Halfords Group plc FY21 20-Week Trading Update

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Welcome

Good morning everyone and thanks for joining the call today. I'm Graham Stapleton, Chief Executive of Halfords and joining me on the call today is Loraine Woodhouse, our Chief Financial Officer. I will start today's update with top level trading highlights. Then we move into a more detailed look at our sales performance, followed by some strategic highlights. We will conclude with the outlook for the rest of this financial year. Loraine and I will then be happy to take your questions.

Key Highlights

Trading in the first 20 weeks of FY21 was clearly dominated by the impact of Covid-19 and the various stages of lockdown across the UK. As an essential retailer we remained open and trading throughout the period to support our customers with their motoring and cycling journeys. Despite the challenging retail environment created by Covid-19, trading has been ahead of our expectations and performance across the Group has accelerated as lockdown has eased. Both Cycling and Mobile Services performed strongly during the peak of lockdown and as restrictions have eased and traffic has normalised we have returned to strong growth in Motoring Products & Services.

As a result, Group revenue was up +7.5% and +5% on a like-for-like basis. This is a good trading performance primarily driven by a significantly larger Cycling market and the current trends towards staycations within the UK; the benefits of our new Group web platform which brought together our Retail, Autocentre and Mobile Products & Services for the first time on one website; and increasing scale in our Motoring Services business with the recent acquisition of both McConechy's and Tyres on the Drive. In each of these areas we executed our plans well and demonstrated good operational agility. This allowed us to fully capitalise on the current market tailwinds.

Beyond our strong sales performance our Cycling Optimisation Plan, which we first communicated last November, has also been gaining real traction within the business, resulting in good underlying improvements in Cycling gross margin. At the same time, rigorous cash management and faster stock turn have meant that liquidity remained strong throughout the period with net cash of £105 million on 21st August 2020.

Sales Performance

In Retail, Cycling like-for-like revenue was up +59.1% with growth across all categories, most significantly in electric bikes and scooters which grew by over 230% year-on-year. An increased focus on bringing unique and differentiated products to market meant that sales of new products were up 114% in the period, with the highlight being our new Carrera range offering customers market-leading specification and outstanding value for money.

Retail Motoring like-for-like revenue was down 28.6% in the 20-week period but returned to strong growth in period five as car journeys returned to more normal levels. A combination of more customers getting back into their cars and our unique fitting proposition showed good growth in batteries, bulbs and blades, which were up +13% in both periods four and five. We also saw a significant shift towards staycation-related products such as roof bars and boxes, which grew by +28.4% in the same period. In our performance cycling business Tredz, we saw sales up by 76% in the period, reflecting strong demand from cycling enthusiasts and successful transfer of customers from our Cycle Republic business which we executed during the Spring.

In Autocentres total revenue was up +30.2% with our acquisitions of last year contributing strongly, alongside new service offerings. Our Autocentres business also benefitted from increased online bookings through our recently-launched Group web platform and the upgrade of our digital operating model, PACE. As you would expect with the UK-wide lockdown in place, demand for our Mobile Services proposition remained high throughout the period as customers looked for both convenience and safe socially-distanced methods of services and repairs. As you can see, a very strong period of trading where we have worked hard to capitalise on the emerging trends and market tailwinds.

Strategic Highlights

Turning now to look briefly at the progress we are making against our vision to inspire and support a lifetime of motoring and cycling and our strategy to build Halfords into a consumer and B2B services focused business with a greater emphasis on Motoring and a more profitable Cycling category. When we presented our preliminary results on 7th July we laid down our strategic objectives for FY21 with particular focus on our cost and efficiency programmes to create an even leaner and more effective business moving to FY22 and a greater emphasis on the support pillar of our strategy to transform and optimise our Services business. I am pleased to say that we have already made strong progress this year against these objectives.

Turning first to our Group services delivery where total sales growth is +6.3% in the period, driven by our increasingly scaled Autocentre business taking share in a very fragmented market. After weaker demand during lockdown like-for-like growth of +8.8% in periods four and five demonstrated the strength of our underlying business and its ability to meet pent-up demand for servicing and MOTs. In fact, since the start of lockdown we have seen both MOT and servicing levels increase significantly, now ahead year-on-year. Encouraged by the significant demand for our Mobile Expert proposition, we added 16 new vans during the period, bringing the current total to 91 and well on the way to our target of 125 by the year-end. To drive awareness of our integrated Motoring Services offer across retail stores, garages and mobile vans, we invested in our first ever Group-wide media campaign. This drove considerable uplift in awareness metrics and helped boost consideration of Halfords by nearly 40%. In Cycling our services were up +17.5% in the 20-week period and +48% in periods four and five, boosted by our free 32-point bike check and the government's special bike voucher scheme where we have gained significant share.

