Halfords - FY22 Interim Results

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Introduction

Graham Stapleton

CEO, Halfords

Welcome

Good morning, everyone, and welcome to the Halfords Group Interim results for the 26 weeks ending 1st October 2021. I am Graham Stapleton, CEO of Halfords, and I am joined this morning by Loraine Woodhouse, our CFO.

You will see as we go through today's presentation, it has been a very busy but successful first half. Despite a challenging trading environment, we are pleased to be upgrading our profit expectations for the full year, and excited to share our plans for the second half.

Agenda

In terms of the structure for this morning:

- Loraine will start by taking you through our financial performance over the first half and the outlook.
- I will then provide you with a recap of our strategy and an update on our progress against this year's plan
- You will then have the opportunity to ask questions at the end.

So to begin today's presentation, I will now hand you over to Loraine to talk you through our first half performance. Loraine?

FY22 H1 Financial Performance and Outlook

Loraine Woodhouse

CFO, Halfords

Welcome

Good morning, everybody. I am going to take a few minutes to cover the highlights of our first half performance.

Basis of financial information

Before I start, on slide four, I want to flag a couple of points that are relevant to today's presentation.

The first is that, where we use comparative data, unless stated otherwise, in my commentary I focus primarily on our performance versus our first half two years ago. This is particularly so for sales and profitability, as last year was heavily disrupted by COVID and it makes meaningful comparisons quite difficult. That said, we have included our prior year numbers throughout the presentation, where relevant, to ensure that we give full transparency.

The second point of note is that our results are now post IFRS 16. The standard has a material impact on our balance sheet and cash flow metrics, and I will do my best to explain the movement where it is relevant.

Strong financial performance on all metrics

Moving now to slide five, which summarises our overall performance. Our new financial year started on 3rd April 2021, just before non-essential retail started reopening across the UK. It is easy to forget how disruptive this period was, despite the relaxing of the stricter elements of the lockdown regime.

Although our stores and garages were open during the period, it was operationally difficult as sickness-related absences increased, supply chains were disrupted and road traffic, particularly for the first quarter of the year, was still very low.

It has been a challenging period for everybody, and that makes us particularly proud of our first half performance.

- Group revenue was up 19.2% on a two-year basis, or 14.2% like-for-like.
- We have delivered an improvement in gross margin of 167 basis points versus FY20.
- Costs as a percentage of revenue have declined by 1.2%, demonstrating how we have leveraged our fixed cost base through strong sales growth.
- We delivered underlying Group profit before tax of £57.9 million, which was £27.7 million ahead of two years ago and £2.1 million ahead of last year. Included within profit is £9.2 million of business rates relief, therefore demonstrating strong underlying profit growth.
- Finally, we have a closing cash and cash equivalents position of £92 million, an increase of £25 million since the start of the year.
- Working capital was an outflow of £12.1 million, but this remains low after experiencing a working capital inflow of £49 million in the prior year.
- Note that net debt, on an IFRS 16 basis, is £233 million.

Strong EPS growth and interim dividend of 3p. Non-underlying credit reflects provision releases

Moving to slide six, I cover most of these metrics in more detail later in the presentation, but I did want to touch briefly on non-underlying items. You will recall that, in the last couple of years, we have closed a number of stores and garages, including stores within our Cycle Republic chain.

At the time, we created provisions for onerous leases and other related costs of closure. The non-underlying credit of £6.4 million shown here, reflects a partial release of the provision, where we have either sublet or assigned leases for better terms than we had originally assumed.

FY22 Group PBT driven by strong performances across Retail; Autocentres impacted in Q1 by MOT deferment.

Given the number of moving parts in our numbers, on slide seven, I thought it would be helpful to provide a simple bridge of our profit versus two years ago. To give visibility of business rates relief, I have stripped it out of the underlying trading numbers and shown the benefit separately.

As you can see, our Retail business has performed very strongly throughout the period, with the impact of the work that we did last year on improving underlying profitability, for example, in improving cycling gross margin, continuing to benefit our overall results.

Autocentre profit was slightly down, driven primarily by a very significant seasonal shift in the timing of MOTs. Our performance cycling business, including the impact of the closure of Cycle Republic, is significantly more profitable.

And, finally, our financing costs have reduced, reflecting the fact that, excluding lease debt, we now have net cash rather than net debt.

Retail performance driven by strong revenue growth; underlying margin improvements

On slide eight, you can see a summary of our retail performance. We delivered good sales growth, our gross margin was extremely strong, increasing to above 50% and we managed the cost base well, allowing us to fund investment for the longer term in areas that we deem to be strategically important.

Retail Motoring strong in H1; Cycling continues to be volatile.

On slide nine, there is a little more insight into our sales performance. Our like-for-like sales growth was 14%, with Motoring growing by 11.9% and Cycling by 15.8%. Total growth was 7.7% as we have closed less productive stores over the last two years, boosting the like-for like performance of the remaining estate.

Our Motoring performance was encouraging, especially after a more difficult year last year. We were pleased with market share gains in our core categories, and particularly in the areas of workshop, car cleaning and staycation as we refreshed ranges and brought new products to market.

