Halfords FY21 Q3 Trading Update

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Graham Stapleton

Chief Executive, Halfords

Welcome

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

Overview

I am very pleased to say that we saw another quarter of strong like-for-like sales even with the challenging operating environment. Despite further national lockdowns and restrictions across the UK in the quarter, the Group posted a like-for-like sales growth of +11.7% with our Autocentres business at 21.1% and Retail at +9.8%. We also continued to deliver on our strategy and particular areas of focus for FY21. This has not only helped us in delivering our results year-to-date but also sets us up well for FY22.

Halfords Retail

Cycling

Looking now to the performance in a bit more detail our Halfords retail business was up +9.8% like-for-like and we delivered our biggest Christmas sales week ever. The overall Retail sales were a consequence of a strong Cycling performance and relatively good delivery in our Motoring business, particularly considering the headwinds here. The customer demand for cycling shows no sign of slowing and Cycling like-for-like was +35.4% over the period. Sales were strong in adult bikes and e-mobility. We delivered our second-biggest kids bike Christmas. This performance was achieved despite the ongoing supply challenges we are seeing through both global sourcing and container availability and congestion at ports. We worked hard to leverage our digital platform through the quarter and mitigated stock challenges for customers, offering alternative and an email when back in stock facility.

Motoring

In Retail Motoring like-for-like sales were -8.4% which given the fewer journeys being made and traffic at circa 25% below pre-pandemic levels, was a particularly good performance. We saw market share growth in key categories, a great performance in Car Cleaning and Touring, and some particularly strong operational performances, most notably across our Blades, Bulbs & Batteries proposition. The launch of our new WeCheck app in Q3 also proved successful with more than 100,000 vehicle registration numbers captured and significant growth in the average number of daily car checks completed. This transformed the shopping experience, giving customers a professional e-record of their check and also increasing our data capture and understanding of buying behaviours.

Autocentres

Moving on to Autocentres which is one of the performances we are most pleased with. Total sales growth for Autocentres was +30.5% and we believe this reflects a significant increase in our market share given that the number of car journeys were 25% below pre-pandemic levels. The outstanding performance here has been delivered through a combination of activities. Firstly, our continued optimisation of our best-in-class digital operating model, PACE. This has transformed the way our garages operate, enhancing the customer experience and simultaneously increasing the capacity and utilisation of our garage business. Secondly, we launched our first-ever nationwide marketing campaign to highlight the breadth of our motoring services. From our garage MOTs and servicing to our WeFit services in Retail such as Blades, Bulbs & Batteries through to our mobile vans. This commenced at the beginning of November across all types of media including the radio, web, CRM and social media. We reached circa 90% of adults in the UK, investing approximately £1.4 million in the quarter.

Motoring Services

Finally, as a reminder, last year for the first time we brought all of our motoring services together onto one group website. This provides customers with a fully-integrated, digital experience across the Halfords Group which we are continuing to optimise. Combined, these actions have given us significant growth across the garages business within the Autocentres group. In addition to this we have seen continued expansion in the Halfords Mobile Expert business where we have broken more records, reporting our biggest sales week ever in the quarter. Building on this success we will continue to invest in increasing the scale of our nationwide van fleet during this year. We are on track to deliver at least 125 vans by the end of March.

Tredz

Our performance cycling business, Tredz, also had another exceptional quarter, seeing like-for-like sales growth of +51.2%. We are confident that consolidating the Tredz and Cycle Republic businesses was the right decision and the results here indicate that we are managing to retain Cycle Republic customers.

Strategy

Service-related sales

Across the quarter we also continued to see good results in our areas of strategic focus. Firstly, Group service-related sales growth was +31% with a strong demand for motoring services and cycle repair mitigating the impact of lower vehicle traffic volumes. We saw a higher proportion of our Batteries, Blades & Bulbs fitted and demand for our cycle technicians and services grew significantly, up over 70% on last year.

