



Business Review



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“When combined with the growth opportunity provided through Nationwide, we believe the business is well positioned to deliver sustainable earnings growth, averaging 15% over the medium-term.”

The strong earnings growth delivered in 2010 reflects a number of contributory factors. Revenue increases were seen in the core categories of car maintenance and cycling. Gross margin enrichment as a result of mix, improved purchasing prices and a higher participation of the Halfords service offer was also evident. Finally, the successful implementation of a series of initiatives reduced the cost base.

Acquisition activity has been firmly established as an important component of the Group's future growth, following the purchase in February 2010 of Nationwide Autocentres (“Nationwide”). Car servicing and repair under the Halfords brand represents a significant earnings opportunity for the Group.

The lack of quality retail sites to facilitate the rapid scaling of our Central European operations led to the decision to close these operations and signalled the Group's intention to focus its resources on UK growth opportunities in the near term.

The core UK retail operations have generated sustained high single digit operating profit growth, in the 5 years following Halfords flotation on the London Stock Exchange, despite changing consumer spending patterns. We are confident that this can be maintained. This confidence reflects the opportunity through our leading positions in strong markets, and the continued development of our multi-channel offer to grow like-for-like sales. This is backed by active gross margin management and tight cost control leading to increases in operating profit ahead of revenue.

When combined with the growth opportunity provided through Nationwide and from re-investing our strong free cash flow in similar opportunities, we believe the business is well positioned to deliver sustainable earnings growth, averaging 15% over the medium-term.

Group strategy

The four elements of the Group's organic growth plan are:

1. Extending range and service advantage
2. Investing in the store portfolio
3. Ongoing focus on cost control
4. Leveraging the Halfords brand in multi-channel

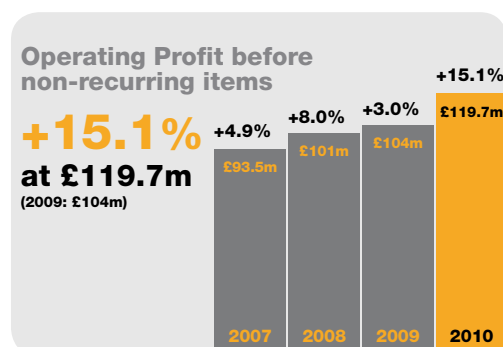
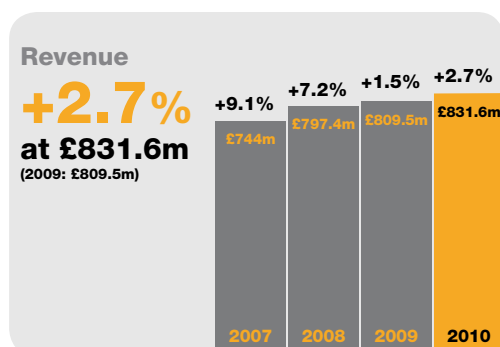
The strength of the Group's cash flows and balance sheet allows us to augment the above organic strategy through the acquisition of quality, adjacent, domestic businesses.

1. EXTENDING RANGE AND SERVICE ADVANTAGE

Halfords Retail maintains market-leading positions across a unique blend of categories with ranges of unrivalled breadth and depth. Halfords constantly strives to enhance its position in each of its markets, seeking out product innovation and new ranges. To complement the product offer, store colleagues are trained to provide expert customer advice and deliver value-for-money **wefit** services. These factors differentiate the offer from the competition and act as a barrier to market entry.



David Wild
Chief Executive



Operating profit was £112.3m (2009: £91.7m)

Pictured:
Our *wefit* service proposition continues to gain traction with the customers.



Car Maintenance

Halfords is the UK's number one parts retailer and a destination store for "needs-driven" transactions where customers are looking to purchase replacement products such as car bulbs, windscreen wiper blades and batteries ("3Bs"). Our strategy of introducing greater value, choice and service to our ranges has contributed to another successful year for this category, that represents approximately 30% of total revenue, with 8% growth in like-for-like sales and increased market share.

