

Finance Director's Report

Halfords Group plc ("the Group" or "Group")

On 17 February 2010 the Group acquired 100% of the issued share capital of Nationwide Autocentres Holdings Ltd ("Nationwide") for cash consideration of £74.9m. This Class 2 transaction has been accounted for by the purchase method of accounting, with the resultant goodwill arising on the acquisition being attributable to the anticipated future profitability and operating synergies from the combination.

Nationwide, the parent company of a Group of companies involved in car servicing and repair, contributed £13.5m revenue and £0.3m to the Group's profit before tax for the period between the date of acquisition and the Group's balance sheet date.

All references to Group represent the consolidation of the Halfords ("Retail") and Nationwide trading entities. Separate commentaries on the performance of the individual entities are not provided as the Group results are 99% attributable to the retail division.

Financial results

The "2010" accounting period represents trading for the 52 weeks to 2 April 2010 with the comparative, "2009", data being for the 53 week financial period to 3 April 2009. Last year's 53rd week represented £14.8m of revenue, £2.1m of operating profit and £2.0m of profit before tax.

Group revenue for the 52 weeks to 2 April 2010 was £831.6m which compares to a 2009 52-week basis Group revenue of £794.7m. This increase of 4.6%, represents a like-for-like sales increase of 1.3%, where like-for-like sales represent those stores that had traded, within the Group, for more than 365 days.

Gross profit at £452.7m (2009: £421.4m) represents 54.4% as a percentage of revenue and compares to last year's figure of 52.1%. The 230 basis points ("bps") accretion in gross profit margin reflects trading strategies delivered by management within each category, including improved penetration of the Group's fitting services, increased accessory sales, and the flow-through of Far East sourcing benefits. Margin has been further enhanced by a continued beneficial mix effect delivered through the relative sales growth in higher margin core categories, such as car maintenance and cycling, compared to the sales decline in lower margin categories, most notably In-car technology.

This mix effect largely annualised during the third quarter and will therefore have a smaller overall impact in the financial year ended 1 April 2011 ("2011"). Despite the challenges provided by the dissipation of the mix effect and cost of goods pressures from the Group's dollar denominated purchases, we remain confident that the ongoing benefits attainable through the self-help measures noted above will contribute to margins being held broadly flat, in percentage terms, in the forthcoming financial year.

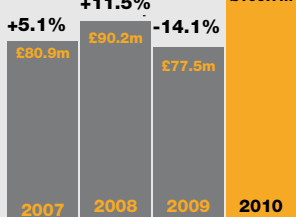
Operating expenses, excluding non-recurring costs, represented 40.0% of revenue (2009: 39.2%). The year-on-year increase of approximately 80 bps largely reflects a reduced level of landlord surrender payments, discussed later, together with the transition costs associated with a further tranche of store labour efficiencies executed in the fourth quarter of the year. Underlying operating costs as a percentage of sales were broadly flat year on year.



Nick Wharton
Finance Director

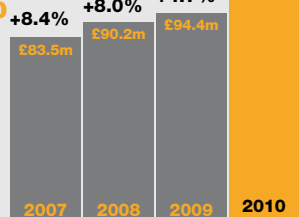
Profit before tax

+41.5%
at **£109.7m**
(2009: £77.5m)



Profit before tax and non-recurring items

+24.0%
at **£117.1m**
(2009: £94.4m)



The Group remains focused on controlling day-to-day costs while delivering a number of strategic initiatives that will reduce costs more materially. The cost saving programmes announced in April 2009 have been successful in driving operating cost efficiency with headcount initiatives in both head office and store operations delivering the scheduled £4m annualised savings.

Specifically, in store, despite having increased service related revenues that carry a higher cost to serve, store labour costs as a percentage of revenue reduced by 60 bps during 2010, totalling 10.5% of revenue over the period. During the fourth quarter, store operations have undergone a further review of working practices, labour scheduling, store hierarchy and reward structures that will deliver cost improvements, totalling £2m, in 2011, while providing store colleagues with greater responsibility and opportunities for career progression.

The Group's year-long project to reconfigure its existing warehousing and distribution infrastructure remains on plan, with the new DC in Coventry scheduled to commence operations in June 2010. This significant project, which is being managed in a manner which minimises disruption to the core retail operation, is progressing in line with planned milestones and is on track to deliver annualised savings of £4.0m from the second half of 2011.

