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Transcription

Halfords Group Update Call

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16 January 2020

PRESENTATION

Operator

Hello and welcome to the Halfords Group update call. Throughout the call, all participants will be in listen-only mode and afterwards, there will be a question and answer session. And just to remind you, this conference call is being recorded. I'll now hand the call over to the speakers from Halfords Group. Please go ahead with your meeting.

Graham Stapleton

Good morning, everyone, and thanks for joining 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 a brief overview of this morning's statement and then we'll be happy to take your questions.

Looking back at the period, against the backdrop of low consumer confidence and an exceptionally mild winter, with few if any frost days, we saw a solid sales performance from the group. This is primarily on the back of strong cycling sales and continued growth in motoring services and B2B. As a result, our total group revenue was up 4.6% per quarter with like-for-like sales ahead by 1.3%.

We took the decision to focus on retaining margin rather than chasing unprofitable sales. The impact of which saw our solid sales performance being complemented by gross margin growth alongside our continued focus on tight cost control.

Looking now in a bit more detail. Retail was up by 0.8% like-for-like on the back of a strong cycling performance and an improvement in our retail motoring categories. In cycling, we saw strong like-for-like growth of +5.9% in the quarter. This was a result of our product innovation and exclusive ranges alongside our service and bike build proposition. Whilst retail motoring like-for-like declined by -2.7%, this was an improvement on previous periods.

With very few frost days versus an average winter, we saw no material benefit year-on-year from the weather, yet we continue to take market share in many categories demonstrating the strength of our offer.

Looking now at online. Online like-for-like revenue grew +27% in this period. Black Friday delivered a strong digital performance with online conversion up +6% year-on-year and attachment rates up +9% year-on-year. This was our biggest ever day of online sales, but it was superseded by Christmas where we broke our online order value records on Christmas Eve, Christmas Day, and Boxing Day.

Around 80% of online orders were click and collect in the period. This continues to highlight the importance of our store network in the delivery of added value and of the web re-platform scheduled for this financial year. The new website will significantly improve the digital experience for our customers, enabling them to access our entire offer across stores, garages and mobile all in one digital location.

Now let's move on to look at the detail behind cycling. We are very pleased with our cycling performance in this period. The growth that we saw here was driven by a number of factors. Firstly, a late reserve and collect deadline with a successful drive to boost collection rates. Also, our unique bike build service, which has real value for our customers and was offered right up until Christmas long after others had already stopped taking bike orders.

The uniqueness of our range with 85% of this being exclusive to us. This includes being first to market with the Disney Frozen 2 range, but also the exciting development of an entirely new and exclusive range of bikes with chunky [ph 00:03:40].

Growth was also delivered through better availability of our best-selling bikes. All of this was supported through the space relay programme in cycling, which we codenamed Project Peloton.

This has delivered a better shopping experience for our customers and helps secure strong sales growth, better margins and reduce working capital levels.

In terms of the trading period for cycling, we had a successful Black Friday. Momentum continued in the run up to Christmas with new orders continuing to come through and we ultimately experienced the highest ever sales of kids bikes in this period.

Christmas collection certainly came late this year. We saw tens of thousands of bikes being built for collection in the last week before Christmas, and Monday the 23rd of December represents our highest ever cycling sales day yet.

Moving now to retail motoring. Low levels of consumer confidence continued to impact the market, spending on bigger ticket discretionary items such as premium tech and workshop remain subdued. This was compounded by the lack of frost days versus an average winter.

Consistent sub-zero temperatures or frost days are what drives materially higher demand for maintenance and servicing products. Of course, this year, like last, has been mild. As a result, motoring has been more challenging. However, despite this, we grew market share in a number of categories, including tech. We also saw positive impact through product innovation for example, sales of our new car security range consisting of GPS trackers, locks and new own-brand RFID wallets are up 50% year-on-year.

Our core maintenance and service offering showed improvement. This was due to pricing, better merchandising, range rationalisation and the growth in demand to do it for new services, all of which have had a positive impact. Our three B's proposition: bolts, blades and batteries also saw growth, even though we saw no benefit from winter weather conditions.