Our scale provides a unique ability to develop and source high quality, own brand alternatives to branded ranges, and to bring the latest "new car" technology quickly to the after sales market. Innovations include brighter bulbs that use Xenon gas technology and QR (quick response) brake lights that enhance safety. In addition to the existing Halfords three and four year warranty batteries, a top of the range Bosch car battery that generates up to 50% more starting power with a 5-year guarantee, has increased sales and margin through a 25% value premium to a standard battery.

Our *Tradecard* offer continues to be taken up by customers operating in the auto aftermarket trade. These customers are incremental and high spending, growing by a further 10% during 2010 to total 100,000.

The *wefit* service proposition continues to gain traction with the consumer. Growing customer awareness of Halfords fitting of the 3Bs and high levels of in-store stock availability help to drive revenue, this was particularly evident when the UK experienced the sustained period of severe weather during December and January. This period also saw winter-related products such as anti-freeze, de-icer and scrapers sell in record volumes. Our level of in-store preparation and supply chain excellence helped us to meet customer needs fulfilling the heightened demand.

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“... our exclusive ranges and unique “set-up and demo” proposition provide a clear point of competitive differentiation.”

Car Enhancement

This category covers staple products, such as car cleaning and car accessories and larger ticket items like car audio and portable satellite navigation devices.

Halfords is the market leader in in-car technology, where our exclusive ranges and unique “set-up and demo” proposition provide a clear point of competitive differentiation. We firmly believe that the ongoing innovation of new technologies for use in the car will provide a constant source of new sales opportunities but equally recognise the natural and relatively short lifecycle of those products. Our revenue performance reflects this trend with strong progress from newer products such as hands-free devices, portable media and in-car DVDs more than offset by declining satellite navigation and CD Audio sales.

The market for satellite navigation devices is mature and although manufacturers continue to innovate, consumers have reduced spending on such discretionary purchases, significantly reducing sales volumes. Reduced revenues have been partly compensated through a focus on significantly increasing sales of higher margin satellite navigation accessories. Overall attachment grew across the year by 50%, with strong promotional activity around *Sendai*, Halfords own brand accessories, further strengthening margin as own brand grew to represent over 40% of accessory sales.

As referred to above, technology innovation provides a flow of important and high value products for the car aftermarket and Halfords' leadership in this market means we can secure distribution from major manufacturers to capitalise on the next wave of development. Many see the introduction of digital (DAB) radio as being the next big opportunity and we are confident that Halfords will be well placed to serve this market and lead to further sales and margin growth.

Leisure

The leisure category continued to grow strongly and now accounts for almost 40% of total revenue, with both Cycling and Travel solutions delivering strong like-for-like sales growth during the year.

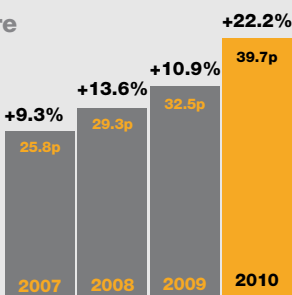
Cycling

Cycling is growing in popularity, powered by demand for a healthier lifestyle, environmental concerns and economic pressures. Our customers want to cycle during their leisure time, as part of everyday life and, supported by a government scheme providing tax relief on bike purchases, by cycling to work.

Halfords' success in the Cycling category, that delivered 15% like-for-like growth in the year, is underpinned by its market leading own brands, including *Apollo* and *Carrera*, with *Apollo* remaining as the biggest selling bike brand in the UK, strong before and after sales service proposition and direct sourcing capability from the Far East.