Cycling was undoubtedly suppressed by supply issues, particularly in the premium end of our own brand bikes, but demand remained healthy, and cycling sales picked up towards the end of the period. Perhaps not surprisingly, it was a volatile period for sales, and you can see that the first quarter was generally stronger than the second as we flagged at our 20-week statement.

The improvements in Cycling GM% are evident as category mix normalises.

Moving to gross margin on slide 10. You can see the positive movements over the last six months. We have been making progress on margins since our financial year 2018, albeit, last year was distorted by a very significant mix shift into cycling products, which tend to be lower margin.

This year has seen a normalisation of motoring and cycling mix and the comparison to two years ago is relevant. The impact of our cycling strategy to improve cost prices and promote more effectively has been material and we believe we can hold onto the majority of these benefits, even as demand and supply normalise.

The Other line here largely represents commissions we pay, including those of Cycle to Work and B2B sales, both of which have grown significantly versus the same period two years ago.

Retail Costs managed well; investment in our transformation programme.

On slide 11, I have broken out the key drivers of the movement in operating costs for the Retail business. We have benefited from £7.9 million of business rates relief in the period, but you can see from this chart that we have kept our underlying cost growth low. Where we have chosen to invest is in areas that we believe to be strategically important.

So, for example, within our transformation cost investment of £10.4 million we have grown our digital team, setup a centralised customer contact centre, invested in technology, such as a centralised data platform and increased colleague training. In some instances, the full benefit of investment will not be felt until subsequent periods, but it will drive future growth and customer experience. This expenditure will continue into the second half of the year.

MOT deferrals impacted H1 profitability in Autocentres; acquisitions have driven strong revenue growth.

Moving to slide 12 and Autocentres. Over the course of the last six months, our Autocentre business has arguably been more impacted by the effects of COVID than Retail. The story is also complicated by the acquisition of three businesses over the last two years:

- The very rapid expansion of our HME business, which is now up to 172 vans; and
- The launch of our Avayler software service, which already has its first active customer.

Revenue growth has been very rapid, with total growth of nearly 90% and like-for-like growth of 15.5%. The shape of that revenue has changed, with a switch into lower gross margin tyre volumes on the back of the acquisitions of Universal, McConechy's and Tyres on the Drive.

As I have mentioned previously, these businesses typically have a different operating model, with lower gross margin but lower associated labour. The reduction in gross margin that we flagged at last year's interims for McConechy's and Tyres on the Drive is further impacted this half by the purchase of Universal.

Profitability for the Autocentre business dipped by £0.3 million on FY20. The most significant impact on profitability was the government decision to exempt vehicle owners from an MOT test between March 2020 and July 2020. Any MOT due in that timeframe was pushed back six months. This has had a sustained impact on the timing of MOTs. Whereas, typically, our first quarter would be busy with MOT testing, the peak MOT period has moved back to our second and third quarters.

The impact is that our garages were less productive in the first quarter of the year but will be more productive in the third. Productivity drives profitability, and we therefore expect a more profitable second half in our garage business.

Less significant, but still important, is the impact of investment into our new businesses. We are still in the process of fully integrating and optimising our Universal and McConechy's acquisitions, although both are profitable in the half and are integrating well.

In our HME business, we have focused on rapid expansion to take market share early and, as hubs mature, they tend to be profit dilutive until routes are optimised. We have also suffered from a lack of technicians in this market alongside the disruptive effect of COVID illness.

Finally, in July this year we announced the sale of our new software package to American Tire Distributors in the US. This will become a revenue stream for us in the second half but in the first half of this year has been a net cost.

Looking forward, the dynamics I have just described will all move positively in the second half of the year, and we remain confident that the full year profit of Autocentres will be materially ahead of FY20.

Our cash position remains strong, albeit still flattered by an abnormally low working capital position

Moving now to slide 13 and our cash position. We have closed the half at £92 million for cash and cash equivalents, which is an increase of £25 million in the period. It is worth me flagging the impact IFRS 16 has had on these numbers as depreciation now includes the amortisation of the right of use assets, which for the half this year, is £33.4 million.

The most notable movement in our cash flow this period is working capital where the movement is an outflow of £12.1 million. If you recall, through last year, we saw a circa £50 million working capital inflow. I expect the working capital outflow to increase over the second half, albeit, the timing of arrival of stock will determine whether our working capital position fully normalises.

Our cash capital expenditure for the six months is £27.3 million. We expect full year CapEx to be somewhere between £50 million to £60 million.

Net debt reduces; capital allocation priorities remain unchanged

As a result of our strong cash flow, including IFRS 16 lease debt, our total debt is £232.7 million, £39 million lower than FY21. Excluding lease debt, we have cash of £92 million, albeit, as I said, this is flattered by an abnormally low working capital position.

Our capital allocation priorities, shown on the right-hand side of this chart, are unchanged. We believe that maintaining a prudent balance sheet, particularly in the current economic environment, is the right priority but we continue to invest for growth.

Declared interim dividend of 3p per share

Although we will invest to grow the business, we are also aware that our ordinary dividend is important to our investors. We updated our dividend policy at our preliminary results in June 2021, reinstating the ordinary dividend from FY22 at 9p per share, intending this to be progressive. We have therefore declared an FY22 interim dividend of 3p per share to be paid on 21st January 2022.