As we grow our strategic focus on our service proposition, the impact of the UK's increasingly variable weather should, over time, be mitigated.

Looking now at our group services business and service-related sales. Our group service-related sales now represent 27% of total sales, an increase of three percentage points between now and last year. Motoring services sales were particularly strong with growth of +17% year-on-year. We saw growth both across the business and through the recent acquisitions we have made in auto centres. Auto centres continue to perform well with like-for-like revenue up +4.6%. We have continued to invest in colleague training and the roll out of our work scheduling and workflow management system to improve our customer experience.

As a result, we continue to see a growth in our Net Promoter scores. I'm also pleased to say that after having won the award in 2019, we have again been nominated for the 2020 garage chain of the year in the car and accessory trader aftermarket industry awards – which is a big achievement.

The integration of McConechy's and Tyres on the Drive into the group is also progressing well and to plan. Both are trading in line with our expectations, and these acquisitions have helped drive total sales growth of over 30% in the auto centre business.

We continue to see services as a key differentiator for us. Visibility of our servicing offer will increase through our new website with customers being able to book services across store, garage and mobile on one website for the first time.

Moving now to our strategy and B2B offer. Again, this is an area where we have seen success continue with double-digit growth achieved in the period. B2B, which includes Halfords for Business, Cycle to Work trade card has seen a 32% growth year-on-year and now accounts for 16% of the group revenue.

We have launched the UK's first garage gift card in Halfords auto centres. This acts as a saving or budgeting plan with access to finance and I believe it will be of real benefit in helping customers manage unexpected costs. Financial services have continued to deliver for us, and the launch of our bike club gift card has performed well.

We have talked a lot about sales revenue across the business and I now want to spend a little bit of time on margin. As I've said, we took deliberate action to ensure we controlled gross margin. As a result of our actions, we managed to deliver better gross margin across the group. This was delivered through strong product selection with new innovative ranges, which, combined with our financial services proposition, negated the need for heavy or early discounting. We also saw uplift through service revenues and higher margins attached to product sales.

Finally, cost control remains an important factor for us. Operating costs have been well controlled again and are marginally below last year on a like-for-like basis, despite upward cost pressures.

Lastly, we've seen a good position on our working capital. As you know, the group remains cash generative and has a strong balance sheet and we remain confident that we will grow free cash flow over the medium term. We have made good early progress in our cost and working capital improvement programmes.

So, to summarise: Despite lower customer confidence and a challenging UK retail market and a mild winter, we have delivered a solid set of results. Within retail, innovation in our product ranges and a differentiated proposition has enabled us to deliver sales growth. Not only have we grown sales, but we've also improved margin, reduced stock levels and increased market share. In line with our strategy, our group service revenue increased 16% year-on-year and now accounts for 27% of total sales value.

Auto centres has continued to demonstrate good sales growth and remains well on track to deliver a third year of profit growth.

Finally, our B2B business continues to go from strength to strength with growth coming from Cycle to Work, fleet and Halfords for business.

Overall, I am pleased with our performance. We made a conscious decision to protect margin where appropriate and I'm particularly pleased with the like-for-like sales growth achieved alongside the gross margin improvement. I believe the results reflect the positive actions taken across the group and our continued focus on our [? 00:10:18] support lifetime strategy.

Looking ahead, we are not anticipating a near-term improvement in market conditions, with consumer spending on big ticket discretionary items likely to remain subdued. Our focus will continue to be on improving our customer proposition, building our services business and managing our costs and operations tightly.

Our strategic focus remains the same: an evolution into a consumer and B2B services-focused business with a greater emphasis on motoring, generating higher and more sustainable financial returns. As a result of all of these actions, we reconfirm our expectation for FY 20, underlying profit before tax on a pre-IFRS 16 and 52-week basis will be in the range of 50 million to 55 million.

Thank you. We will now take your questions.

Q&A

Operator

Thank you. If you do wish to ask a question, please press 01 on your telephone keypad. If you wish to withdraw your question you may do so by pressing 02 to cancel. There will now be a brief pause while questions are being registered.