Group web platform

The second area of focus is continuing to optimise our group web platform. The increased focus and investment here have paid off with sales continuing to be very strong, up +76% in total with Retail performing at +100%. Growth here has undoubtedly been driven by the improvements made to our digital customer journey, which include the introduction of payments online, self-serve enhancements such as where is my order, SMS reminders and alerts, and the WeCheck app. Combined, these actions resulted in our biggest ever online sales day on 23rd December with sales 12% higher than our previous biggest ever day and +35% against the same day last year.

Cycling

The third strategic focus we announced way back in November 2019 was our intention to create a more profitable Cycling business. You will remember that we set ourselves a target of a 300-basis point improvement year-on-year. After 15 months of work, I am pleased to say that we are making great progress against this target and are on track to beat this over the full year.

B2B

Last but not least we continue to grow our B2B business. Here sales grew +44% with very strong growth in our Cycle to Work scheme supported by a good performance in bulk product sales and gift cards.

Net promoter score

In summary some good progress in the areas of strategic focus. The really good news is customers appear to be genuinely seeing a difference here through a much better customer experience when they shop with us. This is particularly evident in our Halfords Group net promoter score, NPS, which improved by +4.3 percentage points year-on-year in Q3. Our customer scores across the Group are now the highest they have been for three years. That would be an achievement even under normal circumstances but when you combine that with the challenges of trading through a global pandemic it is particularly pleasing.

Cost and efficiency

Alongside this strategic progress we also remain focused on the cost and efficiency of our business and we continue to reduce our costs and improve the profitability of our company. We anticipate making savings on our GNFR costs alone worth almost £7 million over the full year. In November 2019 we highlighted our intention to reshape our property portfolio to enable us to deliver a more integrated and flexible customer and services proposition whilst also creating a more cost-efficient business.

Property estate

In April we indicated this may result in closing up to 10% of our property estate. So far this year we have closed 33 sites which include the 22 Cycle Republic stores. We will also be closing a further 47 financially low-returning stores and garages before the end of the financial year, taking the total to 80 locations. The additional closures we are announcing today will result in an annualised P&L benefit of over £6 million after an exceptional cost in FY21 of between £25 million and £30 million. Of this we anticipate exceptional cash costs, including lease payments, of £10-13 million in total across FY21 and FY22. This will be offset by working capital reductions, tax savings and improved profit contribution. Although there will inevitably be some redundancies we are doing everything we can to support colleagues who are impacted. We have a good track record as a business of redeploying colleagues and we are confident that a large proportion of those impacted will be found other roles. We therefore estimate around 200 colleagues will be made redundant from these closures.

Refinancing

The final piece of news I would like to share today is the successful refinancing of our existing revolving credit facility. Given the backdrop this year, arguably one of the most challenging for many, this is a real achievement. We have secured a new £180 million facility as of December 2020, welcoming three new banks into the syndicate.

FY21 Q4 Update

Before we take questions I would like to give an update on the remaining quarter of FY21. As you are aware, the UK government announced a third national lockdown on 4th January 2021. As an essential retailer and services provider our portfolio of stores, garages and Mobile Expert vans will remain open and continue to support keyworkers and customers with their journeys. As we have seen previously, this lockdown will inevitably impact demand for Motoring products with fewer car journeys being made across the UK. We however believe that our Autocentres business will remain resilient and Cycling demand will still be strong. However, the cycling market is seasonally smaller during Q4 and may not give us the opportunity to fully offset the impact on Motoring products this quarter. The immediate financial impact on Q4 is less certain and we therefore do not believe it is appropriate to provide profit guidance. We intend instead to issue a pre-close statement during March 2021.

Our position with respect to business relates relief and the coronavirus job retention scheme is still under review and we will provide an update when the Covid-19 situation becomes clearer. All that said, we remain confident in the financial strength of the business and our operational ability to navigate the ongoing challenges presented by Covid-19. Perhaps most importantly, looking further ahead the significant progress we have made this year will ensure we start financial year 2022 with a strong platform for growth.