Upgrading full year underlying PBT profit guidance

Moving now to slide 16. I would like to cover our outlook for the balance of year. Overall, we are very pleased with our first half performance across the Group and how we are delivering against our strategy. We ended the first half with improved sales growth. And to-date, in the second half, sales have been in line with our expectations.

We have seen growth across the business and, in Cycling, although global supply chain disruption remains, supply constraints have eased somewhat. Inflation, labour shortages and supply disruption will continue to impact the business. However, we believe demand for our products and services will remain healthy and that we will be able to manage and mitigate the operational challenges throughout the second half.

Our strong first half performance gives us the confidence to continue to invest in price in Retail Motoring, where early volume uplifts are encouraging, and in our Group transformation, continuing to invest for the longer term.

As we flagged at our prelims, the investment will impact profitability in the second half. Taking the above into account, we are upgrading our full year 2022 underlying profit before tax range to £80 million to £90 million.

Regarding cash flow, we expect to see a further working capital outflow in the second half, albeit, the quantum will largely depend on the timing of stock flowing into the business.

Capital expenditure, as I mentioned earlier, we expect to spend £50 million to £60 million this year. Graham will cover some of the key areas of investment.

A more resilient business model will help us in a challenging medium-term environment

Looking longer term, our strategy was designed to deliver growth and build resilience. Since 2018, we have seen our Services and B2B revenues grow considerably. We have improved the profitability of our Cycling business and we have strengthened the position of our Motoring products business, underpinning our Motoring Services offer.

Finally, we have materially changed our cost base, reducing our Retail store footprint, improving efficiency and lowering working capital to safeguard future investments. We do not expect the extreme levels of inflation seen on the freight spot markets to be sustained, and we expect supply and demand of labour markets to stabilise, but certain inflationary aspects of FY23 are already known, including national insurance, national minimum wage and energy costs.

We are confident that our established efficiency work streams and our hedging polices will, in part, mitigate some of these costs. We also see some positive aspects looking forward:

- Foreign exchange and rental markets are more favourable;
- Cycling supply should stabilise; and
- Our initiatives from FY22 will begin to build momentum, contributing further to revenue growth.

As a business, we look forward with confidence to another period of transformation and strength. We have developed a stronger and more efficient business, centred around more resilient revenue streams, in markets with opportunities to significantly grow share.

On that basis, we look forward to the next period, knowing that we will need to stay agile to navigate through the inevitable challenges as they arise but, at the same time, excited to deliver the next phase.

I will now hand back to Graham. Thank you.

Strategic Update & Summary

Graham Stapleton

CEO, Halfords

Our Group purpose

Thanks, Loraine. So you can see from Loraine's summary that our first half performance was good, particularly given the ongoing global supply chain challenges that are affecting many businesses. And this continued delivery is clear evidence that our strategy is working.

Our long-term vision therefore remains unchanged, and I believe it is as relevant today as it was when we outlined it at the Capital Markets Day back in 2018. That is, for our customers, we will inspire and support a lifetime of motoring and cycling.

Our Group Strategy, announced in September 2018, remains as relevant today as it was then

The three key strategic goals that we set out to help us deliver against our plan are also entirely unchanged, and can be seen here on the slide.

Reminder of our accelerated strategy

In 2019, we said we would change the emphasis of the plan and accelerate our move towards a consumer and B2B, services-focused business, with a greater emphasis on motoring, generating higher and more sustainable financial returns.

Services and B2B offer higher financial returns in markets with strong growth opportunities

I thought it would be helpful here to set out a quick reminder of exactly why we shifted the emphasis, and why we saw the B2B and Services markets as key to our long-term success. This bubble chart forms part of our investment case, and clearly displays the different dynamics of the markets in which we operate, plotting market growth opportunity upwards, and financial returns out to the right.

The size of each bubble represents the relative size within our Group as of 2019. Our main product markets of Cycling and Motoring are still very important as you can see from the size of the bubble, but either have relatively lower financial returns, or are more mature markets with less growth potential. And while we have landed initiatives to improve or maximise the potential of these, we see far greater opportunities with Services and B2B.

For example, our Autocentres business sits very high up the chart demonstrating a significant growth opportunity. B2B is in a similar situation, showing higher growth potential compared to Motoring products, and better financial returns to cycling. And its a very natural fit to our core business.

Finally, Services and B2B are generally centred around less discretionary aspects of spend, are less impacted by weather, and they have much less foreign exchange exposure. Alongside these benefits, a services business also better enables us to build long-term lifetime relationships with customers. Combined, all of this means that our B2B and our services business tends to be far more resilient to economic shocks and the unpredictable demand patterns that are typical of product markets.

COVID-19 meant that we re-prioritised our strategic focus

So now let us have a look at what we have been doing to deliver our longer-term plan, both:

- The strategy we set out in 2018; and
- The change in emphasis announced in 2019.

With all the uncertainty that we have had to trade through over the last 18 months, we have had to focus our strategic delivery on ensuring that we have the most cost efficient and effective operating platform from which to grow, alongside prioritising the support pillar of our strategy to deliver the quickest returns.