Net finance costs before non-recurring finance costs for the period were £2.6m (2009: £9.6m). Finance costs on bank borrowings were £6.7m lower than the prior year reflecting a prevailing lower level of average net debt and significantly lower LIBOR that followed the Base Rate reductions last year. The costs of forward exchange contracts are £1.1m lower than last year reflecting the shortening of forward purchases of US dollars, less volatile currency movements and narrower interest rate differentials.

Profit before tax and non-recurring items for the 52 weeks to 2 April 2010 was £117.1m (2009: £94.4m) On the more comparative period for the 52 weeks to 27 March 2009, 2010 performance represents an increase in profit before tax and non-recurring items of 26.7%. Profit before tax and non-recurring items as a percentage of revenue has increased by 250 bps to 14.1% from 11.6%.

Profit before tax for the 52 weeks to 2 April 2010 after non-recurring items was £109.7m (2009: £77.5m).

Non-recurring items

As noted in the Business Review the decision was taken and announced in March to close the Group's seven-store pilot within Central Europe. Although international expansion remains on the Group's strategic agenda, the Board have stated that in the short to medium term management and financial resource will focus on the UK and Republic of Ireland markets through retail offer expansion, both through new stores and online, developing and delivering the opportunity in garage servicing and identifying quality, domestic businesses with either brand or capability adjacencies for further value creating acquisitions.

The associated exit costs total £7.4m, of which £4.1m are non-cash costs. The principal areas of expenditure relate to asset write-off (£4.7m), vacant property and property exit costs (£2.4m) and redundancy costs (£0.4m).

The Central European operation, included within the 2010 Group Revenue Statement, generated revenues of £5.9m and a loss before taxation of £2.5m, after operating expenses of £4.7m. Consequently, the closure will generate annualised net savings of c.£2.8m, with the phased exit during the first quarter of the new financial year resulting in an anticipated saving of c.£2.0m impacting the Group's 2011 results.

Portfolio management

The Group continues to actively manage its store portfolio to maximise value creation through generating cash, making profits and reducing ongoing rental charges. However, the property market has proved challenging in 2010, limiting opportunities to both open new stores and to downsize stores where landlords will provide incentives to return excess space.

With regard to new stores, the economic recession has reduced fresh development, while overall market capacity has increased as a result of business failures, but not on the quality parks or locations that Halfords is targeting for future expansion.

Portfolio transactions still represent a sustainable opportunity for the Group, with in excess of 200 superstores located on A1 parks where demand remains relatively high. However until the economic recovery is more in evidence landlords are less likely to undertake speculative development in favour of back-to-back deals which, by their nature, introduce delay in the contract exchange process. Accordingly, landlord surrender payments from the two transactions completed during the year totalled £1.1m (2009: £2.7m) and management expect a similar level of surrender payments in the forthcoming financial year.

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Operating leases

With the exception of nine long leasehold and two freehold properties within Nationwide, the Group's operating sites are occupied under operating leases, the majority of which are on standard lease terms, typically with a 15-year term at inception. The Group has a total commitment under non-cancellable operating leases of £811.5m (2009: £776.1m).

Taxation

The taxation charge on profit for the financial year was £32.7m (2009: £21.7m), including a £1.4m credit (2009: £4.6m) in respect of the tax on non-recurring items, representing a full year effective tax rate of 29.8% (2009: 28.0%). The underlying tax rate was 29.4% (2009: 29.7%), principally due to the non-deductibility of depreciation charged on capital expenditure in respect of mezzanine floors and other store infrastructure.

The increase in the Group's effective tax rate, to a level more in line with the Group's underlying rate, reflects the relatively low level of credit in respect of favourable tax structures in place during the year. This position is expected to reverse in 2011.

Earnings per share ("EPS")

Basic EPS, excluding non-recurring items, was 39.7 pence (2009: 32.5 pence), a 22.2% increase on the reported prior year value. On a more comparative 52-week basis, basic EPS, excluding non-recurring items, increased by 23.8% from the prior year position of 31.8 pence.

Basic EPS for the 52 weeks to 2 April 2010 was 36.8p pence, a 38.3% increase.

Capital expenditure

Capital investment in the period totalled £20.4m (2009: £19.4m). During 2010 management have continued to adopt a prudent approach with regard to capital investment and have focused on investments generating the highest returns.

