Halfords Group plc FY23 Q3 Week Trading Update Q&A

Thursday, 12th January 2023

Q&A

Manjiari Dhar (RBC): Hi, good morning guys, thanks for taking my questions. I just had two if I may. Firstly, given the softer margin outlook has this changed your capex investment plans for the year, into next year and maybe your wider capital allocation priorities? Then secondly on the supply chain supplier terms, what are you seeing there now? I think we have been hearing that that has been easing off a bit recently so that should benefit next year.

Graham Stapleton (Chief Executive Officer, Halfords Group plc): In terms of the first question we will probably see a slight reduction in the capex spend during this quarter and for the full year versus what we have guided before. Just reflecting where we are as a business so I would expect at least somewhere between £3 million and £5 million reduction in capex. In terms of next financial year and beyond we will outline that very clearly at the Capital Markets Day. It is probably better to wait till we can give you the context of where the spend is and why.

Jo Hartley (Chief Financial Officer, Halfords Group plc): However, our capital allocation principles and policies remain the same.

Graham Stapleton: Policy and principles remain the same. We are not looking to change the principles that we have been working to over the last couple of years. In terms of supplier costs and product costs, yes absolutely. We are seeing now some deflation and some opportunities in that space. There is definitely a reduction in some of the input costs and equally in freight. We are seeing better freight rates than we have seen before. We are confident that we will see some movement and improvement there as we go through next year and that will help offset some of the other inflationary pressures that we have outlined.

Manjiari Dhar: Great, thank you.

Jonathan Pritchard (Peel Hunt): Morning all, just two or three for me. In the technicians market I understand the nationwide shortage but how does it work? How long does it take to train people up? How many people do you think you can drag back from retirement? I know you said 1,000 but how long does that process actually work and therefore can we have confidence that you will have the right number of staff to fulfil the high demand? That is the first one. Secondly on bikes, just a quickie really, was that footfall not coming, people not entering that part of the store? Was there anything on conversion or anything like that? Just a little bit more detail there. Then in B2B, obviously a bigger part, and fleet, have companies actually changed their behaviour in the way that customers have? I get the impression if you are on an amber signal in your service or your MOT you let it drift as a consumer but do companies behave like that and say, 'If there are a few thousand miles left on the tyre let it go for a month and we will come back later'? Any change in behaviour there?

Graham Stapleton: Yes. Thanks John, morning, good questions. Let me start with the first question in terms of how long does it take to train and recruit. In the Automotive sector we have got different levels of technical skill. If it is a tyre fitter, we have a lot of those in the business, that is a relatively quick process and timescale. We can get tyre fitters trained and into the business. In fact in that part of what we do we have no capacity issues. That is partly why you see our sales growth still strong in quarter three but the margin mix moving because we are doing more tyres than service, maintenance and repair. For service, maintenance and repair skills it does take a lot longer to train. For example, for an MOT tester you have to have at least three years of garage experience and qualifications as well to become an MOT tester. In the short-term what we are going to have to do is to get better at taking more people from the market to Halfords, which is why when I have just talked about our performance I have made it quite clear why we think we will be able to pull together a compelling colleague proposition to do that. We do have a different toolbox to the majority of motoring services providers in the UK because of scale, because of the retail business that we have and because of the productivity going through [inaudible] the career path we can offer. There are a lot of things that we can do and we can leverage which gives me the confidence that we might not have had as much success as we have had to-date but we have got a toolbox that we can use and develop to get more people into Halfords from other garage service businesses. I hope that answers your question. There are also technicians, we call them tier 2 and 3 technicians, that actually require a little more training. They will need another year, for example, and they are the technicians that we use to do some of the more complex repair and services work.

In the longer-term it is probably worth mentioning the academies that we have already set up are the key. We believe now that we have the scale business we have got we will need to train more of our own people, either bringing them through our retail technician side into our garage business or training them from college, etc. That is the way to get the scale and do it in a more cost efficient and effective way. Of course those academies have been set up but they are not delivering the scale of colleagues that we need today because they have only been in place for a short period of time. Does that answer your question Jonathan on the skills side?

Jonathan Pritchard: Absolutely, yes. That is brilliant, thank you.