Let us look at each of the strategic objectives in turn, with a top-level view of the big changes we have delivered over the last three years.

Inspire

Starting with Inspire. Here, our focus over the last three years has been to inspire more of our customers through a significant improvement in our digital customer experience across the Group. We brought all of our individual company websites together into one Group website in February 2020, and our focus since then has been to further optimise and enhance the way customers shop digitally across every part of our business.

This has included innovative and market-leading functionality in areas like "email me when back in stock" for cycling.

Our Inspire Pillar has changed the way customers shop

As a result, we have seen digital sales more than double as a percentage of Group revenue since FY18. The chart on this slide shows revenue growth, driven primarily by better website functionality.

Bringing all of our products and services together on one website, has also meant the number of customers shopping digitally across the Group has increased by more than 50%. And whilst the main focus has been the digital transformation, you can see that we have also significantly increased our own-brand ranges, and we have also invested heavily in transforming our cycling visual merchandising via project Peloton.

Support

Moving on now to the Support pillar of our strategy, where we will split what we have delivered into Services and B2B. So starting with services.

As I said earlier, this has been the main area of focus and consequently, has seen the most progress to-date. We set out to build a market leading motoring services business, increasing scale and convenience for our customers. And that is exactly what we have done.

Since 2018 we have grown our Halfords Mobile Expert business from just one van to a fleet of over 170. We have also acquired three garage services businesses, adding significant scale and convenience, and invested in a fleet of 192 commercial vans.

With these acquisitions, our Garage and Mobile services business now generates sales of over £330 million. The underlying improvements in the existing Halfords Autocentre Business, combined with the acquisitions, have seen total revenue double in this space over three years.

We have transformed our Services business

As you can see here, this has contributed to significant revenue growth in our total Group services business since 2018. We have added over £100 million of revenue, resulting in full year 2021 sales of £370 million, and with sales over the first half of this year already at £232 million.

Whilst a large proportion of the growth has been driven by Motoring Services, we have also seen Cycling Services contribute, growing plus 35% over two years.

PACE

In addition to growing our Motoring Services business, we have also significantly improved its efficiency, through the adoption of our innovative, in-house, digital operating system, PACE. As a reminder, PACE is a tablet-assisted colleague journey. You can see exactly what it looks like here on the slide. This piece of software really does transform the way our garages and vans operate, simultaneously increasing utilisation, capacity, and margin.

PACE has transformed the productivity and customer experience of our business

And you can see on this chart the significant improvement in sales per worked hour rate, and thus the productivity of our business. It is worth noting that quarter one of this year was impacted by the deferment of MOTs due to Covid-19, with a more representative run rate in Q2.

Alongside the margin improvements, PACE also enables colleagues to deliver a vastly improved and far more consistent customer experience. Consequently, you can see in the second table on this chart that our Autocentre net promoter scores have increased significantly since 2018, reaching a high of 75 points this year, from just 63 three years ago.

B2B is a important and growing revenue stream that leverages our existing assets.

And finally, within the support pillar, we have also grown our B2B business, as you can see from the chart. The key successes here have been expanding our market leading Cycle2Work proposition, growing our Commercial and Fleet businesses, and leveraging our acquisitions. This has resulted in B2B sales more than doubling, and now accounting for more than 20% of total Group revenues.

Lifetime is the least developed but will release significant value in the future.

Moving on to our final pillar, Lifetime, the least developed area of our strategy to-date. Since 2018, our real focus here has been very much on continuing to build the foundations for long-term relationships with our customers. This has meant specifically developing our single customer view and CRM capability. And as you can see on this chart, not only are more customers clicking through, but they are spending significantly more when they do.

We have improved the profitability of the underlying business

Moving on, as I said at the beginning, the customer strategy is underpinned by a relentless focus on cost and efficiency, partly because of the major headwinds we have had to face into, and partly because we needed to ensure that we build the most efficient and effective platform from which to transform the business.

Since 2018, we have made huge progress in this space, significantly improving underlying profitability.

This has been achieved by:

- A major reshaping of our Retail and Garage estate, closing just over 10% of our estate;
- We've lowered working capital requirements by over £30 million in three years, whilst significantly growing revenue;
- We have also transformed our cycling gross margin, up 680 bps in just two years; and
- A focus on Group procurement policies has delivered GNFR savings of over £20 million.

All of this has enabled us to reinvest, grow and transform.

Our colleagues are a point of differentiation and we now have more super-specialist expertise

Moving on now to the final piece of our plan, our most valuable asset of all, our colleagues. Since 2018, we have transformed the way our colleagues operate in support of our Services-led strategy, whilst investing heavily in engagement, wellbeing and development.

In FY21, we implemented a new labour operating model in our Retail stores. This involved removing over 600 management roles and reinvesting this value into even more customer-facing service roles. This has delivered an increase of 1.4 million customer facing hours each year, improving access to our super-specialist colleagues in all stores.

Alongside this, we also centralised and digitalised customer contact from our 400 retail stores into one specialist team. The digital focus here has meant that we have managed to reduce contact volumes by nearly half this year. This initiative was good news for our customers, delivering a step-change in call answer rates that are now industry-leading. And it was also great for our store-based colleagues, freeing up their time to focus on face-to-face customer service, and the delivery of Services in the store or car park.

