancy | 138.3 | 139.3 | -0.7% |
| Warehouse & Distribution | 45.7 | 43.5 | +5.0% |
| Support Costs | 76.0 | 76.8 | -1.0% |
| **Total Operating Costs before non-recurring items** | 363.0 | 359.3 | +1.0% |

Store Staffing costs increased by 3.3%, due mostly to the anniversary of the uplift in the national minimum wage and the 3-Gears wage uplifts. The opening of 6 Cycle Republic stores also contributed to the increase. Partially offsetting these costs were improvements to in-store processes, such as bike building, stock put-away and cash counting. We're currently working on the next batch of process re-engineering ideas.

Store Occupancy costs decreased by 0.7%. Cost increases from rates, depreciation and Cycle Republic opening costs were offset by reduced rental charges as a result of favourable lease renegotiations.

Warehouse & Distribution costs increased by 5.0%. The year began with the continued operation of the in-house 5-day-a-week delivery schedule, before switching to the more cost effective out-sourced 3-day-a-week delivery schedule at the beginning of August 2015. After three previous years of double digit % cost increases in Warehouse & Distribution costs and a period of transition over the last 18 months, we now have a stable solution that is delivering good availability. In the second half of the year costs decreased 10.9% on the prior year.

Support Costs decreased by 1.0%, reflecting lower bonus accruals and efficiencies within marketing, including a rationalisation of the supplier base and a shift in the mix of activity towards digital marketing, partially offset by the impact of pay rises and increased depreciation.

The non-recurring items in the year represented organisational restructure costs.

***Fast Fact****

Every **4 seconds** a shop was open a bulb, blade, or battery was fitted

***Fast Fact****

Every **2 minutes** a shop was open an in-car audio product was fitted

*Fast Fact figures relate to 4th April 2015 - 1st April 2016

## Halfords Autocentres

| | 52 weeks Ended 1 April 2016 £m | 53 weeks Ended 3 April 2015 £m | 52 weeks Ended 27 March 2015 £m | 52 week change |
|---|---|---|---|---|
| Revenue | **153.0** | 150.3 | 147.0 | +4.1% |
| Gross Profit | **98.3** | 95.2 | 93.1 | +5.6% |
| Gross Margin | **64.3%** | 63.4% | 63.3% | |
| Operating Costs | **(94.5)** | (91.1) | (89.3) | +5.8% |
| **EBIT before non-recurring items** | **3.8** | 4.1 | 3.8 | — |
| Non-recurring charges | **(0.5)** | — | — | |
| EBIT after non-recurring items | **3.3** | 4.1 | 3.8 | -13.2% |
| **EBITDA before non-recurring items** | **8.6** | 7.9 | 7.6 | +13.2% |

Autocentres generated total revenues of £153.0m (FY15: £147.0m), an increase of 4.1% on the prior year with a LFL revenue increase of 2.5%. LFL tyre revenues decreased by 3.0% and represented 16.5% of total LFL revenues (FY15: 17.5%). Online-booking revenues grew 18.6% in the year and represented 19% of sales.

Gross profit at £98.3m (FY15: £93.1m) represented a gross margin of 64.3%; an increase of 90 bps on the prior year. The mix out of lower margin tyres combined with improved service, MOT and repair margins has driven the variance.

Autocentres' EBITDA before non-recurring items of £8.6m was 13.2% higher than FY15 (FY15: £7.6m), with the upside in gross profit being offset by continued cost investments as part of the on-going growth strategy. EBIT before non-recurring items was flat at £3.8m (FY15: £3.8m).

The non-recurring items in the year represented organisational restructure costs.

## Portfolio Management

The Retail store portfolio at 1 April 2016 comprised 472 stores (end of FY15: 467).