And our first question comes from the line of Matthew McEachran of N+1 Singer. Please go ahead – your line is now open.

Matthew McEachran

Morning, guys. Thanks for taking the questions. A couple of bits and bobs from me. In reference to the absence of any freezing conditions, are you indicating that the niche-driven winter motoring products were again down year-on-year? Or was it more just a case of flatlining?

Graham Stapleton

We've certainly against an average winter. And we have to remember that year-on-year, last year was also very mild. So, we're not saying, against last year necessarily, we're seeing a big drop in sales on those products because it was very mild with very few frost days last year too.

The message to everyone today is more about against an average winter, that we've seen over the last five to ten years, we haven't seen any material improvement because of the weather. All that said, we have done quite a lot of self-help, knowing that we might have faced this and we have done quite a bit of work in the proposition side, particularly in three Bs, the batteries, bolts and blades, to help mitigate any impact of mild weather. We've actually seen some growth as a consequence in those categories year-on-year. But the weather certainly hasn't helped us against an average winter.

Matthew McEachran

Yeah. So, would it be fair to say that in terms of pointing the finger at the drags in the performance that it’s the big-ticket areas that is still weighing on performance, rather than any particular seasonal differences year-on-year?

Graham Stapleton

Absolutely. It's the big ticket, particularly discretionary purchases. So, if you were looking at expensive dashcams, satnavs and audio products, the premium part of that range, customers are just thinking a bit more carefully about whether they perceive that that purchase – not that they won't do it, but they want to have more confidence before making those very discretionary purchases. That’s what we're seeing, particularly in the motoring area, so in technology, workshop, toolboxes, that type of products.

Matthew McEachran

Okay, thanks. The other question really is around gross margin. You're obviously quite pleased with the gross margin performance. You've been able to offset the dilutive mix effect in terms of strength and cycling versus motoring. I'm just wondering a little bit about whether or not the B2B growth that you've been driving, is that also dilutive? And maybe just qualify a little bit in terms of cycling, whether or not the sales performance there was ahead of your expectations and actually margin is particularly up in cycling.

Loraine Woodhouse

Hi Matthew. So, margin actually is up in both categories: motoring and cycling. So, we were quite pleased with that. Obviously, as you say, we have a negative mix effect that we have to offset, but the incremental margin in both categories allowed us to do that.

B2B is, and it isn't, a drag on margin. It depends on the category. Cycle to work is a key booster for the cycling business and our margins were stronger in cycling, but clearly there is some kind of commission effect. Fleet, which is another core part of the B2B business, is a little bit dilutive in margin, but then there are other areas like gift vouchers, etc. where the effect is negligible. So, it's some and some, but overall those categories improved margin.

Matthew McEachran

And if you could just qualify a little bit. Pretty good cycling performance – you talked about the key drivers, but was that ahead of your plan? Was the late uplift in purchasing greater than you anticipated?

Loraine Woodhouse

A little bit, yes. So, we planned for a strong Christmas. We were thinking about the proposition and range, obviously, very early on in the year. We bought into a good Christmas, certainly in terms of kids' bikes, so we were pleased with the outcome, but we were pleased because it was the execution of a plan, effectively, rather than a really material surprise. We felt we delivered on the plan well.

Matthew McEachran

Understood. And in terms of where you're left on inventory, what is the profile of stock now in cycling? Does that leave you short on stock in certain areas or was it all about just getting the child's and kids' gifts out the door?

Loraine Woodhouse

We've come out of stock pretty clean, actually; we don't have significant overhang of seasonal stock, which is good. A lot of our lines are continuity lines, obviously. We've got one or two areas where bikes sold through incredibly quickly. So, mountain bikes is an example where we had just fantastic demand. So, there's one or two areas that have come out a little bit short, but we're already rebuilding those stocks.

Graham Stapleton

We were forecasting a strong Christmas anyway, because we were confident with a unique and differentiated and new ranges that we’ve got. Because it’s not too much over where we forecasted it to be, it has meant that we've come out pretty much as planned, and certainly season stocks will come out in a good place year-on-year.