Finally, we have significantly increased our investment in training and development, nearly doubling since FY18, giving our colleagues the skills and knowledge they need to provide superior levels of customer service.

This year, Inspire continues to transform the customer experience

So, as you can see, over the last three years:

- We have made huge strides in the way we support our customers, increasing the scale and convenience of our services business, alongside the transformation of our Group website.
- We have grown our B2B business; and
- We have enabled a much more cost-efficient way of working.

Turning our attention now to this year. And the good news is, the value we have created through the delivery of our support and cost and efficiency plans, has meant that we are now able to reinvest and grow the Inspire and Lifetime parts of our strategy. These become a much bigger focus as we move into the second half of this year.

So, again, let us take each of the strategic objectives in turn, looking at what we are delivering in FY22.

Halfords Digital

Starting with Inspire. Here, we will, of course, continue to build on the progress made so far, including making further enhancements to our digital proposition, and transforming the way we visually merchandise our parts, accessories and clothing ranges in Cycling.

But the main focus now is Fusion. As we talked about earlier, bringing our separate websites into one platform, means customers see and shop our complete Group offer on one website.

Fusion aims to do exactly that for all of our physical assets in a town, thus completing the Halfords omnichannel customer journey, through the transformation of our physical customer experience. Specifically, Fusion brings together all of the shopping and services locations that we have across a town, leveraging all our customer touchpoints, and creating an end-to-end experience that provides a full solution to every customer.

Our revolutionary Fusion towns help customers shop across our retail stores, garages and our mobile offer

On this slide, you can see that Fusion encompasses:

- A new format destination retail store;
- An updated Autocentres garage; and
- An extended Halfords Mobile Expert offer.

All operating in conjunction with an online and home delivery proposition across a single location.

We launched our first Project Fusion trial store in Colchester this summer and although it is early days, with much still to refine, we are seeing very promising early results in terms of sales, cross shop and net promoter scores.

Building on this momentum and taking key learnings forward, our second trial town is now in development and launches later this month.

Support continues to see significant progress driving Services further

Moving on now to Support, and again, splitting this into Services and B2B. This year in Services, we said we would further increase the scale of our Mobile business, setting a new target of 200 Halfords Mobile Expert vans. We now have 172, with more in plan for half two, moving us closer to our goal of 80% UK coverage.

In terms of our acquisitions, the integrations are progressing well with all our McConechy's sites now rebranded and refurbished. In half two, we plan to continue to scale up the Autocentres business, getting us even closer to our medium-term target of 550 garages.

And if we look at our Electric credentials, we set ourselves a target of training 2,000 of our 6,000 colleagues in Electric Services by the end of this financial year. At the end of half one, we had over 1,300 trained and we are on track to achieve our target by year end.

Later this month, we launch an exciting new third-party partnership to install electric vehicle home charging points for our customers.

We've entered new B2B markets that offer international growth opportunities

And this year in B2B, we leveraged the success of our PACE software, announcing our entry into the Software-as-a-Service market, through the launch of a new business, Avayler.

Our first, client, American Tire Distributors, or ATD, are one of the largest independent suppliers of tyres to the replacement tyre market in the US, supplying 80,000 garages. Our Avayler software will be used by both ATD and their partners, Tirebuyer and Treadsy. It is an exciting journey for us with multiple growth opportunities ahead.

We will introduce a market-leading, multi-channel, Motoring loyalty club

Next, let us look at Lifetime, and here, there are some exciting changes ahead. Half one has been about getting the planning and infrastructure in place. In half two, we see a step change, and really start to get into some of the more strategic transformation work, with the launch of a market-leading, multichannel motoring services club.

This will see us put the customer and their car at the centre of our club, allowing us to anticipate what they will need in terms of repairs, MOTs and servicing, then offer bespoke advice and savings to help keep customers on the move, and save money by shopping across the Halfords Group.

It fully leverages our unique market-leading breadth of offer, across the lifetime of a vehicle. We aim to get to know more about a customer's car than they do, enabling us to support them in a way no other motoring products and services business could.

ESG remains a core part of our strategy and represents a significant strategic commercial opportunity

Finally, within ESG, we will also be taking a leading role in the motoring and cycling industries. We are in the very fortunate position that for us, ESG is not only critical to the way in which we do business, but it also represents a significant strategic commercial opportunity. We believe that leading the industry here with our electrification strategy, will also enable us to develop valuable long-term relationships with our customers.

Cost and Efficiency

Each of the strategic pillars of our strategy are of course underpinned by a relentless focus on cost and efficiency. And this year, the progress here continues. Alongside a large number of established work streams continuing to target cost and efficiency, we have renegotiated 28 lease renewals in retail saving on average 25% on their annual rents.

We have also purchased our entire energy requirement for FY23, safeguarding ourselves from further cost increases and mitigating further risk next year. As an aside, all our electricity needs are now from 100% renewable sources.

