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Presentation

Operator

Hello and welcome to the Halfords Group Update Call. Throughout this call, all participants will be in listen-only mode and afterwards still be a question and answer session. Just to remind you this conference call is being recorded. I will now hand the call over to the speakers from the Halfords Group. Please go ahead.

Graham Stapleton

Thank you. Good morning, everyone, and thanks for doing the call today. I'm Graham Stapleton, Chief Executive of Halfords, and joining me is Loraine Woodhouse, our Chief Financial Officer. I'll start by giving you an overview of this morning's statement and then we will be happy to take your questions.

So, in terms of trading: In the first 20 weeks of our trading year, we've seen good growth in Group service sales, online and B2B, but this has been more than offset by the impact of extreme weather comparators and low consumer confidence on our retail business. As a result, group like for like revenue was 3.2% less than last year.

Our auto centres delivered growth of +1.1% on a like for like basis and our retail performance ended the period down -3.96%. More positively gross margin across motoring, cycling and auto centres has improved year on year, and we continue to control costs tightly across the business. Looking at our overall sales performance in a bit more detail.

As I mentioned earlier, we've seen positive year on year growth in Group service-related sales. This was delivered to improve service penetration and the introduction of new weCheck and cycle care services. Group online sales also grew strongly at +8.4% year on year with 85% of halfords.com orders continuing to be collected in store. B2B delivered strong double-digit year on year sales growth following increased sales focus and investment online.

Moving to retail in a bit more detail then. Given the extreme hot and settled weather conditions last year, fighting sales performed in line with our expectations at -1.1% like for like. We continue to see very strong growth in the rapidly developing electric bike category and less discretionary kids cycling area. However, this was offset by weaker big ticket discretionary mainstream cycling performance as a result of weakened customer confidence.

Given the macro uncertainty, we believe this trend is likely to continue. However, remain competent of the long-term growth potential of cycling. For motoring, despite continuing to take market share in many of our core motoring categories, we saw retail motoring sales decline -5.9% on a like for like basis.

Less discretionary areas of spend performed well with our core three Bs (bolts, blades and batteries) returning to growth in the period. As with cycling, performance is weaker in big ticket discretionary categories, such as workshop and car technology where some consumers are consciously delaying spend. Motoring has also been impacted by this year's cooler, wetter weather, particularly in the areas of touring, camping and car cleaning which benefited from long periods of warm weather in 2018 and a more pronounced location trend.

Turning to auto centres. Auto centre sales growth continues with like for like sales +1.1% with both our garages and fleet business in like for like growth. The business continues to make strong progress against the auto centre transformation plan and is on track to deliver profit growth again year on year.

Now moving to our strategy and looking at that. We continue to make progress against our customer strategy to inspire and support a lifetime of motoring and cycling. We are already seeing early positive results that will underpin the long-term sustainable growth of our business. At the interims in November, I plan to update you in more detail on the strategic priorities for our business. However, I want to share with you, some headlines on progress now.

Against our strategic objective to inspire our customers through differentiated super specialist shopping experience, our integrated group website remains on track to launch later this year. The re-platform will allow customers to access services from both retail and auto centres through one website for the very first time. This will provide a truly exceptional level of choice and convenience where for example customers can book their servicing when they want and where they want in a garage, in store, or at home or at work, all at the touch of a button.

In store we have also refreshed the cycling space in 220 stores to deliver a better shopping experience whilst generating working capital efficiencies through a 'right range right store' approach. The remaining stores will be relayed during the second half of the year. In terms of supporting our customers for an integrated, unique and more convenient services offer, another of our objectives, we have eight Halfords mobile expert vans now in operation, providing a wider range of mobile services to our customers. We are proud that that business currently holds 9.5 Trustpilot score.

The financial performance of vans based out of our first regional hub is positive and a further rollout is planned later this year, which will increase our UK coverage further. Added to this, our on-demand retail motoring services trial in auto centres garages continues to deliver promising results and these two initiatives combined are important enhancements to our servicing offer.

To enable a lifetime or motoring and cycling, we have continued to invest in strengthening our financial services offer for our customers and financial services delivered double digit growth year on year in the first 20 weeks. In addition, through targeted cross-group promotions, the percentage of customers shopping across both retail and auto centres has increased by 10% year on year and we are looking to increase cross-shopping penetration further.