Graham Stapleton: In terms of bikes it is probably best to say that it is a tough market. It is 21% down year-to-date versus last year. That is the cycling market as a whole. To give everyone some confidence we are circa 10% down year-to-date versus the market's -21%. Whilst we have not painted a picture of share growth in detail you can see by the delta between those two numbers that we are definitely taking market share. That I am clear about and that has been a consistent theme all the way through the year. Our kids bikes performance, albeit we have not seen the share yet, I am confident with a 4.6% increase like-for-like in kids bikes we are likely to have seen a share growth there in December as well. The bottom line is that as we are seeing everywhere else in the retail industry, where customers are having to make decisions on big ticket discretionary items which is predominantly where we are with some of our adult bikes, they are deciding to delay the purchasing. That is what is impacting our business. That is what is impacting the market. Yes, there is less footfall into the cycling business. There are less clicks online in total through Google. What our job is to do, which I think we are doing, is to ensure we are taking as much share as profitably as we can through what market is left. I am confident we are doing that. That is bikes.

In terms of B2B and fleet, one of the reasons that we have put so much emphasis in growing the B2B and fleet part of our business is its resilience. It is definitely more resilient than the consumer part of the business. We are not seeing businesses shy away from their regulatory requirements on things like MOT. There is obviously more risk for businesses. They do that as well. We are also seeing the behaviours from businesses more consistent. We are not seeing businesses cancelling contracts at scale. We are also increasing the amount of business we do from others as we now have a nationwide commercial business network. We are very confident about that part of our business. There is huge growth there, as we have reported. There is more growth to come. The large acquisition is working as well as we expected. If not, we are actually seeing some upside on what we expected to see. We have got a very good leadership team at Lodge that are actually helping us now consolidate our business there and take more share. That is definitely a better news story in that part of what we are doing.

Jonathan Pritchard: Brilliant, very clear. Thank you.

Graham Stapleton: Thanks Jonathan.

Matthew McEachran (Singer Capital Markets): Morning guys, two or three from me as well and if I just kick off again on the recruitment side. I did hear your response to the earlier question so thanks for that. Could I just ask are you going to moderate the targets? If I could ask you to elaborate a little bit on what you think has not worked so far. Is it the approach, is it awareness or is it the payrate? In order to really try and deliver on the recruitment are you going to be changing any of these and in particular are you going to have to increase the rates of pay for these new recruits?

Graham Stapleton: I think what has happened over the last quarter Matthew is that at the same time as we started to ramp up our recruitment we have also seen an even more competitive recruitment market take place. As we were obviously part way through the quarter into an MOT peak as well coming [inaudible] preparing to be met. Our view is we are going to have to do a combination of things. There might be some more we have to do on pay. We are probably going to have to look at hours as people want to work less and more flexibly. We are going to have to look at what we do around weekend working. They are the three key areas that we are looking at. What we are not saying at this stage is that we think that we will have to reduce our profitability because we are going to have to sort these three areas out. What we are confident that we will be able to do is we will be able to work with supplier partners to help ensure we have got value from them to ensure we can deliver this. We also think that we can be more scientific with the Autocentres proposition. You know the work we have done on cycling over the last few years on price elasticity and proposition development. In the garage services sector that is not as far forward just generally as an industry. We have a consultancy in our business at the moment and we are also about to work with another company to develop some more scientific proposition building tools where we can look at how we are able to move pricing to ensure we can solve those three areas. The advantage with a services business, I said this when we started growing services, is that a lot of the very high value service, maintenance and repair work is very difficult to compare if you are a customer. How much is a steering column versus others if it is fitted? It is very difficult to find the answer to that on Google. Therefore there should be a much better way of optimising the pricing elasticity in this space because it is not as transparent as buying a branded Kercher pressure washer, for example, or a Garmin satnav. We are confident we can find a way of unlocking proposition opportunities and our supply economies of scale to enable us to give colleagues an even more compelling proposition. It means we will retain more which is primarily the first focus to retain more people but also attract more. In the short-term that is what we are going to have to do. We will not be able to grow our own fast enough to meet the unprecedented demand. That is the last thing that I would say here. If you look at the scale of growth we are talking about in the Autocentres business the disappoint we have is that it is not even bigger. The strategy of this business is to make that even bigger much faster but we do need the skilled technicians to do it. I am confident we will unlock it. It is just going to take longer than a few months.

Matthew McEachran: Yes, okay, no, appreciate that, thanks. Tying into that I wonder how much of an adverse influence this will have in terms of your previously anticipated synergies coming from National both n terms of quantum and/or phasing. Is there any update you can provide in relation to that?