Finally, looking at cost and efficiency we are on track to improve our Cycling gross margin by 300 basis points in FY21, driven by more favourable buying terms, component rationalisation and more effective promotional activity. Regardless of stronger than expected sales so far this year, we will continue to target operating cost reductions across the Group through location closures, labour efficiencies and other initiatives. Specifically we are making good progress towards our target of closing up to 10% of our property estate in FY21, which includes the previously-announced 22 Cycle Republic stores and seven additional stores and garages closed so far this financial year. We are confident that the successful execution of our strategic areas of focus in FY21 and a strong balance sheet to enable further investment will place the Group in a strong position to continue its strategic journey in FY22.

Outlook

Turning to the outlook for the rest of the year, in our preliminary results announcement on 7th July 2020 we provided details of potential outcomes to profit and net debt based on differing like-for-like trading scenarios for the remaining three quarters of the year. This included insight on the margin and cost impact of a higher Cycling mix and the incremental costs associated with operating in a Covid-19 trading environment. These factors remain unchanged and so the relative dynamics of the scenarios remain valid today. Since our last market update our trading performance has strengthened and the seven weeks since Q1 were significantly better than we anticipated in early July. This has given us more confidence in our profit outturn for half one, which we now expect to be in the range of £35-£40 million. This assumes expected levels of trading in September and stability in the relative value of the US dollar.

We have seen stark differences in the relative performance of different product categories and this is further exasperated by significant uncertainty on macro factors such as the impact of a second wave of Covid-19 and economic contraction driven by rising unemployment and the impact of Brexit. All of these factors combined with the relatively high operating costs mean that the range of possible profit outcomes for half two is very wide. The macro headwinds of our [inaudible], together with a natural fall-off in the relative strength of Cycling and staycation products during the winter months means that profit in the second half could be significantly lower than the first half.

That concludes today's update. Thanks for listening. We will now be happy to take questions.

Q&A

Tony Shiret (Panmure Gordon): Morning and very well done. The question is about the gross margin and that is whether you could clarify your comments a little bit. Is the gross margin in actual terms going to be up or down in the first half, would you know? Within the Cycling gross margin how much of the underlying benefit is from reduced markdown and how much do you think you will hold on to? The second question is what your view is of the cycle market next year, bearing in mind how strong it has been this year and whether we should anticipate you adjusting your capacity for cycle sales next year. Thank you.

Loraine Woodhouse (Chief Financial Officer, Halfords Group plc): Morning Tony. I am expecting gross margin still to be down for the first half but there is no doubt it has been on a better trajectory. I think it will be close by the time we get to the half year. Obviously, it was very challenging in the first few months of the year as even with sales coming through they were coming through much more strongly from Cycling. Gross margin percent will be a little bit down year-on-year. In terms of Cycling quite a bit of the margin has come through, as you might expect, from reduced promotional activity, but not all of it. Quite a chunk of it is sustainable, some through the actions we had already taken on Cycle Republic which allowed us to consolidate some of the buying through our performance cycling business but also through Halfords mainstream where we have been buying better and buying deeper on popular lines for quite some time. There could be some exaggeration in the gross margin impact over the last couple of months because of the extraordinary demand but I am confident we will hold on to margin gains as we go forward too.

Graham Stapleton: In terms of the cycling market, firstly I would say that even before Covid-19 our cycling business was in growth and we finished last financial year with the cycling business growing. That is because of the underlying themes that we are seeing around fitness, health, climate and infrastructure investment. All of those things were true then. I do think that as we go into next year we will still see a good cycling business into next year. We are also seeing some change certainly over the past 20 weeks towards cycling becoming more of an essential purchase rather than just a leisure purchase. Customers are buying bikes to get around because they are trying to avoid public transport. They are certainly buying bikes more for exercise and to keep fit. As we stand now that trend is likely to carry on alongside the government infrastructure investment that is starting to take place. There will still be some strong tailwinds.

Obviously, there could have been some business pulled forward in the last 20 weeks that would have been potentially spent next year. We do not know how much that would be but there is a risk around that too, which balances some of that out. In summary, it is difficult to be absolutely sure where the cycling market is going to be next year but there are both positives that will balance out some of the challenges as well.

Tony Shiret: Okay, thanks.

Matthew McEachran (N+1 Singer): Morning guys, thanks for taking the question and well done on a good update. Can we start with the caution around the second half and the perspective around your three scenarios that you laid out? Looking at the worst scenario, it would appear that you would require a loss in the second half of about £45 million and in the best scenario a loss of between £15 million and £20 million. Can I double-check, are those outcomes in the second half really within your forecasting range?

Loraine Woodhouse: Hi Matthew. What we were trying to convey with the scenarios is that the relative movement as you apply differential like-for-like growth is still relevant, not that you would take the second half of those scenarios and add them to our first half guidance. We were trying to say that as you move like-for-like by *x*% then the margin and cost movement is still relevant. All we are saying on the second half for now is that we are taking a prudent approach and at this stage we believe it is likely to be lower than what we have seen for the first half, for all of the reasons that we have spelt out in the statement.