Matthew McEachran

That’s great. Well done. Thanks very much.

Operator

Thank you. Our next question comes from the line of Adam Tomlinson of Liberum. Please go ahead. Your line is open.

Adam Tomlinson

Morning. Three quick questions from me, if that's OK. The first one, just picking out the strong growth rates in cycling and auto centres there. So, it feels like those were quite a way ahead of the general market performance. So, it'll be useful just to get your understanding in terms of what the market looked like over Christmas in terms of growth.

And then the second part of that question, just around the sustainability, of not necessarily those exact like-for-like growth rates, but just driving that positive like-for-like, is it a case of more of the same in terms of what you're doing with self-help? Are there particular initiatives you don't yet think have impacted but will come into play? Just some thoughts around the outlook going forward. That's the first question.

The second question, with regards to online, I guess very strong growth looks a little bit ahead of what we are used to from your reporting. Was that in line with your expectations? And I guess that's before the re-launch of the website in Q4, so looks like a strong performance. I'm just wondering a little bit more colour around the drivers of that.

And then just, thirdly, on gross margin, noting the comments in the update around not needing to heavily discount, feels like that's going against the grain of generally what we're seeing in retail, so obviously confidence in your offer, in your ranging there, but again just what's happening in the market in terms of the competitive environment and price cuts; anything going on there that you could give as well. That would be great.

Graham Stapleton

I'll try and take those and Loraine can chip in. In terms of cycling and auto centres, yes, they have both grown very well – just under 6% and just under 5% like-for-like respectively, in any market is pretty good at the moment, so we are pleased with the performance of those two areas.

In terms of our auto centres business, we don't get market share data in the garage world, so I can't give you a sense of whether that's a market share growth or not. In terms of the sustainability of the growth in the automotive business though, we are confident that this is the start of seeing some of the investments that we have made and are making coming through. So, the full benefits of the workflow management system, the operational systems, we will not have seen yet. We will see more next year. In fact, the second version of that workflow management software only just goes into our business this quarter in time for peak trading.

We haven't seen the benefits yet of the financial services offer fully in our auto centre business for sure either. We know that there is more demand for the auto centre. There's more demand coming into the auto centre business than we're able to fulfil currently, so we are recruiting more technicians. That will give us growth. And then of course, as we add additional businesses to our mix, be that more scale in our traditional business through McConechy's, and therefore the opportunities and synergies that come with that, albeit more mobile bands for our mobile business with the acquisition of Tyres on the Drive, you will start to see the benefits of those two acquisitions coming through next year, more than you will, obviously, the benefits in this year where we're concentrating on integration.

So, I think you should see auto centres as the start and a journey that we are continuing to develop with the investments that we're making – not the end. We're very, very confident there.

In terms of cycling, we've talked in the past about the conditions for cycling and macro conditions for cycling being good and I think some of that you are seeing within the performance of the cycling business now, with the growth of electric, with health, climate, all the things that customers – you see talking about; we talked about even in the press today. That is definitely feeding into the momentum we've got in cycling. I do think we will have grown share in cycling. We don't have the granularity that we do in the motoring side – we did OK – but we do get enough information from our suppliers and the general market and some sense of what's going on and I will be surprised if we haven't grown market share in this space.

The business, from a sustainability perspective, I would expect that growth to continue, because we've seen it come through electric and through new and innovative and unique products, and that's what our focus has been, and will continue to be.

In terms of online, your second question. I think online we've seen really good growth. How has that happened? Certainly, the optimization of the existing web re-platform. That's what our focus has been. We've seen better conversion on Black Friday and the peak events than last year – it was 5% up, and we've also seen better attach rates for sales online as well. They were 9% up on Black Friday. It is all about optimization, that experience, and then obviously in parallel to that, we've been developing a new web re-platform with the hope to bring all of that best practice onto a new web re-platform that brings together all of our business into one place digitally. And with the salesforce engine behind that new web re-platform, we'd expect over the course of next year for that growth to accelerate further.