Basic earnings per share before non-recurring items

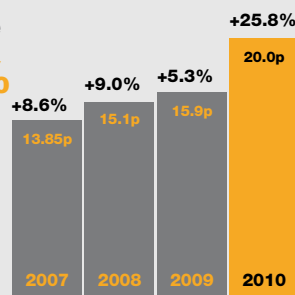
+22.2%
at 39.7p
(2009: 32.5p)



Basic earnings per share was 36.8p (2009: 26.6p)

Dividend per ordinary share

+25.8%
at 20.0p
(2009: 15.9p)



Pictured:
Halfords' success in the Cycling category has delivered 15% like-for-like growth in the year.



“Halfords had its best ever Christmas for cycle sales, building and selling almost 250,000 bikes in this key trading period.”

Halfords' cycle service proposition continues to be well received by customers, with more than 95% of the bikes we sell being built in-house. All new bikes purchased come with the offer of a free six-week check-up and we aim to develop an ongoing service and repair relationship through the sales of a Bike Care Plan, providing customers with the certainty of labour-free repairs. Sales of these plans increased by over 50% during the year and have contributed to a doubling of our service sales revenue.

Despite selling one in three bikes in the UK, this ratio has not been achieved in the areas of premium and children's cycles. These two categories have been the subject of management focus over the last two years and have generated significant uplifts in cycle sales.

The *Boardman* range, designed by Olympic Champion Chris Boardman, leads our premium bike offer through an exclusivity agreement in the UK. The *Boardman* range has been widely acclaimed for its leading designs, construction and price competitiveness, and is further endorsed through use by World champion riders including Olympian Nicole Cooke and by Alistair Brownlee, the reigning World Triathlon champion. Sales have grown significantly since the launch two and a half years ago, to 21,000 units over the past year, a level that we believe to be in line with some of the more established premium brands distributed via independents.

Halfords had its best ever Christmas for cycle sales, building and selling almost 250,000 bikes in this key trading period. Halfords continued to grow its share of the children's cycle market through an improved range of licensed character bikes including *Ben 10*, *Power Rangers* and *Hello Kitty*. Importantly, these cycles were complemented by full ranges of similarly branded accessories so children could personalise their bikes, thereby increasing overall transaction values.

Travel Solutions

Halfords has established a reputation as the destination store for travel solutions. Products such as roof boxes and bars, cycle carriers and child seats help make our customers' journeys easier, while our camping range means they can enjoy their leisure time more actively. This fragmented market continues to expand through the popularity of domestic holidays, where 5 million families undertook a holiday in Britain in 2009, and provides a continued sales opportunity.

Within the core travel equipment area, changes to the price and range architecture for roof bars and roof boxes encouraged sales growth and improved profitability.

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“Our direct sourcing capabilities allow us to provide customers with great value offers like our market leading family tent pack at £99.99.”

Camping had another successful year with record sales in key lines enabling a clean stock exit and achieving further gains in market share. Our direct sourcing capabilities allow us to provide customers with great value offers e.g. like our market leading family tent pack at £99.99. In the current financial year we are building on this success by doubling the number of lines of outdoor leisure products stocked both in-store and via halfords.com and with a further range expansion with brands including *Gelert* and *Wild Country* on offer.

The Group continues to grow its share in the child seat market, through a clear focus on ranging the leading brands and innovative products, such as ISOFIX seats. This range breadth is further enhanced online and supported, in store, by expert advice and fitting where over 2,000 colleagues are professionally trained and accredited by RoSPA to fit child seats to cars.

We have trialled and launched a new range of mobility aids, including scooters, wheelchairs and walking aids. The mobility market is valued at an estimated £500m in the UK and is set to grow with one in three people in the UK forecast to be over 60 years by 2024. In addition, there are currently 9 million permanently or temporarily disabled people in Britain, many of whom also need mobility aids. With a shortage of accessible retail outlets, selling mobility products at competitive prices, this initiative has been welcomed by customers and mobility represents a further opportunity for Halfords as a natural extension of our travel solution ranges.

Service

Expert knowledge, advice and service remain at the heart of the Halfords customer offer and specifically through fitting, differentiates and defends the Halfords offer and generates attractive levels of return.