Finally, coming on to our guidance for the full year. During the first half of the year, we have seen weaker sales growth than we expected, the impact of which has been partially mitigated by stronger margins and tight cost control. Poorer summer weather together with weaker consumer confidence has had a negative impact on performance, all be it less discretionary categories particularly motoring services have been more resilient.

At this point in time, the impact of the uncertain economic environment remains an ongoing risk in the second half and we will therefore remain focused on improving gross margins and managing the cost base. Despite the challenging environment we have seen a positive contribution to sales and profit from key elements of our customer strategy. We will continue to actively invest in these areas in the second half, focusing our resources where we see good growth opportunities.

On this basis, we would anticipate FY20, underlying profit before tax to be in the lower half of our understanding of current market expectations. So, between 50 million to 55 million. So, in conclusion, despite sales growth in Group services, online and B2B, we have seen our overall sales impacted by cooler, wetter weather and a weaker consumer confidence year on year. The market has been challenging but we are pleased to have seen an increased market share in our core categories and a growth in our service-related sales.

In the second half, we believe the economic and political uncertainty will continue to impact big ticket discretionary spend and therefore, as in the first half, we will continue to improve gross margins and focus on controlling costs. We set out a new strategy for the business at the end of last year and whilst it is still early, we have already seen encouraging signs of progress. We remain confident that it is the right strategy to drive the sustainable growth of the business and I look forward to updating you in detail on its progress at our interims in November.

Thanks for listening. We will now be happy to take questions.

Q&A

Operator

And if you do wish to ask a question please press 01 on your telephone keypad now. If you wish to withdraw your question you may do so by pressing 02 to cancel. And the first question is from Jonathan Pritchard from Peel Hunt. Please go ahead. Your line is now open.

Jonathan Pritchard

Morning. Just on the store estate. Are you happy with the scale of the store estate and the look of the store estate because I think that even though there are external factors this is a disappointing update and I think urgency is required in refreshing the store estate. Do you agree? And if you do agree, do you think that perhaps having a more free cash flow to play with, i.e. cutting the dividend, might be the way forward?

Graham Stapleton

Hi Jonathan, it's Graham. Thanks very much your question. Let's break it down into a couple of parts. So, in terms of the scale of the store estate, I think we said at the capital markets day that we are going to continue to review the size of that retail estate. At the moment we are closing around about six stores a year and I think that's what we indicated we would continue to do. Obviously with all the current headwinds and climate, we will continue to review every store on a case by case basis. We're fortunate enough to have some short lease lengths. So, I think from memory we've got well over 200 leases up for renewal within the next four years. So, unlike some other businesses, we have ample opportunity to look at that shape of retail estate quite regularly and we are doing it very forensically. So, in terms of the shape side of the retail estate, I think we're onto that.

In terms of the shopping experience in a retail store. Absolutely, it can be improved and updated. I think what we said earlier in the year though, is that we wanted to prioritise our investment in this financial year to our web platform and our services business because we felt there were bigger opportunities there. And equally because customers start their shopping mission online. We wanted to ensure the right platform was in place before we developed the physical assets of the business.

We are spending a little more capital this year than we did last year. So, we're not spending much less, we're spending a little bit more even in these uncertain times, unprecedented uncertain times. We will be able to show I think some examples of where that shopping experience in a retail physical store environment will go next year.

Jonathan Pritchard

Okay, that feels like quite a long time ago, but as I say I just feel as though you'd be able to run faster if you didn't have the millstone of the dividend. Have you got any remarks on distribution at this stage?

Loraine Woodhouse

Hi, Jonathan. No, we didn't feel it was appropriate to talk about the dividend at a 20-year trading statement. Clearly, when we get the half year, as Graham has mentioned, we will be talking a little bit more broadly about the strategic progress and at that point in time we will obviously talk further about the dividend.

Jonathan Pritchard

Okay, thank you.

Graham Stapleton

Thanks, Jonathan.

Operator

Next question is from Tony Shirette from Whitman Howard. Please go ahead. Your line is now open.