Our super-specialist colleagues offer market-leading advice and knowledge

And finally, we come to our colleagues, where this year, the focus is very much centred around two specific areas:

- Firstly, we will implement the new Group operating and reward model, to ensure the way we work and engage colleagues is aligned with our Group strategy and our One Halfords Family values.

- Secondly, with the new retail operating model in place, and as part of building a services-focused business, we are now significantly investing in training and upskilling customer facing colleagues.

Put very simply, in the past, approximately two-thirds of our customer-facing colleagues were required to deliver just one skill, or technical service for a customer. The focus on training has meant we have really moved the dial here, so now every single customer-facing colleague can deliver a minimum of six skills.

As you can see from this chart, this means that for all our core on-demand services, we are now better able to respond to customer needs when they need us the most.

The scale of our change

So we have looked at the progress we have made since 2018, and the further changes we will deliver this year. Before we finish, I want to bring this together, and give you a flavour of how all of this strategic change has impacted the overall operation. So let us now look at the change in the scale and shape of the business from 2018 to today.

Firstly, in just three years, the way customers shop our business has altered considerably. So as you can on this slide, in 2018, we had a much smaller digital presence across multiple websites. We had many more stores than garages, and virtually no mobile presence.

Today, you can see that customers have changed the way they shop, and we now have almost equal numbers of customer touchpoints by channel. The number of customers who shop digitally has doubled. We have a huge garage services business including our mobile proposition. And we have reduced the number of stores by just over 10%.

You can see here on the slide, the bar charts on the left show the change in shape, and on the right, the corresponding changes in revenue.

And on the next slide, you will see the way our products and services mix has changed. Three years ago, the largest proportion of our business was product sales, with services just 23% and B2B 10%. Today, we have a much bigger services and B2B business, which together now account for approximately half of the Group's revenue.

Summary

So in summary, you can see from the progress I have outlined today, that we are making significant strides in changing the shape and scale of our business.

Despite the impact of a global pandemic, our ambition to become a consumer and B2B, services focused business is being realised, and at pace. We have generated a strong platform from which to further transform this year, with the focus now on inspiring more and more customers, and building better, stronger, and longer-lasting lifetime relationships with them.

That concludes today's presentation. Thank you for listening. There will be a short pause now whilst we move across to the live Q&A, where Loraine and I will be happy to take your questions.

Q&A

Jonathan Pritchard (Peel Hunt): The usual, three for me. Firstly, on Cycling gross margin. That is a fantastic two-year build. Has that flatted a bit perhaps over the last 18 months by lack of availability, and therefore everything going through full price? And could we see that perhaps come off a little bit over time? That is the first one.

And then two, not very good questions really. But first the loyalty card, it might be commercially sensitive. Is there going to be an app, is it going to be card, how is that going to work? And then on Fusion, if I live in Colchester, how do I know about this? Have you marketed it much? Is it just word-of-mouth? How do I feel the Fusion vibe if I live in one of your towns?

Graham Stapleton: Morning, Jonathan. Thanks for your three very good questions. Starting with Cycling gross margin. We started the work on Cycling gross margin well before the pandemic. So we are confident that a big proportion of that margin will stay. It is obviously very, very difficult to know exactly how much post-pandemic will be there, but a big proportion of that growth we expect to retain.

In terms of loyalty card, yeah, unfortunately it is a bit too sensitive to explain exactly how that is going to work, whether it is an app, whether it is a card at the monument. We will be in a position in quarter four to share more details on that and we look forward to doing that with everybody, but we are very, very confident about the proposition which has researched and tested very well with customers.

In terms of Fusion, we have done some limited local marketing in Colchester to ensure that customers are aware of the new Fusion offer. We have also done a little bit of PR as well and we have got some interest through that. But there is no national advertising for that one site that we have done to-date.

Manjari Dhar (RBC): I was just wondering, could you give a bit more colour on the market for electric-based vehicles and for bikes and the sorts of growth rates you are seeing there? And perhaps secondly, just on the cross-selling in store. Where is that at currently? And where would you hope to get to it in time?

Graham Stapleton: Yeah. So thank you, Manjari. Let us start with the colour for the market on electric. So we are seeing very strong growth on both electric bikes and scooters, where we are seeing those two categories together a 140% up on two years, so a very significant growth, both categories there doing well, scooters slightly stronger growth than bikes.

And then in terms of our servicing of electric vehicles over the first half compared to pre-COVID, we are looking at growth of over 120%. So very big growth in both the products that we are selling and then the servicing that we are doing on electric and hybrid vehicles as well. So really pleased with that.

What we are doing as a consequence and we announced this today is we have got 1,300 technicians trained in the first half of this year on electric hybrid servicing. We are on track to hit 2,000 by the end of this year and we have announced today we will double that to 4,000 technicians trained to do electric servicing across bikes, scooters and vehicles, next financial year. So we are really starting to see momentum there.

In terms cross-shopping, we have made good progress in this space this year. We have seen particularly strong results as we have come out of this half. We have not given any explicit targets for cross-selling, if you like, this year. And we are not intending to set any new targets for the second half. But we are seeing good growth, double-digit growth in that across the Group.

We expect after the launch of the motoring club that that will go up even further because a big part of that club is to encourage customers to shop across motoring services everywhere, be that garbage, a van or a store.