Colleagues

Finally, to close today's call I feel it is really important to acknowledge the hard work and commitment of our Halfords colleagues during this exceptionally challenging time. Through ongoing lockdowns and increased restrictions the entire Halfords team continue to work tirelessly to keep customers moving across the UK & Republic of Ireland. The Board and I would like to express our sincere gratitude for their continued support, without which none of this would be possible. Thank you for listening. Loraine and I will now take your questions.

Q&A

Adam Tomlinson (Liberum): Morning all, thanks for taking the questions and three to kick off with, please. The first one on Autocentres and I guess just looking through the shorter-term disruption taking a more medium-term view on that, lots of initiatives have gone in that are driving some real momentum. My sense is it does take time for the full benefits of those to flow. Can you give your view in terms of the digital model, in terms of the workflow systems, where we are in that journey in terms of realising the full benefit of those and what is still to come from that? Then around that as well additional self-help that is really yet to impact at all that we should be thinking about in terms of Autocentres, please. That is the first question.

The second question just on mobile vans. Any indication of what kind of capacity they were running at? I appreciate volatility over the period but any info around capacity, the contribution they are making and whether that impacts your longer-time target in terms of the potential for the number of vans there? The final question please just around new customers. Given your data insights, any colour you can give around new customers that are shopping across the business or anything you can do in terms of that cross-shop stat from Retail into Autocentres and just a sense of growth that is coming from new customers? Thanks very much.

Graham Stapleton: Thanks Adam. Let me try and pick some of those up and Loraine, feel free to add if you wish. In terms of Autocentres, your first question, and PACE, the digital model there, how is that bedding in and how much more is there to go? It is really the first full-year this year that we have had with PACE operating across the entire business because we introduced our PACE system also to McConechy's, the business we acquired just over a year ago. It is being optimised but it is really the first full year of what we call PACE 2.0, which is our upgraded version of that system. There is definitely some benefits in the business this year, hence why I have referenced that system but yes, there is definitely more to go for. We have certainly got more we can do with that system to fully optimise it everywhere and we are working hard to do that.

In terms of self-help, the Autocentres business we spent a lot of time over the last three years with a lot of self-help. There is always more that we can do and I think we are particularly excited with the way we are looking at moving the customer experience in a town next year through our Project Fusion which will not just be potentially benefitting our retail stores but it will also in effect give potentially clearer experience for customers shopping in Autocentres as well. There is definitely more potential outside of the digital operating platform and some of that is very much embedded in the strategic priorities that we have already outlined that we are going to continue with for next year. Lots more to go for I think in that business.

In terms of mobile vans, the best way of describing it is we only had a handful of vans last financial year and we gradually increased the number of vans from I think it was about eight to 121 now which gives you a sense of capacity and how we are moving through. Obviously, we only put more vans on and introduce more hubs as we believe the opportunity becomes available. We have got some hubs definitely at close to capacity. We have got some new hubs that are building their capacity. Certainly the hubs that we opened over the last 3-6 months they are not at full capacity yet because customers are still getting used to having that service available in that locality. There is a real mix of more mature hubs to new ones but we still believe there is significant opportunity nationwide to grow this van business. We still believe as well that that can be done profitably hence our outline again today that we will have at least 125 vans by the end of March and the end of this financial year.

The last thing to say on the mobile vans links to my next point which is the other exciting thing about mobile is it is bringing new customers into the Halfords Group. There are customers, be they female or younger, that prefer a mobile service to home or work rather than visit a centre. Equally, during the winter periods that we have had recently we are obviously for the first time able to get to customers and fit their batteries on their drive. Before that Halfords was not able to access that market because we relied on customers getting their cars to a garage or a retail store. What we have seen very recently with the colder weather is some really good incremental new customers coming to our business because it is practically impossible to get your battery any other way than on the drive. There are very good long-term prospects.