Recognising that the economic outlook in 2009 made such a value proposition more attractive, we set stretching targets to increase awareness, uptake and service revenue. While all product categories include a core service element, for example Bike Care Plan, Free Bike Build (**webuild**) and 6 week service (**wecheck**) within cycling and “Set-up and Demo” within technology, the foundation of the proposition remains, **wefit** being the on-demand fitting of Car Bulbs, Windscreen Blades and Batteries.

In advance of driving awareness we invested in colleague training, availability and visibility to ensure customer fitting requirements were met in real time. Our strategy to grow awareness of our fitting capability ensured all advertising contains reference to **wefit**, together with a dedicated Autumn radio campaign. This holistic approach proved successful with penetration uplifts of 50% in our core 3 Bs, such that approximately 20% of all batteries, bulbs and wiper blades that are sold are also fitted by Halfords in-store colleagues.

While we are encouraged by the annualised run rate of c. 1.7 million **wefit** jobs, we are confident in further increasing fitting penetration. However, such progress requires continued strategic investment across the business to ensure that colleague capability is maintained and has included in 2009 an intense training programme for our 5,000 in-store experts — to equip them with the latest technical/product details and sales skills.

2. INVESTING IN THE STORE PORTFOLIO

The Group operates through two discrete store chains:

(1) Halfords Retail

The quality and layout of Halfords Retail 462 store estate is a key element of our customer proposition and a source of competitive advantage. This national scale also supports our position as the store of first choice, as 90% of our customers are with a 20-minute journey of one of our stores.

Accordingly, the Group’s strategic focus remains in the development and progressive refurbishment of the two formats of choice, the superstore and the smaller format Compact store. Compact stores provide a comprehensive Halfords offer to smaller catchments, carrying some 6,000 of the 10,000 lines available within an average superstore.

(2) Nationwide

The Group also operates a national presence from its 224 Autocentres where the strategic focus is on expanding the chain.

Pictured:
Expert knowledge, advice and service remain at the heart of the Halfords customer offer.



“The Group remains confident that there is a long-term opportunity to grow the retail store portfolio in the UK and ROI.”

United Kingdom & Republic of Ireland (“UK & ROI”)

Halfords Retail operates from 462 stores in the UK and ROI including 403 superstores, 26 compact stores, together with 33 small format Metro stores located on busy high streets where no suitable edge of town retail opportunity is locally available. During the year, excluding the closure of *bikehut* stores, the Group increased its UK and ROI portfolio by four stores, having opened ten stores and closed six, mainly Metro, stores.

At the end of the year 240 stores traded with a mezzanine and we believe a further 100 stores have potential for conversion. The mezzanine is a highly cost-effective route to space expansion. It also enhances the store environment by creating a spacious, clearly defined area where we can display our cycle ranges for maximum impact.

The Group is confident that there is a long-term opportunity to grow the retail store portfolio in the UK and ROI and our intention is to open five to ten stores in the UK in the current financial year. The lack of quality, new development and the poor quality of recycled property, however, provides a challenge in developing new store opportunities.

In addition to new stores, Halfords Retail continues to invest in its existing estate to ensure that it remains contemporary and reflects the latest store navigation signposting and the latest product merchandising. During the year 48 stores were refurbished.

With the acquisition of Nationwide the Group operates garage servicing and auto repair from 224 autocentres. The Group has identified an opportunity to expand the autocentre chain with a further 200 centres in the medium term, with 80 centres anticipated to open in the next three years.

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“We control costs, both through cross-functional initiatives as well a culture of cost awareness that provides a constant stream of improvement ideas.”

Central Europe

Following a strategic review, the Board decided to close the seven Halfords stores in Central Europe, the costs and impact of which are described in the Finance Director's report. Despite an improvement in recent performance and the possibility that the region could still prove attractive in the longer term, the continuing recession has severely limited the availability of suitable properties and therefore the opportunity to move the operation to a viable scale in the medium term.