Matthew McEachran: Okay, that makes sense, thanks. In relation to labour and productivity, you have obviously traded very hard during these latter two periods. Did you have any staff on furlough? If so, roughly what proportion? What is the likely improvement in productivity that you have been able to achieve as a result of this performance against a backdrop of reduced headcount?

Loraine Woodhouse: It has been really significant, which is one of the reasons we were confident in putting out a range on our half one performance. I would say in both businesses we have seen incredible productivity, particularly Autocentres but in Retail too. The challenge has been, when you get such a sharp uplift in demand trying to find and apply colleague hours quickly enough is really challenging. Therefore you get an unexpected boost to productivity. I would say we have probably run too hot at times because we have had such incredible and unplanned demand. We would try to moderate that in the second half to give a better colleague experience and customer experience. However, there is no doubt that that productivity will benefit the first half. To your explicit question, we have no one left on furlough now and have been running with very few heads on furlough for the last six weeks or so. Furlough for us was heaviest in the first two periods of the year.

Matthew McEachran: Yes. Okay, thanks. One final one in relation to [inaudible]. Could you give us some qualitative comments around availability and flow of stock, if you have got insight into an order book which presumably you still do? Any comments on that would be very helpful.

Graham Stapleton: Availability of motoring products has been pretty good all the way through and we are obviously now starting to exit the camping and staycation part of our range. Availability in those categories will be seen now because we are moving out of season. In Cycling we have benefitted from being open earlier than some of our competitors and therefore we have been able to plan our stock more effectively over the last 20 weeks as we knew that there was going to be a big demand perhaps earlier than some and put orders in accordingly. Whilst we are not back into full stock yet on Cycling we believe we are in a better position than some of our competitors are in terms of the breadth of range on offer and the depth of stock that we have in the products that we have got. Kids bikes are pretty much fully back into stock, adult bikes will probably take a bit more time as we get into the autumn to get fully into the stock position that we would normally expect to trade with because demand has been strong and the lead times are long.

At the moment there is quite a challenge on cycling stock globally because it is not just the UK that are seeing the uptick in bike adoption. It is many countries around the world. What we are doing is using our relative scale in the UK and our specialists to focus on this to make sure we get the right proportion of stock when we are trying to fight for that on the global market that we are in. A couple of other advantages we have got is 85% of our bike sales are own brand so we have relationships directly with the manufacturers and the component suppliers. That does give us some advantage when stock is short. That is where we are, not a perfect world but we think we are doing a good job relatively of getting that cycling stock through.

Matthew McEachran: Okay, that is great. Thanks very much indeed and well done. Cheers, bye.

Jonathan Pritchard (Peel Hunt): Morning all. Can I just ask Matthew's question perhaps in a slightly different way on the second half? The last four second halves you have made £35 million, £35 million, £28 million and £28 million so essentially what you are suggesting is that the second half this year when you entering with a very serious tailwind, is that you are going to make significantly less than you have ever made in a second half before. I do not quite understand the almost catastrophic assumptions that you would have to make for that to be the case. I understand prudence but are you not taking it to a bit of an extreme?

Loraine Woodhouse: We will find out, Jonathan. There are a few things in what you have just said. The tailwinds that we have undoubtedly benefitted from in the first half are generally more beneficial to the first half of our calendar year because of the nature of them.

Cycling and staycation being the two obvious examples. Even if you assume those tailwinds persist, and we do, the likelihood is they will have a less positive effect on the second half. We are nervous about the economy and any potential impact of a further lockdown or even localised lockdowns because for the same reasons we think that we would not potentially trade as well through a second lockdown in our winter months as we did in our summer months. Then we have got the costs of Covid-19 that we flagged previously. For all of those reasons we are not guiding on the second half but we are saying that cautiously as we sit here today we can certainly see a scenario where the profits could be materially lower than the first half of the year.

To your point, we really do not know and we could see a more positive pattern than we are currently predicting. Certainly, if we continue to see very strong motoring sales then that helps us through the second half obviously. We are unsure as we sit here. We take a prudent approach and then try to manage it as best we can. I think what you can see from the first half is if the demand is there then we will be able to take the necessary actions to benefit from that demand.

Jonathan Pritchard: Okay and just two quickies. Firstly, your comment on e-scooters, have you seen a pickup in demand since hiring them became legal? Then attachment rates on bike, is that a KPI and have you seen any progress in it?

Loraine Woodhouse: Attachment is absolutely a KPI and really important for us because it drives additional margin. Attachment rates have typically been lower through this first period because we have sold a lot more online and it is much easier to attach if you are face-to-face with a customer. We expect that to continue to improve as more sales become physical once more but online. Over that first 20 weeks attachment is down.