New customers overall, I think one of the great things about the Q3 performance that we have just described is that we are seeing such significant growth that we are very confident that we are taking market share in many areas. We are taking market share in the motoring products area despite the fact that it is down year-on-year. We are taking market share in

Autocentres. We are taking market share in Cycling. We have just talked about Mobile Expert. We know that there are a lot more new customers coming into the Group across the piece and the Group website is helping that cross-shop that you also asked about, Adam. Our cross-shop is moving up versus last year. Not probably to the extent we had hoped because of the pandemic and challenges for customers shopping generally. However, we are definitely moving that cross-shop number forward as we go through this year.

Adam Tomlinson: Okay, that is very clear. Thank you very much for all that.

Kate Calvert (Investec): Good morning everyone. My question is on your supply chain issues. From your email when in stock system do you have a feel for the level of potential sales you have left on the table?

Loraine Woodhouse (Chief Financial Officer, Halfords): Morning Kate, yes we do. We have got quite a good sense but I do not want to disclose the number specifically. We are able to see where we were out of stock on specific lines and where we know we had demand for that. We are able to analyse that quite accurately. The big question is what happens to that demand. Will we see that demand sustain and therefore those sales will come through as certain lines flow back into stock or whether customers have either satisfied their demand elsewhere or desire for a bike has gone away for whatever reason? We are pretty confident that we have got a good lens on that and because we are still seeing demand as stock comes in we do think that that will help us certainly within the first quarter of the year as we go into the spring/summer cycling season, if you like. To what extent it helps we are not yet sure but, yes, the answer to your question is we can see that quite accurately.

Kate Calvert: Great and just a follow-up in terms of your stock levels at the moment. You may have talked about it, I missed part of the call, but when we last spoke you said you were starting to rebuild your stock levels. How far have you got to where you ideally want to be?

Loraine Woodhouse: It has improved. We have seen stock inflow over the period since we last talked to you guys so it has got better. It has not got better though to the extent where we have been able to restock our shops appropriately. We have been able to fulfil some lines but others not yet. I would say it is building and we hope it continues to build towards the end of the year so that we are appropriately stocked for that really important spring season. However, it is not where we would have wanted to be because evidently we have had some challenges. We are seeing at the moment probably somewhere between a 2-3-week delay from the shipping perspective, being able to get a boat onto the water, but it has probably been worse than that because we have been dealing with not only carriage delays but also then the port congestion this end as well.

Kate Calvert: Great. Okay, thanks very much.

Jonathan Pritchard (Peel Hunt): Good morning, two for me. On that point on stock availability, how confident are you that your loss is better than the competition just from gossip and your own looking round? Are you very certain that you are getting more than the competition? Then what is stage two from an advertising/marketing/sale end perspective?

Loraine Woodhouse: We are pretty confident, Jonathan. We do a lot of scouring competitors' websites to understand the number of SKUs that they have on offer and the number of SKUs that they have available. We do the same obviously within our own website.

That is only indicative but typically at this point in time you would want your website well-stocked rather than your stores so we think it gives us a good sense. From doing that we believe that we are comparatively better-stocked and have been all the way through the pandemic. We also think that going forward our supply chain relationships and the strength of our balance sheet allows us to place orders further ahead and give suppliers a greater commitment for their production lines. That should also give us relatively good stock positions versus the competition going forward.

Graham Stapleton: Obviously we are very encouraged by the response that we got to the advertising this quarter on Motoring Services. It is really just the tip of the iceberg though. We know that awareness of our garage services business and our vans business is still very, very low. I think customers find it difficult to piece together all the different motoring services that we offer and just how convenient they are. We think there is still a lot more to go there in terms of getting customers aware and our plan is to continue to invest in that Motoring Services plan during the remaining year. The emphasis of our marketing and advertising will move more towards Motoring Services, and strategically where we are heading as well of course, than it has been in the past.

Jonathan Pritchard: Understood, many thanks.

Matthew McEachran (N+1 Singer): Good morning guys. I have got a few bits and bobs. Can I just follow up on the question in relation to Autocentres and ask it a slightly different way? In this period you have obviously had a great level of volume and activity going through the centres and I am wondering whether or not the visibility over the bottom line contribution that has had, I recognise that it is still not the finished article, has changed your view on what sort of profit margins the Autocentres business can deliver.