Although an international strategy clearly represents an opportunity for future growth, the Board has decided that management time and financial resource are better devoted, at the present time, to the growth opportunities available in the core UK market.

3. ONGOING FOCUS ON COST CONTROL

We are committed to an ongoing focus on cost control. This ensures efficient use of resources, the correct operating base for the prevailing economic environment and provides headroom to fund strategic investments in future growth. We control costs, both through cross-functional initiatives as well a culture of cost awareness that provides a constant stream of improvement ideas.

We continue to increase the level of products sourced directly from manufacturers across Asia. Our Far East team operate an agile sourcing model, moving manufacture, of products designed by the Group's category management resource in the UK, between regions and countries as cost and duty profiles change. They also control all aspects of the supply chain to eliminate unnecessary costs in transport, shipping and stock holding and ensure a seamless coordination with our store operations.

During 2009 the Group progressed a key initiative to reconfigure its logistics infrastructure, replacing our existing three Distribution Centres. Central to the Group's new infrastructure is a new 320,000 sq ft national distribution centre ("DC"), at Coventry, which is our centre of gravity. This facility will commence operation in June 2010 and will become fully operational in September. The new DC is equipped with modern logistics technology such as radio frequency scanning and will ensure more efficient delivery of stock to Halfords stores. The reconfiguration will deliver annualised cost savings in excess of £4m, including rent savings, transport reductions and labour efficiencies. The final element of our revised logistics configuration will be a single warehouse, in Redditch, dedicated to cycles.

Following the initial improvements made to store colleague rotas in the final quarter of the 2009 financial year, a further efficiency programme in stores has been implemented which will result in improved colleague availability and better service for our customers. These improvements will, however, be achieved with a net reduction in colleague hours as resource is removed from low footfall periods and processes are made more efficient. The programme has realigned store grades, rostering and schedules across the store, week and network. The changes, which have impacted, in some way, the majority of store-based colleagues mean we can also provide clearer career paths for colleagues, strengthening our position in the recruitment market. These changes will also differentiate us from our competitors so we are in a strong position to further develop our business and continue to grow sales and operating profit.

The reduced operating profit stimulus from the slowdown in new store openings has been and is anticipated to be mitigated in the future by the favourable impact of rental negotiations at lease renewal ('regears'). From 2012 onward the Group has lease maturities at an average of 25 per annum where the strength of the Halfords covenant, together with reduced demand for such space, provides opportunity for either reduced headline rent or landlord investment for example in the form of a rent free period in order to secure continuity of tenure.

Naturally, our focus on cost control continues and we have identified a number of further areas, including the regear opportunity outlined above, that we plan to target in the current financial year.

Pictured:

In leveraging the Halfords brand in multi-channel, our strategy is to seamlessly integrate halfords.com with our store network.



“Our strong brand, leading internet site and focus on developing this channel have led us to grow our online business at twice the average market rate this year.”

4. LEVERAGING THE HALFORDS BRAND IN MULTI-CHANNEL

The Internet is changing the way that our customers shop and providing us with new opportunities to grow our business. Our strong brand, leading Internet site and focus on developing this channel have led us to grow our online business at twice the average market rate this year. Our online sales currently represent approximately 6% of Halfords Retail overall sales and we have ambitious plans to increase this share.

Our strategy is to seamlessly integrate halfords.com and store operations and, following the introduction of a dedicated website in ROI in early 2009, all of our retail territories are so structured. Whether for normally ranged products or for our increasing number of extended ranges held outside of stores, this intent mirrors our customer feedback, which tells us they like the convenience of buying online but also want to visit our stores for expert advice and recommendation and added value services such as fitting.

To cater for all demands we have introduced 3 ways to shop online

1. *Reserve and Collect* – a service where products researched online are reserved for collection at a nearby store. Eighty per cent of online sales now use this channel and more than 1.5 million products have been sold via this route.
2. *Order and Collect* – allows customers to order products from our more extensive online catalogue and have it delivered to their local store for collection free of charge.
3. *Direct delivery* – products ordered online are delivered direct to customers' homes.