Adam Tomlinson (Liberum Capital): Three questions from me, please. First of all, just on the Fusion that trial site there. I appreciate you said it is early days there. But perhaps it would be helpful if you could just give a bit more colour in terms of the results you are seeing from that, the sales, the cross shop. And maybe a little bit in terms of economics of that around the cost base, how that changes? Just to provide a bit more colour on that. And I guess looking forward, if that trial does continue to go well, how quickly perhaps and the opportunity to role those Fusion sites across the state, how quickly that could be done? That is the first question, please.

Second one is just on freight rates. So I know you mentioned that you are not expecting those to continue at the same level as they have done. I imagine you are in discussions now. So can you perhaps give a bit of colour on where you see those coming out for next year, please? That would be helpful.

And then thirdly just following on from the last point you were talking about there, Graham, in terms of that cross shop metric. It feels to me certainly when we talk to investors that is a key steps and a key KPI, I guess, for you. We know directionally where that is going and you talked about it being at the 2% level in terms of retail customer shopping in Autocentres previously. But whether you are going to consider actually closing that so that the market can understand? You might not want to do that quarter-by-quarter but maybe every half year and full year, just so we can see where that is heading and the progress being made. That is the third question.

Graham Stapleton: Thanks, Adam. Loraine, do you want to start with freight rates?

Loraine Woodhouse: Yeah. Sure. So I think we talked about this a little bit last time out, Adam. We have contracted for this year obviously and I think we include in the statement the fact that this year our freight cost was £5 million above last year.

When we say that freight rates, we do not expect them to continue, we mean at current spot levels. Obviously, spots being very high for a sustained period of time, but we still think there could be increases in freight rates coming through for next year. That is what we are planning for. I am not going to give you a level because I think we will have a better understanding of that when we start our own negotiations. It is a little bit early yet, but I can easily imagine another shift from FY22 into FY23.

But I think from a freight point of view, it will then start to moderate to be on that point. Obviously, there are other inflationary factors which we have talked about in the statements, but I think freight is probably, as you have identified, the most substantial.

Graham Stapleton: Okay. Just moving on to Fusion. As you said, Adam, it is early days. We have literally had just two full months of trade in Colchester.

In terms of top-level view of results, sales have been strong. We have also been encouraged with the cross shop. We have managed to get across the town. We have had some very good NPS results in our retail business particularly and some great feedback from customers around the new shopping experience, some really positive feedback and that is coming in every week.

We have still got some opportunities we think to improve where we are with how we sell solutions within each of those channels of the town. And the next step we would be very much looking at how we value engineer the experience to ensure then that we have something that we can rollout to a lot more towns and at pace. We have got a second town going live very shortly, in fact in the next week, in Halifax. And that will give us even better data to give us a sense of where we go with those two towns but also how many towns we can roll this to and in what format and proposition.

So it is too early to really give you any more than that, but we are encouraged with some of the results around the customer experience that we have seen so far.

In terms of cross shop metric, it is a good question. I think it is probably a little premature to set the targets now because if you look at cross shop through the lens of three major component parts, the first part is bring all of our websites together, so customers can shop digitally across the Group in every part of our Halfords world.

The second piece is Fusion, which is bringing all the physical assets together so customers are able to show that better. And as you know, we are only one town in to that with the second one just about to come. And then the third constituent part is the club. We are going to start with monitoring to help customers understand the range of motoring service that they can get across retail carriages and vans. And we also have plans to do a similar thing for cycling next year.

So I think as we go through next financial year, this cross shop metric will become even more important and there will be more reasons, if you like, to look at how we measure and report externally against it. So I shall say watch this space next year.

Matthew McEachran (Singer Capital Market): Can I just come back to Fusion and just ask the boring question again, and I am sorry, because I have asked it probably in each of the last result sessions. But I mean, that is helpful feedback in terms of some of the factors you are seeing. But when we look at the overall revenue take and attachment, what would you deem success to be in terms of growth as a result of Fusion? I mean, are we talking a small quantum, let us call it single-digit quantum improvement in takings? Or is your aspiration and the hope that it is a much more substantial increase in market share and conversion in these local markets?

Graham Stapleton: Yeah. I mean, I think at the moment we are very much focused on the customer experience itself. So that is NPS, solution selling, cross shopping and just seeing how we can optimise those three parts within Fusion.

The sales in effect becomes almost an outcome of how well we do those three things. So the very specific targets around those three areas. The sales growth, I think we would want to see a double-digit growth in sales from Fusion Town with the investment that we are making. And to-date, we are happy with what we are seeing.

Matthew McEachran: That is useful. And if you see success in Halifax, what is the capacity in terms of phasing over more national rollouts of Fusion across the state or across the catchment?

Graham Stapleton: I mean, there is certainly an opportunity to roll the Fusion concept that we have put in place into many, many more towns across the UK if we can find a proposition that works for customers and us financially. And that is why we started Fusion the way we have and picked Colchester and Halifax, because they are representative of the largest proportion of towns and cities we could go into and do this type of customer experience.

So we are talking 100-plus, not just sort of tens and tens of towns and cities, if we can get the experience and the financial business case right for this particular proposition.