Tony Shirette

Morning, Graham. Morning, Loraine. Just, not very similar questions. I just wondered if you could give us a bit of an update on the financials in the mobile van trial that's encouraged you to roll it out. If you could give a bit more granularity on that, as the first area. Secondly, in terms of the Opex containment that you're currently being able to achieve, I wonder what sort of areas of Opex you've been able to contain. And lastly, bearing in mind the way that our government is screwing the currency amongst other things, I just wondered if you could tell us what your hedge position is going forward? Thanks.

Graham Stapleton

So, thanks for your questions, Tony. I suggest Loraine I take the van one and then perhaps you pick up Opex and currency?

So, in terms of the vans, as I said in my statement, the great news on the Halfords mobile vans is the customer demand is very significant. The feedback we've had from customers with that Trustpilot score at 9.5 is exceptional. The other good news for Halfords, as a group, it seems to be resonating this service with younger customers as well, which are the customer group we want to attract most at the moment.

What we've found in terms of the economics is we've got to the stage now over the last six months where we haven't just got an individual van in an area. We have opened our first hub in West London, which means we've got a number of vans operating out of that hub, which gives us some economies of scale and operational efficiencies and it's that that's given us even more confidence that we can make the economic model work. Certainly, on a per job, per van basis now, it's looking very positive.

So, our plan is to roll out more of the hubs that we're talking about there during the course of this year. At the moment, even with eight vans, we have actually got access to about 30% of UK households, albeit obviously we couldn't service everybody if they phoned us on the day. We are literally getting into that amount of the UK.

Tony Shirette

Okay. So no cannibalisation? Have you been able to do tests on things like the overall impact within the region?

Graham Stapleton

Yeah. Absolutely. I think it is a really good question. The cannibalisation is very minimal, and I think it is partly because we are attracting a very different customer type for that mobile service to home or work. So, it tends to be younger, more female orientated. It's also customers of course, that maybe have a problem with their car on the drive and cannot then drive it to a store or a garage, that at the moment we don't service. And we think that's quite a big percentage. If your battery is flat, you can't go anywhere. You need someone to come to you. So very, very minimal cannibalisation. Lots of additional customers and a model that's starting to make a lot of sense from a financial perspective.

Loraine Woodhouse

Morning, Tony. Shall I talk a little bit about the Opex? Clearly when sales are challenging, we've had to go through the cost quite forensically and we've seen success in a number of different places actually. And I would say we've done it by and large by being a bit more forensic about when and where we apply costs. So, some of the big areas we've seen good progress on are logistics, where we've been able to replenish stores in a much more cost-effective way. So, without materially impacting availability we've been more precise about when we replenish and how we replenish. So, that has been quite successful.

We've hired a new procurement team, so every contract now goes through a formal procurement process. So from a GNFR perspective, we're seeing savings on almost every contract that comes through just through applying good procurement disciplines, I would say. Marketing is a good example of that where we've managed to achieve the same for less. We're obviously seeing some positive impacts from any rental reviews that come through, so I think we've talked about on average around 10%. And then on people costs: in store again we've tried to be a bit more clever about timing and the resourcing of stores to when we see greater activity.

So, we've tried to be more specific about right time right place. And then in the support centre. We obviously still need to continue to invest around our strategy. But where we've been reviewing resource to make sure that we've got the right resource focused on the right thing. So we've actively taken resource down if it isn't a strategic priority.

So the honest answer is almost everywhere, and we've seen good opportunities. Many of them a bit more tactical in nature. Obviously, over time, there are some more strategic opportunities to go for, but where we've seen tactical opportunity, we've been able to take them. So that's the cost piece. On the hedging: we are fully hedged for FY20 and we hedged out at around about the 130 mark so not dissimilar to last year.

We are 20% hedged approximately for FY21. Obviously FY21, more challenging given the economic uncertainty where the sterling is sitting at the moment. But we will work through our plan for hedging effectively. We're thinking about our business in different segments and some of the segments, the growing segments actually, are much less vulnerable to FX, which is encouraging, but we will always have an area of discretionary spend where we are subject to the vagaries of the dollar.

Tony Shirette

Thank you very much. Yeah, yeah, very well. Thanks.

Graham Stapleton

Thanks, Tony.

Operator

Next question is from Adam Thomlinson from Liberum. Please go ahead. Your line is now open.