Graham Stapleton: Yes, I am very confident that synergies that we put in the business case for National despite a huge decrease in the tyre market we will still deliver in full the synergies in the business case. That gives you a sense of how fast we are pedalling and dealing with the things that we can control. We can control the conversations with our supplier base and leverage our scale. We will deliver in full the synergies that we put into the business case for National despite a massively declining tyre market.

Matthew McEachran: Yes, interesting, okay. Then one final question in relation to cycling and the market there. I am assuming that the backdrop has become quite a lot more promotional. I wonder what the plan is for the surplus stock that you are sitting on. Are you just going to sit on that, reduce intake and normalise by the time you get to whenever it is, late spring/summer? Or are you actually going to take action and try and clear some of that through?

Graham Stapleton: The first thing to say is that we have seen more promotional activity over the last quarter in both motoring and cycling for sure, particularly in cycling. In cycling I think some of our competitors are really struggling now. We are seeing some discounting that when we look at it just does not make any sense whatsoever from a profitability perspective. My guess is that some businesses, particularly small ones, need to get the cash through. We are in that part of a recession where we are having to obviously compete against some unnatural activity in terms of what we are doing. We forecast that some of that would happen and the supply chain team in our business and commercial team have done an outstanding job in ensuring that we manage the pipeline of stock coming in. Even with the numbers that we have just talked about I am not looking at the moment at any significant issues on stock this year or our need to reduce our products in some form of clearance. We are not in that place at all. We are in good shape for stock. If we did decide to do something in that space it would be because we believe there was an opportunity to take share and still deliver PBIT. That might well be the case by the way at the end of this quarter because I think the market will start to be better able to be consolidated as we go through the back end of this quarter and some people start to come out.

Matthew McEachran: There has already been some of that, particularly in the premium end. When you say this year talking about stock and being in a comfortable position on stock this year, you are referencing the financial year rather than the calendar year with the peak season ahead.

Graham Stapleton: Financial year.

Matthew McEachran: Right, okay.

Graham Stapleton: I am referencing the end of March. That is where we expect to be.

Matthew McEachran: Yes, okay, that is very kind, thanks very much guys.

Jo Hartley: I was just going to mention the inflation in the cost of goods sold will mean that stock values are likely to be slightly elevated on the previous year end but as Graham says the stock volume is incredibly well controlled.

Graham Stapleton: Our stock position is where we expect it to be so there is no shift. Even though we have seen a dip in discretionary spend in December we are confident we can manage the pipeline for this quarter and year-end.

Jo Hartley: Yes.

Matthew McEachran: Got you. Okay, that is great, thanks very much. Cheers guys.

Graham Stapleton: Thanks Matthew.

Adam Tomlinson (Liberum): Morning everyone.

Graham Stapleton: Morning Adam.

Adam Tomlinson: The first question from me is really around costs and I know you have talked in the statement about the difficulty of guiding on FY24 but perhaps some of those lines that you have a bit more visibility on. An update on where you are in terms of FX, wages with the minimum wage increase coming through from April 2023. Have you made any decision around that and in particular whether you maintain the differentials between paygrades? Also, where you are on energy. That is the first question around costs.

Jo Hartley: Yes, let me take that one. In terms of FX for FY24 we are around 46% hedged now at a rate of 1.22. As we described at the interims we will see an inflationary headwind as a result of FX going into next year but we have bought about half of it, 46% to-date. In terms of energy we have bought 100% of our summer requirements and 50% of our winter requirement which means we have bought about two-thirds of the energy requirement for next year. We have locked in inflation as a result of that. As a reminder, we bought very well for the financial year that we are in and saw no inflation year-on-year in this financial year. As a result of that we may take a little bit more inflation than others as we look forward.

Adam Tomlinson: Are you able to help on the magnitude of that at all?

Jo Hartley: Yes, based on what we have bought to-date bearing in mind we have still got about a third of it to buy there is inflation of close to £10 million coming through as a result of the buy we have made to-date.

Adam Tomlinson: Okay. That is helpful, thanks. Then on wages as well?

Jo Hartley: Yes on wages the honest answer is we have not made a final decision on pay review or payrates going into next year. We flagged the fact that the increase in the minimum wage would have an impact at the interims but we have not concluded it. Given the challenges that we have described that we are facing in the Autocentres business, it is likely we will need to maintain some of our differentials but we are not in a position at this stage to quantify that because we have not made our final decisions.