Loraine Woodhouse: Yes is the short answer to that. I am not going to give you a number Matthew or tell you how much we think margins might improve but obviously one of the biggest costs within the Autocentre business is labour, not surprisingly. It is a labour business and if you are able to get greater productivity then that is beneficial to the bottom line. What this has helped to do is understand a little bit better the sort of sustainable productivity levels that we might be able to achieve out of Autocentres. Andy Randall accordingly will be expecting a higher target for his operating margins going forward because it will definitely support a better level of profitability.

Matthew McEachran: Yes. Then in terms of the labour scheduling planning, there will come points where you are going to need to put in additional labour and technicians. You may already be at that point. What is the pipeline looking in terms of filling in those gaps?

Loraine Woodhouse: We are already doing that. If you recall, at the half-year we talked about the number of roles we were creating within the Motoring side of the business more generically. That did include a number of Autocentre technicians. Yes, you are right, we have been adding technicians. We have got more to go. Where an individual Autocentre has got ramp capacity then we are able to add in an additional technician and bring in a significant amount of business. We do know that centres with a higher number of technicians as long as we have got physical space are generally more productive and definitely more profitable. We are able to find technicians because we are an attractive employer obviously in the current environment. However, as you will be aware, the pandemic does create some short-term volatility, not least of all with some sickness as well.

Matthew McEachran: That is great, thanks. The next question was in relation to online retail sales, your performance there in sales penetration and Click & Collect versus home delivery. There were no major stats in the statement but could you just elaborate a bit more in terms of performance and general trends?

Graham Stapleton: I think we have mentioned in my summary there that our Retail web sales grew 100% so overall the number was I think just over 70%. However, our Retail business has enjoyed even stronger growth over the period of Q3. We spent a lot of time looking at customer journeys on our website over the last nine months after we have introduced the new website. We have made a lot of changes as we have used the Salesforce platform that we have got to really optimise every step of a customer's experience with us online. As a consequence of that we have seen improved conversion and I have also mentioned the NPS increases today as well. Those NPS increases you can directly look back at what the changes were that we had made online and how those NPS improvements have come through. It has obviously been even more important to do this and we said way back in April how much more investment and focus we are going to put on our website this year, some of which was even unplanned at that stage. We cannot put enough time in. There is just so much more we could do better in this space. However, the work is not finished. I gave four or five examples in my update but there is a lot more to do. We will be investing more in the website and the digital platform over the course of next financial year as well. The great thing is we have got a really good platform to optimise and improve. That was the big reason for making the change at the beginning of last calendar year.

Matthew McEachran: In terms of Click & Collect versus home delivery, obviously it probably fluctuates given the massive fluctuations in restrictions and changes there, but can you give us some sense as to what the general trend has been?

Loraine Woodhouse: Matthew, interestingly it has not fluctuated much so it is still around 80% which I know feels very intuitively odd given the circumstances but I think customers feel safe coming to the stores and picking up their products. They often need perhaps to have it fitted or some advice so they have continued to do so. It wobbles around the 80% but it has not really moved intriguingly.

Matthew McEachran: Yes, that is interesting. I have just got one last question relating to the JRS and grants comments and then your Covid costs. Could you give us the JRS and grants benefits to-date in the year? Have you changed your estimate of £

20 million which was your rough approximate number for the full-year Covid costs?

Loraine Woodhouse: The JRS is unchanged, Matthew, so that was just over £10 million at the half-year. Business rates is about £36 million for the full-year so we are nine twelfths of the way through that. The Covid costs, no, I do not think we have changed that specifically. Obviously we are still mindful of what could happen for the next three months of the year, whether or not there is any need to put any additional support in, particularly for colleagues. However, at the moment we are expecting that number to be broadly the same.

Matthew McEachran: Yes. Okay, that is brilliant. Thanks very much.

David Green (Boldhaven): Morning everybody, a couple of quick questions. The experience post previous lockdowns was a general consumer desire to avoid public transport and that actually paradoxically led to an increase in car journeys and definitely an increase in cycling demand as well, as people look to avoid obviously that mode. As we come out of this next lockdown do you feel like we will see similar trends coming through?