Adam Thomlison

Morning, guys. Just a few more questions in terms of category performance if I can. Firstly, on the three Bs. So, the return to growth there: If you could give a little bit more detail in terms of what's actually driving that and any colour you can give around the penetration in terms of fitting on those three Bs. And then more widely, the growth in services, the initiatives that are achieving that given you've still got the impact from the new website to come later in the year.

Sorry, secondly just on cycling as well. -1.1% on like for likes. It feels to me as though that could have been worse given the weather and the consumer backdrop. So, just wondering if you give a little detail as well around the performance from mainstream versus the more performance end. So, your treads, wheelies, and your Cycle Republic.

And then just thirdly, in terms of some of the more structurally challenged areas, the statement mentions weakness in some of the bigger ticket categories like car workshop and car technology. Some of those areas are facing more structural challenge, so I'm just wondering how much of that was an impact and what you can do to offset that as well.

Graham Stapleton

Okay, shall I start? So, if we start with the three Bs and the performance. We have actually what we would call 'range reviewed' a part of that range during the course of the last six to 12 months. So, we've put a different range for example of bulbs on display which is a much bigger proportion of own-brand bulbs, displayed more effectively in store. So, part of the growth has come from reviewing the ranges and introducing new products and new range architecture and hierarchy and structure.

Part of this is what we've talked about already, which is these are less discretionary. So, categories like this where customers have actually had a problem with their lights or their windscreen wipers or their battery fails. It's not really discretion whether they replace it or not. They have to do something with it. So, as a consequence, we still see the demand coming through better than we do in the more discretionary parts of the business.

So, I think it's a combination of a better range architecture, bigger focus on own brand, coupled with the fact that these items are less discretionary from a customer perspective. There's more demand there in the market, regardless of the headwinds. In terms of penetration. Penetration has grown. I think we said that from memory in our in our announcement. We have seen a growth in penetration of fitting on these services. We're very, very focused on service-related sales. It's a big part of our strategy. There's been more training and more focus in the retail business on that and as we also said we are bringing some of these fitting service jobs into our auto centre services business as well which will mean more of those types of services for garage customers too.

Group services overall. I think that was your last point. Look, we've seen a growth in that. A continued growth. A continued increase in the proportion of the business-related group services. Just to give you an idea of the scale we're talking about here by the end of this year, we forecast that about 38% of our sales will be either service related or B2B. So, it's a very significant number now and that's grown significantly over the last 12 to 18 months. And our strategy very much is to continue to grow. That's because it's where we have a much bigger market share opportunity. We only have 2% of the garage services market just remind everybody. And it's a more unique and differentiated proposition versus other retail businesses etc. and Amazon out in the marketplace. So, some green shoots, some good progress and we're very confident that remains the right strategy.

In terms of cycling sales. You're right, we were as we forecast to be. So, after the hottest summer in 100 years last year, we weren't expecting to see, particularly with the consumer confidence where it was a massive growth in cycling sales on the back of last year's summer. We were expecting a 1% decline. That's exactly what we delivered. It's split if you look at the moving parts of the cycling business. Electric grew very strongly at 40%. So, starting to become a much bigger proportion of our business.

And obviously a growing part of the cycling market overall and kids cycling, which is much less discretionary because you'll by your first kid's bike because it's your first kid's bike, that also performed well offset by the big ticket discretionary spend impact that we saw in mainstream adults. So, where some leisure cyclists are deciding to delay their spend on those big-ticket items.

But overall, the cycling business was as we expected it to be. The performance cycling business is performing well. So, what we're also seeing, another theme to our performance, is that in the performance cycling business where bikes are an integral part of someone's life i.e., they use them to ride to work or they are using them consistently, weekly as a social leisure activity. Again, that spend tends to be less discretionary. It's something you're going to continue to spend on and as a consequence, we're still seeing growth in that marketplace.

So, that's cycling. I think the last point was this in terms of other big-ticket items, I think you were mentioning motoring workshops and technology and is there a structural challenge there. In technology, there is always change and what we are finding there is whilst we are seeing some impact with weaker consumer confidence and people delaying big ticket purchasing, we are still seeing growth in new technology like dash cams. Not just growth but growth in market share as well.