Adam Tomlinson: Okay, thank you, that is helpful on costs. The second question was around bikes. I know you have mentioned bigger ticket items in terms of actual bike sales. I am just wondering what kind of trends you have seen on perhaps some of the parts, clothing and accessories and the servicing element of bikes which is perhaps lower ticket. Just the trends in there.

Graham Stapleton: We do not normally go through that level of detail but I will give you a sense Adam. Servicing has been a bit more resilient relatively so we are definitely seeing a pattern where some customers are looking to maintain their existing bike rather than buy new bikes. That is a trend we have seen throughout the year and that has not changed. In terms of the packs it is there or thereabouts in terms of the trend that we expected to see. We are not necessarily seeing that go up further or down more. It is in line with the rest of the cycling proposition.

Adam Tomlinson: Okay, thanks, that is helpful. Then the final question please was anything you can give commentary-wise around expected net debt at the year end. I am also interested in any thoughts you have around the dividend, potential maintenance of the dividend year-on-year or is it sensible to assume that comes down in line with profits? Thanks.

Jo Hartley: Taking the question on net debt, we do expect to be in a net debt position, a net bank debt position at the end of the year. As you will recall, we were cash-positive when we announced at the interims but subsequent to that we have obviously acquired Lodge. We are expecting to be in debt from a leverage perspective including our IFRS 16 lease debt. We do expect to be within our guided range of 1.8x excluding M&A and 2.3x including M&A at the end of the year.

Adam Tomlinson: That is helpful, thanks. Any comment, just to follow up, on the dividend?

Jo Hartley: Our expectation at the moment is that we will continue to pay the dividend in line with what we paid previous year although we have not made a final decision on that yet.

Adam Tomlinson: Okay. Helpful, thank you very much.

Graham Stapleton: Thanks Adam.

Kate Calvert (Investec): Good morning everyone. Two questions for me. The first one is on the tyre market. I know no downturn is the same but could you elaborate on how the tyre market behaved in previous downturns and how long did the consumer hold off spending? I am trying to get a feel for why it might be different this time. The second question is, how much did the success of the Motoring Club do you think exacerbated the mix swing away from higher-margin jobs in Autocentres as you had to satisfy some of those MOT offers?

Graham Stapleton: Let us start with tyres to begin with. Thanks for those questions Kate. It is very, very difficult to look at the past as a forward proxy to the future because the last downturn, the financial crisis, obviously had different dynamics to the one that we have today in terms of what it means for consumers and the specifics of the cost of living crisis. If you took the data from last financial crisis, I cannot say which supplier, we have spoke to at least two very big manufacturers of tyres to get this data. Last time it was up to six quarters, so between four and six quarters that they saw before the market started to get back to some form of normality. It was longer than they expected at that time in the 2008 crisis.

Everybody was expecting it to be no more than 12 months because of the MOT period and the fact that that would then correct where things were. However, it actually took longer in the last financial crisis than everybody expected then. Looking at that data, that is why we are confident that FY24 should see a recovery because you are into a position then where the vast majority of those customers will have been through an MOT if they have got a car that is over three years old. We have seen a slight improvement in the tyre market over the last month. That gives us a bit of confidence. We think the wetter weather may well have helped and people skidding on bald tyres. Aquaplaning has probably made some people think about tyre replacement now but it is definitely taking longer than everybody expected. Our supplier partners are also forecasting an improvement in the tyre market next year as well in the way they are building their budgets. That is the other reason that gives us confidence that we should be looking at a similar pattern. I cannot give you a load of detail there Kate but does that help a bit?

Kate Calvert: No, that does help. Thank you very much. Yes, it is very useful.

Graham Stapleton: The Motoring Club actually has not had any negative impact on the mix in Autocentres. What it has done if anything is given us a slight upside because we have been able to present MOT, service, maintenance and repair customers to the garage business without having to spend acquisition on Google to get them. We have been able to reduce the cost of acquiring customers and present customers from the Club to the Autocentre business to deliver the MOT numbers that we can actually do. The missed opportunity is the fact that we have then not been able to convert as much of the existing MOT base that we would normally get through the normal routes of acquisition. That is one you can see that is still growing but we are just not growing as much –

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