The following table outlines the changes in the Retail store portfolio over the year:

| | Number | Stores |
|---|---|---|
| Relocations | 2 | Belfast (Connswater) & Biggleswade |
| Lease re-gears | 25 | Shoreham, Putney, Eastleigh, Fareham, Watford, Hamilton, Peterhead, Glasgow (Rutherglen), Loughton, Newhaven, Hove, Cardiff, Sheldon, Kingston-upon-Thames, Leicester (Putney Road), Camborne, Oldbury, Eastbourne, Southend, Newcastle (Kingston Park), Plymouth, Romford, Hedge End, Merthyr Tydfil, Gravesend |
| Rightsizes | 1 | Luton |
| Openings | 6 | Battersea, Bloomsbury (London), Bristol, Fenchurch Street (London), Manchester & Nottingham |
| Closures | 1 | Newcastle (Newgate Street) |

The six openings in the Retail portfolio were all Cycle Republic. Eleven new Autocentres were opened and two were closed in the year, taking the total number of Autocentre locations to 314 as at 1 April 2016 (end of FY15: 305).

With the exception of eight long leasehold and two freehold properties within Autocentres, the Group's operating sites are occupied under operating leases, the majority of which are on standard lease terms, typically with a 5 to 15-year term at inception and with an average lease length of less than 7 years.

Management anticipates opening around 5 Cycle Republic stores and 10-15 Autocentres in FY17, as well as refreshing 15 to 25 Retail stores and Autocentres.

## Net Non-Recurring expenses

The following table outlines the components of the non-recurring items recognised in the year:

| | 52 weeks Ended 1 April 2016 £m | 53 weeks Ended 3 April 2015 £m |
|---|---|---|
| Asset impairment charges | **—** | (0.7) |
| Release of Focus lease-guarantee provision | **—** | 0.2 |
| Onerous lease provision release | **—** | 0.2 |
| Organisational restructure costs | **(1.7)** | — |
| **Net non-recurring expenses** | **(1.7)** | (0.3) |

# Chief Financial Officer's Review continued

In the prior year, all non-recurring items arose within the 52 week period to 27 March 2015.

In the current year organisational restructuring was undertaken across Autocentres and Retail, mainly in their support centres, to better align resource to the implementation of the new strategy.

Non-recurring costs in the prior year represented the net effect of: £0.7m charge in relation to the impairment costs to support the Stores Fit to Shop initiative; £0.2m income from the release of the final balance held in relation to the Focus lease guarantee provision; and £0.2m income from the release of an excess onerous lease provision following the finalisation of the exit agreement for the Wembley store. The provisions had all been previously charged as non-recurring items.

## Finance Expense

The net finance expense for the year was £3.0m (FY15: £3.5m). Lower average debt and favourable interest rates following the amendment and extension agreed in November 2014 contributed to the reduced charge.

## Taxation

The taxation charge on profit for the financial year was £16.3m (FY15: £18.0m), including a £0.3m credit (FY15: £0.1m charge) in respect of non-recurring items. The effective tax rate on profit before tax and non-recurring items of 20.5% (FY15: 21.5%) was higher than the UK corporation tax rate (20.0%) principally due to the effect of non-deductible depreciation charged on capital expenditure.

## Earnings Per Share ("EPS")

Basic EPS before non-recurring items was 33.2 pence and after non-recurring items 32.5 pence (FY15: 32.7 pence before non-recurring, 32.5 pence after non-recurring), a 1.5% increase on the prior year. Basic weighted-average shares in issue during the year were 195.2m (FY15: 194.1m).

## Dividend

The Board has recommended a final dividend of 11.3 pence per share ("DPS") (FY15: 11.0 pence), taking the full year dividend to 17.0 pence per share, an increase of 3.0%. 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.

## Capital Expenditure

Capital investment in the year totalled £40.3m (53 week FY15: £37.5m) comprising £32.1m in Retail and £8.2m in Autocentres.

Within Retail, £13.4m (53 week FY15: £18.5m) was invested in stores, including 25 store refreshes, 3 of which were also store relocations or right-sizes, as well as general capital spend relating to training rooms, roofing, flooring and heating. By the end of FY16, 97 stores were trading in a refreshed format. Retail continued to roll out the Cycle Republic brand, opening 6 dedicated stores in the year. Additional investments in Retail infrastructure included a £17.4m investment in IT systems, such as continual development of the online Retail proposition, refresh of store tills, investment in vehicle recognition software and tablets in store and investment in the underlying web platform.