Graham Stapleton: Just to build on that, selling solutions as a super specialist is absolutely where we are heading. There is a very big focus on attach solutions selling because we think the combination of omnichannel assets that we have got gives us an opportunity to do that better than lots of our competitors do, particularly those that are just online. There is a very big focus in that space to build that out over the coming months and years.

In terms of electric scooters, as most people know, there is a regional trial taking place at the moment where the government are looking to see what would need to be true to legalise the use of electric scooters on the road. We are obviously watching that very closely and we are hoping that that trial is successful so we can join the other countries around the world that have electric scooters for use on public highways. In the meantime, we are still selling a lot of electric products, scooters and bikes. It is one of the highlights of our results today. 30% of all adult bikes were electric during this period against 14% the previous year. A very, very big shift into electric and I think taking my point of earlier, it may well signal this move more towards essential usage as well because electric bikes do get used for commuting and not just leisure.

Jonathan Pritchard: Great. Okay, thank you very much.

Adam Tomlinson (Liberum): Morning guys, just two or three follow-ups from me, please, if that is okay. First question, on Motoring and the Autocentres side of the business, having used your garages a couple of times over the last few weeks it feels like waiting lists are quite long there or reasonably long. Has the strong demand and the success of that side of the business changed your plans in terms of the number of people you need and the hiring intentions for those operations? The second question is on Covid-19-related costs. I think you have previously given guidance there of around £20 million for this year. Any updates on that and changes to your thinking on that. The final question around the 10% closure of the property estate, I know you have noted previously that that will depend on lease negotiations. I was wondering when you are negotiating it what kind of results you are getting on those. Presumably, they are in line with what you were planning, given that you are still aiming for that target.

Graham Stapleton: Thanks, Adam. In terms of Autocentres we have as you can see through the results seen a very significant increase year-on-year over the last couple of months particularly. However, we are managing that pretty well. Our average wait time for bookings is seven days from the call at the moment. That is not too dissimilar to what we would find trading through a peak period which is what we are in at the moment. September is one of those peak periods. That said, we are looking to potentially recruit more MOT testers at the moment because we do expect to see a very significant uplift in MOT in October as those that have been deferred come back into the market. You will see us recruiting for technicians currently in the market.

Adam Tomlinson: Okay, thanks.

Loraine Woodhouse: Hi Adam. In terms of Covid-19 costs there is no real update. We could see relatively clearly a little while ago what the on costs were likely to be so there is no great change to those. Obviously, the most significant of those tend to be carriage, the shift to online but also the additional labour costs in retail stores where you have got to have somebody at the front of the store helping customers navigate the store. Given the latest on Covid-19, I do not really see that changing in the near-term. That is unchanged.

On these store and garage closures we are making good progress with our plan. We have got a tight list of stores and garages that are going through a much more detailed assessment to make sure we understand the potential transfer rate of sales, which is important, but also what the likely customer proposition would be in any given geographical area. We are making good progress on that.

We have done relatively few lease negotiations in the first part of this year, mostly because we think we will have higher chances of success as we go into the second part of the year. However, those that have been done have been done at very attractive rates, better than last year on average, particularly for retail stores. Garages are a different market with much lower rents but more rental inflation. Particularly within retail we are seeing some good results. Within each of the mini appraisals of the stores that are on the list for review, if you like, we already have assumptions in there around what we might be able to negotiate from the lease perspective. We have an expectation of what we might be able to get to. We will be in a position to announce more either in November or at our trading statement in January.

Adam Tomlinson: Okay, that is great. Thank you very much.

Kate Calvert (Investec): Morning everyone, just two from me. The first one is in terms of Autocentres have you seen [inaudible] period just traded from catchup MOTs or is that [inaudible] going to weighted towards the second part of the year? The second question, on the store closures you have not done that many at the moment. I assume most of them are going to come after Christmas. Is that fair?

Loraine Woodhouse: In terms of Autocentres, we have started to see some catchup on MOTs but we do think there is more to come. Interestingly, quite a lot of the recent business that we have seen has been in services or servicing and repair, which we think has certainly been aided by quite a prominent position on the Group website now. Quite a lot of the growth in periods four and five was actually full service. MOTs I think from memory were down in that period. There is probably a little bit more to come from MOTs as we go through the next few months.

Then on closures, Kate, you are absolutely right. Any closures are likely to be back-end weighted because we would want to be able to take the benefit of any Christmas trading and the associated stock cleardown that comes with that. I would say pencilling in Q4 for any closures that we do decide to do is probably right.

Kate Calvert: Okay, thanks very much.

Graham Stapleton: Okay, great. Thanks for joining the call today. Thank you.

Loraine Woodhouse: Thank you.

[END OF TRANSCRIPT]