Investment in new stores, where there has been a marked decline in the supply of quality locations, has reduced compared to recent years. However, management also continue to invest in the existing store portfolio to ensure it remains contemporary and despite a smaller level of new store openings, the Group has expended £7.4m on the store portfolio.

The largest single element of expenditure during 2010 has been the DC project, in which the Group has invested, in line with the plan, £6.7m. The Group continues to invest in its internal business systems, ensuring that it has the infrastructure to support the changing demands of the business and expanding the functionality of the Halfords website, which saw the successful introduction of the *Order and Collect* proposition.

The forthcoming financial year will see the completion of the DC project at an anticipated additional investment of £2m and will see the execution of the

initial elements of the three-year plan to significantly increase the scale of the Nationwide business. This will include the re-branding to Halfords Autocentres at a cost of c.£2.5m and the opening of between 12 and 15 centres.

Reflecting the capital "light" nature of Nationwide expansion, Group capital expenditure is anticipated to remain in line with historic norms at approximately £25m.

Inventories

The Group continues to manage its stock holding to ensure high levels of availability and range breadth, and inventories at 2 April 2010 were £138.5m (2009: £147.0m). Management has continued to implement the inventory control programmes that were developed in the previous financial year, and have achieved further reductions in stock with a consequential improvement in stock turn. Stock levels continue to be carefully managed and have reduced year-on-year by 6.7%, 7.2% after inventory investment in new stores and a limited investment in additional stock to ensure availability during the period of changeover in supply to the new distribution infrastructure.

Over the economic cycle the Group has stated its intention to increase stocks at approximately 50% of the rate of sales increase adjusted for the necessary inventory investment in new stores.

Cash flow, net debt and capital structure

The Group's debt facility comprises a £180m five-year term non-amortising loan, falling due for repayment in July 2011, together with a £120m revolving credit facility, which also falls due for renewal in July 2011.

The Group continues to generate strong operational net cash flows, which, in 2010, were £148.1m (2009: £73.8m), representing 103.0% (2009: 57.2%) of earnings before non-recurring items, interest, tax, depreciation and amortisation ("EBITDA"). The significant improvement in operational cash flow reflects the increase in the Group's profitability and a working capital inflow of £33.1m (2009: Outflow £19.0m), which reflects the inventory reduction and an increase in trade creditors.

Total net bank debt at 2 April 2010 was £143.5m (3 April 2009: £164.0m) and there are further borrowings of £12.0m (2009: £12.2m) in respect of the Head Office finance lease that in total generates net debt at £155.5m (2009: £176.2m). This reduction in net debt has been achieved after cash outflows totalling £72.3m arising from the acquisition of Nationwide.

The Group is committed to both a progressive dividend policy and continued investment in the growth of the business, both through organic development and other business development opportunities as they might arise. It is also committed, over the long term, to maintaining an efficient balance sheet, returning any surplus capital not required to fund Group growth, to its shareholders.

As part of this capital structure, management are currently reviewing, with the Group's brokers, the optimal capital structure for the enlarged Group that will provide the necessary flexible funding to deliver its strategic agenda. Management envisage that renewed debt facilities will be agreed and in place in the second half of the financial year ended 1 April 2011.

Dividend

In line with the Group's progressive dividend policy, the Board is recommending a final dividend of 14.00 pence per share (2009: 10.90 pence), which, in addition to the interim dividend of 6.00 pence per share (2009: 5.00 pence), generates a total dividend of 20.00 pence (2009: 15.90 pence), an increase of 25.8%.

Subject to shareholder approval at the Annual General Meeting the final dividend will be paid on 6 August 2010 to shareholders on the register at the close of business on 2 July 2010.

Principal risks and uncertainties

The Corporate Governance report on pages 66 to 70 describes the systems and internal control processes through which the Directors identify, assess, manage and mitigate risks. The Board recognises that the nature and scope of risks can change and so regularly reviews the risks faced by the Group as well as the systems and processes to mitigate them.

The Board's primary assessment of risk is against the Group's strategic corporate objectives that are summarised below.

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

With reference to the strategic objectives, the Board considers that the principal commercial and financial risks to achieving its objectives are those identified below.

(a) Commercial

Economic and market conditions (1,4)

The economy is a major influence on consumer spending. Trends in employment, inflation, taxation, consumer debt levels and interest rates impact consumer expenditure in discretionary areas.