Adam Tomlinson

And just on that web re-platform. Obviously, the hope is for that to go as smoothly as possible. Is there expected to be some sort of disruption to online there or do you see that as being pretty seamless in terms of the customer offer and just keeping the sales growing?

Graham Stapleton

It's a very significant web re-platform that we're undertaking, so there is always risk with anything transformation of this scale. We have some contingency in the plan to mitigate some of that risk. With any web re-platform of this scale you have to be mindful of that. One of the reasons we're deciding to launch this in this quarter, it is one of our quieter trading periods. So, if there is any risk, it is mitigated also by the lower levels of trade going through this quarter, traditionally. And we obviously want it to be in the right place for peak, which comes in the spring.

So, everything we're seeing suggests that we'll be in a good place. Just to give people confidence. We are on track to deliver that still this quarter and by the end of the financial year.

In terms of your third question, which was gross margin management. Yes, you're right. We have taken a different stance to perhaps some other retailers over this period. We have deliberately reduced our focus on chasing on possible sales and just cash and being a bit more deliberate about where we promote and how we promote. We've been able to do that because of the strength of the underlying offer. As I said earlier, 85% of our bike rage is unique and exclusive to Halfords now; you can't get it anywhere else. So, it means our requirements at discount is different because customers aren't able to compare and contrast a lot more of our products. And our aim is to continue to grow the scale of that within our business. Our relevance is there and the need to discount is less.

Adam Tomlinson

Great. That's very clear. Thank you very much.

Operator

Thank you. Our next question comes from the line of Ben Hunt of Investec. Please go ahead. Your line is now open.

Ben Hunt

Morning. I was just wondering if you could tell us where you are in terms of FX and where you're hedged for going forward and compared to where you were at the moment?

Loraine Woodhouse

Hi, Ben. We are obviously 100% hedged for the current year now. We are just over 50% hedged for FY 21 and at the moment we're hedged at just over 129. All things being equal, we expect to be able to move that up to 130 or just above by the time we're fully hedged out for the year. So, we've managed to carefully hedge through some quite challenging times for sterling, obviously. So, we've been smart about when and by how much we hedge over that period in order to be able to mitigate any downside risk. I think we're in a reasonable position given where the market has been.

We implemented some – not a huge number – but a small number of derivatives that allowed us to participate in any upside should the market move upwards. That will probably give us a little bit of [? 00:26:46] and help us to move towards that 130.

Ben Hunt

Alright. And then secondly, on your cycling performance. Have you been able to pinpoint any benefit you might have had from Evans stores have been closing at all or are you really not seeing any major [? 00:27:03] from them closing?

Graham Stapleton

There's no doubt where Evans stores have closed very close to our Cycle Republic stores, particularly, we have seen some sales transfer. There is no doubt that there has been that. In the last quarter, the performance cycling market has become very promotionally aggressive. So, we have seen a lower level of sales growth through quarter three in performance cycling than we've had through the previous quarters in this financial year because basically that part of the market has been very aggressive on price. We haven't followed that because we said at the start, we made a conscious decision not to go for impossible sales.

Ben Hunt

Yeah, OK. And then finally, could you give any more details on your progress accelerating the autos business and mobile expert. It sounds like it's been more of integrating the two recent acquisitions. But any colour on how that's all going would be great.

Graham Stapleton

It’s going absolutely as we planned it to. So, it's going to our forecast. Loraine and I have both been up actually to see McConechy’s in Scotland. We're really pleased with what we've acquired, particularly the colleagues were fantastic that we met. They are really pleased that they’ve joined the Halfords family; very excited and engaged. We see as much opportunity there as we thought before, if not a little more, and the same from a Tyres on the Drive perspective. We've been recruiting additional technicians for that part of the business, so we can fulfil the demand.

And, of course, that mobile part of our business, I think, will benefit more than any other when we launch the new web re-platform because at the moment that's not as visible to customers because it's relatively new and suddenly it will be visible to everybody that visits the Halfords brand. So that, I think, is very exciting for the end of this quarter.