Graham Stapleton: What I would say there is it is still very, very early to be able to call any trend because we are literally days not weeks into this lockdown. As we have said in the outlook piece, we do think there will be a reduction in car journeys. My guess would be that that will also include a reduction in public transport usage as well. I actually think that the amount of public transport available will also come down potentially in this period looking at the wires. I think there will be a change there. We are not anticipating at this moment a slowdown in our cycling demand. We did not see it in the previous two lockdowns and we do not believe it is going to happen this time either. We will just see a seasonally smaller cycling business because we always do at this time of year.

David Green: Okay, that is very helpful. Then on the Autocentre side there is obviously a lot of self-help that you have put into that business and market share is also important. Is that business now becoming less cyclical and macro-sensitive? What kind of growth rates could we potential expect going forward and within that circa 20% growth how much of that would be market share gain?

Graham Stapleton: Unfortunately it is very difficult to get an accurate read on market share in the garage services industry as there is not any market data as such. We know roughly how big it is in totality and we think we have got about 2% share but when you are at that level it is very difficult to know just how much share you are taking. The correlation I explained earlier is that with 25% less car journeys taking place on average over the last quarter then our increase of 20% suggests that we should be taking share because of the difference between those numbers. In terms of future growth and growth opportunities we have already signposted in November 2019 our intention to continue to significantly grow the Autocentres part of our business, be that through additional garages or more vans. We have put more vans in this year. We have integrated McConechy's in the North of England and Scotland this year. I am confident there is an opportunity to carry on growing inorganically or through acquisition over the course of the next year or two and certainly to hit the targets that we suggested in November 2019. The business is performing better and better. It is getting more profitable. It has got a better operating platform than it had a few years ago and they are also fully utilising all the assets in the business to make that business better. Be that Retail customers making sure they know about our garage business or the advertising we talked about today. We are very positive about the momentum there.

David Green: What percentage of the estate is open at the moment?

Graham Stapleton: All of our estate is open with a possible exception of any stores that have obviously Covid cases at the moment. We do have the odd store as you would expect in the middle of a pandemic that sometimes have to close for a short period of time and reopen. Not a large number but they are happening as they did in the last lockdown.

David Green: Have you made any decision yet on paying back furlough?

Loraine Woodhouse: No, is the short answer. We are obviously still in a period where we are in and out of lockdown so we want to see greater stability in the external environment before we make a final decision around our furlough repayment if there is any.

David Green: In terms of reimplementing the dividend, are there any further thoughts on that?

Loraine Woodhouse: Same position. We have said all along that we would like to get back to the point where we can pay a dividend. We know it is very important to our income investors but again we need some stability in the external environment, the environment we are trading within, before we are able to really be clear on our decision around that. I am sure at some point, whether it is in March or whether it is at our half-year, we will update accordingly but we have not made any decisions on either furlough or dividend to-date.

David Green: A final question on pricing and apologies if this question has already been asked because I joined the call late. The first question was on the Cycling side, are you in a situation where you are able to supply the current demand for Cycling? Is the supply chain there keeping up with demand? Then the other question is I think you mentioned in the release improved Cycling profitability and being on track to exceed the 300 bps increase in gross margin. I was trying to get a feel for how much you can go for there in terms of beyond that 300 basis points?

Loraine Woodhouse: We are not going to disclose the latter but this is the first point at which we have been confident to say that we will exceed the 300 basis points. The plan is going well. On the Cycling demand, we did touch on this earlier but in essence we are not quite able to meet up with demand at the moment because we have had some delays from either port congestion or containers and/or both. However, we are confident that that demand remains so as supply comes in we expect to be able to fulfil demand at that point.

David Green: Great, many thanks.

Graham Stapleton: Thanks very much for joining us today and we will look forward to speaking again shortly. Thank you.

Loraine Woodhouse: Thank you.

[END OF TRANSCRIPT]