The Group constantly seeks to enhance its position as store of first choice in each of the markets that it serves. Halfords continues to invest in both its existing estate to ensure that it remains contemporary and in constant product innovation to meet customer needs. In addition, the Group's market leading **wefit** proposition provides a range of services at a lower cost to our customers than that provided by competitors.

Whilst many of the products that Halfords sell are non-discretionary in their nature and predicting future trends is difficult, Halfords reflects the latest independently sourced estimates in its internal plans.

Competition (1,2,3)

The retail industry is highly competitive and dynamic. The Group competes with a wide variety of retailers of varying sizes and faces competition from UK retailers, both in stores and online, as well as international operators. Failure to compete with competitors on areas including price, product range, quality and service could have an adverse effect on the Group's financial results.

We aim to have a broad appeal in price, range and store format in a way that allows us to compete in different markets and to use service as a point of differentiation in each market segment. We have an established training infrastructure to ensure that our colleagues receive ongoing product and service training. We track performance against a broad range of measures that customers tell us are critical to their shopping experience, and monitor customer perceptions of ourselves to ensure we can respond quickly if required.

The Company adopts a granular approach to its wide-ranging cost control activities to ensure that significant opportunities for operational cost management are complimented by a culture of cost awareness.

Reputational risk (1,3)

The Halfords name is a key asset of the business and as the largest operator in its markets, expectations of the Group are high. Failure to protect the Group's reputation and brand could lead to a loss of trust and confidence. This could result in a decline in the customer base and affect the ability to recruit and retain good people.

The Group has a Quality Assurance team and legal and regulatory control processes, both in-house and externally, to advise and take action on existing and emerging risk management issues. We continually monitor loyalty to the Halfords brand through independent surveys and seek, through activities such as Charity of the Year, to contribute to society more widely. Our various Codes of Practice regulate our behaviour in our dealings with all stakeholders including customers, suppliers and colleagues and the Corporate Social Responsibility report details the Group's attitudes toward such areas as the environment and ethical trading.

Ultimately the protection of the Halfords brand and position in its core markets will be sustained by a high service based customer proposition, unique and extensive product offerings and a multi-channel approach to sales.

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Responsiveness to changing consumer preferences (1)

Some of the products that Halfords sells, particularly in the car enhancement category, are subject to rapidly changing consumer preferences. Halfords has recruited experienced, knowledgeable colleagues who can identify and interpret trends and consequently respond in a timely manner to changes in consumer preferences. Some of the products Halfords sells, such as children's cycles, face competition from alternative products (such as games consoles) and our colleagues monitor developments in these areas.

Reliance on foreign manufacturers (2)

Halfords sources a significant proportion of the merchandise it sells in its stores from outside of the UK, either directly or via third-party suppliers. Consequently, the Group is subject to the risks associated with international trade (particularly those which are common in the import of goods from developing countries) including, but not limited to, inflation, currency fluctuation, the imposition of taxes or other charges on imports and exposure to different legal standards and the burden of complying with a variety of foreign laws and changing foreign government policies.

Extensive research is conducted before the Group procures product from any new country or supplier. The Group's strong management team in the Far East has been recruited from local nationals who understand the local culture, market regulations and risks.

Information technology ("IT") systems and infrastructure (2)

In common with most businesses, Halfords is reliant on the reliability and suitability of a number of important IT systems where any sustained performance problems, particularly with regard to store or warehouse and distribution systems, could potentially compromise our operational capability for a period of time.

Extensive controls are in place to maintain the integrity of our systems and to ensure that systems changes are implemented in a controlled manner. Halfords' key trading systems are hosted within a secure data centre operated by a specialist company remote from our Head Office. These systems are also supported by a number of disaster recovery arrangements including a comprehensive back-up strategy and access to a further data centre elsewhere in the UK in case of a major incident.

Furthermore, the ongoing project to reconfigure the Group's core distribution structure is a significant and operationally complex change activity. Having successfully replaced each of its core business systems over the past six years, the Group has significant experience in managing the risks associated with such activities and is applying similar governance processes. The project is firmly on track to achieve occupation and commence operation in the summer of 2010.

Dependence on key management personnel (1,2,3,4)

The success of the Group's business depends upon its senior management closely supervising all aspects of its business, in particular the operation of its stores, autocentres and the design, procurement and allocation of its merchandise. Retention of senior management is especially important in the Group due to the limited availability of experienced and talented retail executives.