The £8.2m (53 week FY15: £6.8m) investment in Autocentres comprised of the opening of 11 centres in the year (FY15: 9) along with investment in refreshing centres and new equipment.

On a cash basis, total capital expenditure in the year was £38.5m (53 week FY15: £39.6m).

## Inventories

Group inventory held as at the year-end was £157.9m (FY15: £149.3m). Retail inventory increased to £156.5m (FY15: £147.8m) mostly due to the impact of foreign exchange. Autocentres' inventory was £1.4m (FY15: £1.5m).

## Cashflow and Borrowings

Cash generated from operating activities during the year was £103.7m (53 and 52 weeks FY15: £142.2m). In the prior year there was a reduction in working capital of £25.3m partly due to the change in timing of year end, compared to an increase of £11.2m in FY16. After taxation, capital expenditure and net finance costs, free cash flow of £45.4m (FY15: £66.4m) was generated in the year.

Group net debt was £47.9m (53 and 52 week FY15: £61.8m), with the non-lease-adjusted 12-month net debt: EBITDA ratio at 0.4:1.

## Financial Guidance

In November 2015 we set out our medium term financial target of maintaining Group EBITDA % roughly flat as we invest to drive sustainable long-term growth. We also stated that we expected FY17 Group Profit Before Tax to be broadly unchanged on FY16. This guidance was issued on the basis of a US Dollar exchange rate of $1.50. There is no change to this profit guidance other than the impact of the extent to which the US Dollar rate varies from our original planning assumption of $1.50. Each year we buy goods worth approximately £200m denominated in US Dollar and about half of that is hedged in advance. The impact on cost of goods of a 5 cent move in exchange rate (for example from $1.50 to $1.45) would be around £3m in a full year.


# Getting into the *community spirit*

**Storm Desmond flooded the UK in December leaving many in Cumbria needing help. At Penrith colleagues held a collection for unwanted clothing and furniture for those whose homes had been damaged and also donated a number of household batteries, hand warmers, sponges, buckets, torches, snow shovels and hand wipes to aid people in their clean-up efforts.**

Jerry cans were also sent to mountain rescue to help them get water to people who had supplies cut off and two jumpstart packs to allow people without power to start vehicles and charge mobiles. Well done Penrith for making a huge difference in the local community.

There is no change to our prevailing guidance on capital expenditure requirements in the medium term, which we continue to expect to average around £40m per annum for the Group over the next three years. In FY17 we anticipate this to be circa £45m, split as circa £35m in Retail and circa £10m in Autocentres. We anticipate the Group depreciation and amortisation charge to be circa £34m for FY17.

We anticipate the net finance expense to be circa £3m and an effective tax rate of circa 20% in FY17.

The timing of Easter is different year-on-year and we have estimated the impact on trading to be as follows:

- In Q1 FY17 there is no Easter compared to half an Easter period occurring in Q1 FY16. We estimate the impact of this will be circa 1% of LFL revenue in Q1 itself.
- In Q4 FY17 there will be no Easter compared to a full Easter in Q4 FY16. We estimate the impact of this will be circa 2% of LFL revenue in Q4 itself.

## Principal Risks and Uncertainties

The Board considers risk assessment, identification of mitigating actions and internal control to be fundamental to achieving Halfords' strategic corporate objectives. In the Annual Report and Accounts the Board sets out what it considers to be the principal commercial and financial risks to achieving the Group's objectives. The main areas of potential risk and uncertainty in the balance of the financial year are described on pages 30 to 33 and in note 20 of the Annual Report and Accounts. These include:

- Economic risk
- Business strategy risks
- Competitive risks
- Compliance
- Supply chain disruption

- Product and service quality
- Information technology systems and infrastructure
- Dependence on key management personnel

Specific risks associated with performance include Christmas trading as well as weather-sensitive sales, particularly within the Car Maintenance and Cycling categories in the Retail business.

Jonny Mason
Chief Financial Officer
1 June 2016