Loraine Woodhouse: Sorry, Matthew, just something to add on that. I think the other thing to think that with Fusion is not necessarily just to think about the Fusion concept that has gone into Colchester being rolled, but there are elements of it that we may choose to rollout faster, for example, or into more towns, because it hangs together in its own right. So there might be something, for example, around the car parks that looks really interesting that we might be able to roll wider and faster.

So do not think of it as just as big infrastructure thing that has to be rolled. I think there are elements of it that we might take and move faster, because they are successful in their own right and quick and economic to do.

Matthew McEachran: Yeah, understood. And if we look at Halifax, what is the timeline from starting this project to your planned launch time? What has been the work stream there?

Graham Stapleton: Halifax launches around now and it takes us about three to six months from start of identifying a town to actually execute in that town as it stands now. Obviously, that timescale is such partly because we are learning a lot as we go. We have only done one town. So there is a lot of bespoke things that need to be done.

We would expect if we did a national rollout to be rolling out something that is more proven and faster to get to market.

Matthew McEachran: And second question was on working capital. I do not know if you mentioned the number earlier. Apologies if I missed it. Just in terms of the suboptimal working capital position and inventory position, if you normalise, what would be the effective flattery in that H1 cash number?

Loraine Woodhouse: Yeah. So I think I did not mention the number, Matthew. I am working internally on a range because the actual working capital number for the second half for the year becomes very dependent on the timing of stock flow in and therefore the creditor position at the end of the year. But I think if you were looking for a central number to say that it is flattered by, I would use around £30 million.

Matthew McEachran: And then final question which is on your dollar hedge rate. Are you fully hedged yet for FY23? And could you give us some ideas to the rate that you are going to achieving?

Loraine Woodhouse: Yeah. Now, we are not fully hedged yet, so I think we are about 40% hedged and we are at just over 1.35 at the moment.

Kate Calvert (Investec): Three from me. The first one is, can you give some more colour around Peloton 2 relays and the results that are coming through there?

The second question is on gross margin in Autocentres, which has obviously been impacted by the low-margin acquisitions. Where do you think you can get your Autocentres' gross margin back to over the medium term?

And the third question is on lease renewals. Obviously, you are doing well there. Do you have a similar number coming through in FY23 compared to FY22?

Graham Stapleton: Do you want to start with lease renewals?

Loraine Woodhouse: Yeah, shall I start with the last two, Kate? So yeah, lease renewals still seeing good results. We have done 28 renewals in the first half. And we are getting about a 25% saving on average. That is not to say that will continue forever, but I am pretty confident that we will see more coming through for the second half, so there are further savings to come out of rent, which is positive clearly.

The gross margin on Autocentres, this has changed quite fundamentally obviously with the acquisitions: McConechy's, Tyres on the Drive and now Universal. And clearly that does dip the gross margin percent but the labour as a percent of sales also dips. So the thing that becomes a focus for us is increasing the gross margin per labour hour.

Labour is the resource in Autocentres and increasing that gross margin increases the profitability of the overall business. And I am pleased to say that we have continued to move the dial on that. We have not released the gross margin per labour hour. That is clearly quite competitively sensitive, but it is at its peak at the moment for the Autocentre business.

We had a little dip in the first quarter because of the MOT business, which is in and of itself high-margin and also attracts high-margin service-related revenue to it. So I am not sure that we will see the Autocentre margin move forward that sharply, very much depends of course on our acquisition or organic rollout plans. But what I hope we can still see continue is that gross margin per labour hour. That is important, and I think we can continue to still grow them.

Graham Stapleton: Yeah. Just a couple of builds on that as well. Obviously, the acquisitions that we are bringing to the Group in this space give us an opportunity over the mid-to longer-term to put a different product mix into the business, so less tyres, more amortise, more servicing. So over time, that margin mix improves.

The other thing we are doing and even more quickly and successfully than before is we are adding PACE, the digital pricing platform into wherever we acquire much faster. So we are getting Universal, McConechy's onto that digital platform. And what that does is ensure a consistency around how we plan work and how we manage and encourage customers to spend. And that in itself over time also improves the gross margin in the businesses that we acquire. So short-term, as Loraine says, mid-to long-term, a lot of reasons to be cheerful there.

Kate Calvert: And on the Peloton relays?

Graham Stapleton: Moving to Peloton, we are very pleased with the customer colleague feedback on Peloton 2. Peloton 2 was very much taking the principles of the first Peloton programme which was around bikes. So to improve the visual merchandising of the PACs category, parts, accessories, etc., in store.

We think there is even more potential in Peloton than we have got now, primarily because we are still a little short of the mid and premium tiered bikes. And it is the mid and premium tiered bikes that we see the biggest attach right for PACs. So as that stock becomes more plentiful as we go into the second half, I expect Peloton 2 to deliver an even better performance.

We have not given any specific numbers around Peloton 2. And at the moment, therefore I cannot give you any more guidance than that. But we are pretty much there in terms rollout across most of our stores and probably better performance to come as mid and premium tier bikes get in into stock.

Well, thank everybody. Thanks for joining and look forward to catching up with you shortly.

[END OF TRANSCRIPT]