Ben Hunt

Okay, great. Thanks.

Operator

Thank you. Our next question comes from the line of Tony Sherett of Whitman Howard. Please go ahead. Your line is open.

Tony Sherett

Thanks. Hi, Graham. Hi, Lorraine. Just a couple of things. First of all, in terms of the longer term, customer positioning regarding female customers, younger customers, is there anything you can tell us about progress you might or might not have made there?

And secondly, in terms of the way in which you are able to contain costs through the opex and working capital programmes, can you give us your sense of how much more or how easy it is going to be to sustain those mitigating programmes, as it were, during a tougher 2020, or a tough 2020? Thanks.

Graham Stapleton

No problem, Tony. I will pick up the customer one and I think Loraine will pick up the cost one. In terms of younger and female customers, there are a few things that we've done very consciously over the last year to attract more of that customer demographic. Klarna, our financial services offer, which we really have focused on heavily – we've doubled the amount of financial services business that we've had in the course of this year. What we are finding with Klarna is that we are getting more of that type of customer into our business, particularly younger customers with Klarna because we're providing better, easier options to pay across the business.

Equally, some of the product development innovation that we brought in – things like e-scooters for example, which we've seen huge growth in this year - that's also attracting a younger demographic of customer. So, if you just take the e-scooter example, not only are we offering that type of product which is more suited to younger customers, we're also then offering a Klarna financial services option as a way to pay for that product. So, in some instances, they are coming together to provide a very compelling proposition for different parts of customers.

The Halfords mobile expert division that we're developing with the integration of Tyres on the Drive, that's also more attractive to younger, female customers. They prefer motoring services work to happen either at home or at work than potentially going to some sort of garage. And the Do It For Me, we fit, we check options that we put into the market and even more aggressively over the last quarter have also resonated with those customer groups. So, there is some very deliberate actions that we are taking to change that.

Tony Sherett

Will you be able to give us some data at the prelims, do you think, of penetration of those age groups?

Graham Stapleton

Yes, we can certainly have a look at that, so leave that with us.

Loraine Woodhouse

Morning, Tony. If we talk about cost and working capital, you can tell from the statement that we're really pleased with where we've landed on, both costs and working capital stock, in particular. It's fair to say that we went after the lower hanging fruit initially, as you would expect. There were some areas where we could go after both of those quite quickly, particularly around stock and putting in really good discipline about the level of stock that we buy and being very analytical about our gross margin return on investment. So, we have some good, I think, robust analytics that go around how we purchase stock. So, all of that has gone in over the last year. We are pleased with the impact of that.

Similarly, on the cost base, a better procurement function and, again, better discipline around the spending of costs; so, all of the approval or processes that you would expect.

There is further opportunity. It becomes a bit harder to get after, naturally, as you get beyond the low-hanging fruit, but we have cost opportunity in supply chain, in property, and in our support centre still to go after. It's more structural, so it takes a little bit longer to go after and we need programmes in place to target it, but we have that under way.

And then in stock, similarly, we think there is more opportunity. Probably not at the scale that came out over the last year because that really was quite significant on an average basis, but there is certainly more to go for and our plan is to access that. It's through a combination of things. Better means of buying that stock, so shortening lead times, which is something we are working hard on, particularly in cycling. It's also around the range that we hold in store. So, we were successful in changing cycling. We will go after motoring this year to make sure we put the same disciplines in. So, it's a little bit harder to get, but it's definitely there and we still see opportunity going forward.

Tony Sherett

Great, thank you very much.

Operator

Thank you. Just to remind everyone, if you would like to ask a question, please press 01 on your telephone key pads. You can cancel by pressing 02. And there will now be a further pause while any questions are being registered.

And we have no further questions on the line, so I'll hand the call back to our speakers for closing comments.

Graham Stapleton

Thank you very much. Thanks, everybody, for joining the call today and we look forward to catching up with the end of year results too, and if there's anything in the meantime, please come back to us.

Operator

This now concludes our conference call. Thank you all for attending. You may now disconnect your lines.