So, we don't think there's a structural issue here. We just think there is a consumer confidence issue impacting the timing of some consumer spending. Just remember that this time last year, we were in low single-digit growth on motoring and that wasn't that long ago. So, it doesn't feel structural. It feels much more short term and confidence related to me with some weather impact.

Adam Thomlison

Okay, thanks. Are you able to give any rough idea on the percentage of sales it comes from, those areas you mentioned: the workshop and the car technology?

Graham Stapleton

I don't think we've published that before, so I'm not sure we're able to give that level of detail here. It's obviously commercially sensitive as well.

Adam Thomlison

Okay, fine. Okay, thanks for those other answers.

Graham Stapleton

Yep. Thank you. No problem.

Operator

Next question is from Adam Cochran from Citi. Please go ahead. Your line is now open.

Adam Cochran

Hi. Good morning. A question really on the business model as you look at managing margin and cost control and the number of people in the stores. At the same time as trying to build an increased service-led proposition. I just wanted to make sure that when you're – you talked about the Halfords mobile expert Trustpilot score – the measures that you have in store for customer service or however you're measuring some kind of NPS. You're not seeing any deterioration in those metrics as you are taking some of these cost measures importantly.

And secondly, in terms of the gross margin uplift that you saw in in the period, have you decided not to re-invest some of that in promotions or price because you don't think you get the pay off in terms of sales uplift? Thanks.

Graham Stapleton

Yes, good questions, Adam. Thanks for those. I think first and foremost, we do measure customer experience, not just in retail though but in auto centres, our garage business and in our mobile business too. So, we've obviously got those different businesses, all equally important to us. The good news is that in all of those businesses the customer experience scores have actually gone up. So, the way that we measure our services– in fact in our garage services business they have gone up significantly, which I think is contributing to the auto centre growth in both sales and profitability that we're seeing.

So, we're very, very cognisant of the fact that yes, we need to look at cost but we have where possible ring fenced frontline colleagues that deal directly with our customers because if we're going to build a services first business, we have to make sure the experience is good. Now, is it perfect? Could it be more consistent and even better? Of course, it could. But certainly, the metrics that we're seeing is definitely moving it in the right direction now and we're very, very focused on that.

In terms of your second point around gross margin and investment. We're confident we're getting the balance right so wherever we have market share days – and we have it for a fair number of categories within motoring and we're now starting to get some data in cycling – wherever we've got it, we are seeing shared growth across the majority of what we do, which suggests to us that we are investing and seeing the right results where we are doing it.

We have, however in categories that are more discretionary, and we have seen a drop off in customer demand and we know through the customer insight, not just through the numbers, that that's happening. We have in those instances decided not to chase aggressively categories with much, much weaker demand because we think overall that would be negative for Halfords. It will mean that in effect we will make much less money on a similar or less than our sales.

So, we've been quite selective looking at where we are currently, but I think importantly we have grown share.

Adam Cochran

That's great thank you.

Operator

And just as a reminder if you do wish to ask a question, please press 01 on your telephone keypad now. The next question is from Kate Calvert from Investec. Please go ahead. Your line is now open.

Kate Calvert

Morning. A couple from me. The first one is relating to your profit guidance range of 50 million to 55 million. Can you give us an idea of what the assumptions are in terms of like for likes behind the top and the bottom end of that range? And my second question is on bike inflation. What sort of level are you seeing on bike inflation at the moment relative to the wider market?

Loraine Woodhouse

Hi Kate. Shall I cover the first one? We've given a reasonably wide profit range obviously which reflects the uncertainty around the market at the moment, particularly with the consumer. I don't want to be too precise around the sort of like for like guide the top and bottom of that range because it is also obviously very contingent of what we're able to do with margin and cost. But what I can say is that as we go into the second half, our comparatives become an awful lot softer.

So we are expecting to see an improvement in the second half. But we don't need to see significant like for like growth in order to deliver the top end of that range, if that makes sense. As long as we're able to maintain what we've seen on margins and costs. So, that's what I'd say on the first point.

On the second point. I think your point on price inflation. In essence, none. So, what we are seeing is ASP movement but that is about mixing to more expensive bikes particularly electric. So, I think at the moment, it is not a market where any retailer can really be forcing through price inflation per se, but actually where categories are innovative, new and there is considerable customer demand, which there is for electric bikes and scooters. We are able to benefit from the ASP coming through that, but it is via mix and not price.