If the Group were to lose the services of members of its senior management such as David Wild (Chief Executive Officer), Nick Wharton (Finance Director) or Paul McClenaghan (Commercial Director) and were unable to employ suitable replacements in a timely manner, its business could be adversely affected.

Our Remuneration Policy outlined on page 72 details the strategies in place to ensure that high calibre executives are attracted and retained. The Group also operates a talent management process to help individuals achieve their full potential within Halfords and to ensure that appropriate succession plans are in place to meet the future needs of the business.

(b) Financial

Treasury policy

The Group's treasury department's main responsibilities are to:

- Ensure adequate funding and liquidity for the Group;
- Manage the interest risk of the Group's debt;
- Invest surplus cash;
- Manage the clearing bank operations of the Group; and
- Manage the foreign exchange risk of its non-sterling cash flows.

Treasury activities are delegated by the Board to the Finance Director ("FD"). The FD controls policy and performance through the line management structure to the Group Treasurer and by reference to the Treasury Committee. The Treasury Committee meets regularly to monitor the performance of the Treasury function. Monthly Treasury Reports provide management information relating to treasury activity.

Policies for managing financial risks are governed by Board approved policies and procedures, which are reviewed on an annual basis.

The Group's debt management policy is to provide an appropriate level of funding to finance the Business Plan over the medium term at a competitive cost while ensuring flexibility to meet the changing needs of the Group. The Group has a syndicated five-year term facility totalling £300m that provides the Group with committed bank facilities until July 2011.

The key risks that the Group faces from a treasury perspective are as follows:

Financial risk

The Business Plan and cash flow forecasts are subject to key assumptions such as interest rates and the significance of these risks is dependent upon the level of EBITDA and the strength of the balance sheet.

Interest rate risk

The Group's policy is to manage the interest cost of the Group within the constraints of the Business Plan and its financial covenants. The Group's borrowings are currently subject to floating rate and the Group will continue to monitor movements in the swap market.

Foreign currency risk

The Group has a significant transaction exposure through direct sourced purchases of its supplies from the Far East with most of the trade being in US dollars. The Group does not hedge either economic exposure or the translation exposure arising from the profits, assets and liabilities of non-sterling businesses whilst they remain immaterial.

During the 52 weeks to 2 April 2010, the foreign exchange management policy was to hedge via forward contract purchase between 75% and 80% of the material foreign exchange transaction exposures on a rolling 12-month basis. Hedging is performed through the use of foreign currency bank accounts, spot rates and forward foreign exchange contracts.

Credit risk

The Group's policy is to minimise the risk that foreign exchange and interest rate derivative counterparties, the holders of surplus cash and the providers of debt will be unable to fulfil their obligations and also, in the case of lenders, unwilling to extend the loan facilities when they expire. In executing this policy, the Group ensures that such counterparties, who all sit within the syndicated Group, that are used for credit transactions and ancillary business held at least an A credit rating at the time of syndication (July 2006).

The Treasurer is responsible for determining credit worthiness of each counterparty, based on the overall financial strength of the counterparty. The counterparty credit risk is reviewed in the Treasury report, which is forwarded to the Treasury Committee and the Treasurer reviews credit exposure on a daily basis.

Liquidity risk

The Group ensures that it has sufficient cash or loan facilities to meet all its commitments when required. The Group ensures that there is sufficient cash or working capital facilities to meet the cash requirements of the Group for the current Business Plan. The minimum liquidity level is currently set at £30.0m.

Forecast liquidity is reviewed each month by the Treasurer to determine whether there are sufficient credit facilities to meet forecast requirements.

Covenants are monitored on a regular basis to ensure there are no significant breaches, which would lead to an "Event of Default". Calculations are submitted at least bi-annually to the syndication agent. Reporting on covenant compliance forms part of the Treasury Report. There have been no breaches of covenants during the reported periods.

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

The Group manages capital by operating within debt ratios. These ratios are lease adjusted net debt to EBITDAR and fixed charge cover. Lease adjusted net debt is calculated as net debt and leases capitalised at eight times, as a multiple of EBITDA plus operating lease charges. Fixed charge cover is calculated as being EBITDA plus operating lease charges as a multiple of interest and operating lease charges. As a result of the current economic conditions and the attitude towards debt, the Group has decided to reduce the level of net debt and therefore operates favourably to these target metrics.

Nick Wharton

Finance Director
10 June 2010