In seeking to identify further innovative and convenient ways in which customers can interact with Halfords Retail, we also launched a *Text and Reserve* service so customers can text their car registration to us, to identify and reserve the correct replacement product for their vehicle.

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“Halfords has a clearly articulated acquisition strategy for assets that can provide additional avenues for significant growth.”

Enhancing our online offer and further extending our multi-channel presence is a clear investment priority. In line with market trends, we continue to increase the amount of advertising dedicated to this medium and this year have added 40,000 customer ratings and reviews to the site together with an “Ask and Answer” facility to allow customers to tap into the expertise and experience of other users.

We have also extended significantly the range of products we offer in areas like bike parts, car seats and camping. In all we carry 2,000 more lines on halfords.com than we do in store. Much of the extra inventory is managed in partnership reducing stock costs and obsolescence risk. This approach provides the model for significant range extension going forward.

Acquisition

In addition to the significant organic growth opportunity provided by the core UK and ROI retail operation, Halfords has a clearly articulated acquisition strategy for assets that can provide additional avenues for significant growth. Our criteria are for quality, domestic businesses in adjacent markets where the Halfords brand would resonate strongly or where we can apply our core capabilities.

Nationwide Autocentres

During this period Halfords made its first significant acquisition, Nationwide Autocentres. Nationwide is a market leading, growing business operating from 224 centres nationally and provides motorists with a full range of auto servicing, MOTs and repairs for both the consumer and fleet markets. Nationwide is the only national operator that offers dealership quality service at more affordable prices.

Nationwide complements Halfords Retail closely and builds on our growing car parts and **wefit** service business. The acquisition creates the largest specialised UK operator focused on the car maintenance, servicing and car repair market. Car aftercare is a large and highly attractive sector with a value of £9bn. Capacity is shrinking as the number of independent garages declines leading to increasing demand from motorists for a reliable, quality independent operator.

There is significant scope to grow the new Group and we intend to double Nationwide’s operating profits in the third year of ownership. Operational scale will significantly increase by opening 200 further centres in key towns over the next seven years. Further growth opportunities exist from cross-marketing the Group’s complementary customer base, increased fleet penetration and there will also be cost and purchasing synergies.

Nationwide’s business will continue to be driven by their successful management team who have joined the Halfords Group. The first new centres have been launched under the Halfords Autocentre branding and the whole estate will be rebranded during the current year, after a trial to be conducted across May and June.

Pictured:
Loading bays, new Coventry DC.



“We continue to augment such incremental margin, through a continued focus on margin enhancement, operating cost control and capital discipline.”

Summary and outlook

Halfords retains clear leadership in its core retail markets of cycling and car maintenance, where it is delivering good like-for-like sale increases and growing market share. We continue to augment such incremental margin, through a continued focus on margin enhancement, operating cost control and capital discipline. Together, these factors mean we have continued to perform strongly, increasing profit before tax and non-recurring items by 26.7%.

Our performance through this period of recession emphasises the resilient quality and adaptability of the business. We believe Halfords' unique, market-leading position provides strong potential for us to consolidate further the fragmented markets in which we operate.

The acquisition of Nationwide Autocentres gives us a market leading entry point into a large and unconsolidated market and opens another exciting avenue of growth for Halfords.

We expect the consumer environment to remain challenging, but we have demonstrated that our business can make good progress in these conditions and improve operating returns. However, our strong market positions, ongoing actions to reduce costs and strong cash flow characteristics provide a solid platform for future sustainable earnings growth through our core strategic growth initiatives and acquisitions that meet our stringent criteria.

Through this focus on creating value for our customers and active management of the business, the Board believes the Group is well positioned to deliver earnings growth. In the year ahead this is anticipated to be in line with market expectations, with sustainable growth across the medium term anticipated to average approximately 15%.

David Wild
Chief Executive Officer
10 June 2010