Kate Calvert

Given that in cycling most of your competitors are independents and they don't have as many levers to pull in terms of cost etc. are they just passing straight through price increases or starting to put prices up, do you think?

Loraine Woodhouse

No, we don't think so. The truth is, we believe we've taken some share in cycling. It is an incredibly difficult environment at the moment for both independents and mainstream retailers. A lot of independent bike stores make a lot of their money from servicing. They have a large service income. So, to some degree, they rely on that as much if not more than they do from selling bikes.

But we don't believe that price inflation is across the market anywhere in cycling. Interestingly, some of the mainstream players particularly in premium have probably been a little bit less promotional, which suggests to us they are trying to manage their bottom line rather than their top line.

Kate Calvert

Okay. Thank you very much.

Operator

Next question is from the line of Matthew McEachran from N+1 Singer. Please go ahead. Your line is now open.

Matthew McEachran

Morning guys. I have a follow up question in relation to the motoring side. I understand that you don't want to give away the mix or scale of the workshop and tech business for commercial reasons. I just wondered if you could maybe give us some steer [ph 00:33:53] to whether or not when customers are purchasing in those areas, are there a lot of add on purchases just in the normal part of mix and consumables?

Are you losing a rump of business that would ordinarily be there but is no longer there because these customers are just not coming to store and they're not shopping or do they tend to be isolated, single purchases, which are not cross-shop?

Graham Stapleton

Thanks for the question, Matthew. I think it's split really. In workshop less so. So here it's things like your big tool chests that are hundreds of pounds potentially that people are just deciding to delay spend on because they are able to do that. They're waiting. In tech, again, this is your £100 to £200 dash cam or satnav etc. that people are delaying spending on there, there is some potential additional fitting spend.

It's not as big as you would get in the three Bs. We don't have the same level of penetration of fitting. This is service-related sales in tech as we do there. But yes, there will be some knock-on impact on add-on on tech but not as much on workshop.

Matthew McEachran

Yeah, okay. And your comments– Within this, what's happening vis-à-vis DAB radio and the activity levels there?

Graham Stapleton

We're just about to look at completely refreshing the audio part of the business actually, which will include that. So, we're looking at Apple CarPlay, Android CarPlay, DAB, and really trying to bring up to date our audio part of the motoring business. So, we're literally in the process of repositioning that at the moment because that's one area of our technology offer that is behind where it needs to be, and we do need to accelerate how we improve the customer shopping experience there quickly.

Matthew McEachran

Sorry, would you say that this period includes a period where there was some disruption or where you were actually making changes or exiting out of old stock. Or is this not a factor in terms of the weaker performance?

Graham Stapleton

Not really. At the beginning of the financial year, we said, [? 00:36:38] that we did refresh over 200 cycling stores. That did mean right range in those stores and that did mean some change. So, there would have been, obviously as you would expect any major change in layout, there will no doubt have been some transition period, but nothing material, certainly nothing that we would suggest created any of the numbers today.

Matthew McEachran

Yes, okay. So, I'm just focused on this motoring and the bigger ticket areas which are obviously more discretionary. Do you think that the exit rate is worse than the average over the period? Is this still deteriorating as we speak and therefore fixing the audio and refreshing the audio range and proposition is a must do or how are you feeling about the direction of travel here?

Graham Stapleton

Fixing the audio range is not related to this. That is purely all the category strategies and customer insight that we've got suggests that we just need to improve the customer experience in that space because the technology and optionality for customers have changed. Apple CarPlay, Android CarPlay are now much more important, and they have to feature more centrally in that offer.

So, that's nothing to do with replacing the other discretionary areas of spend, it's just something we must do to keep up with technology themes and trends. In terms of exit rate on these other categories: no. At the end of the day, our guidance assumes that we will continue to see what we've seen in the first half in the second half. Not further deterioration at this stage.

Matthew McEachran

Okay, that's very good. Thank you very much.

Operator

And there are currently no further questions registered, so I'll hand the call back to the speakers. Please go ahead.

Graham Stapleton

Okay. Well thanks very much indeed everyone for joining today and we will look forward to catching up with you in November if not before.

Operator

And this now concludes the conference call. Thank you all for attending. You may now disconnect your lines.