halfords

OPERATIONAL REVIEW

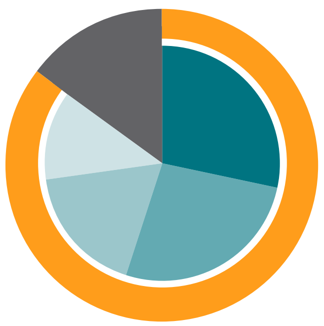
"This was another year of strong Retail performance, driven by our actions to improve the product and service offer. The results illustrate how we're beginning to build a significantly enhanced Retail customer experience."

A YEAR OF STRATEGIC PROGRESS, STRONG SALES GROWTH AND IMPROVED PROFITABILITY.

Total Group Revenue

Divisional Sales %

- Retail 85.4%
- Autocentres 14.6%



Retail Categories %

- Cycling 34.4%
- Car Maintenance 32.2%
- Car Enhancement 21.6%
- Travel Solutions 11.8%

The repositioning of Halfords Retail to offer an enhanced customer experience is now well under way, with significant steps taken during the year.

This has resulted in a strong sales performance, particularly in Cycling and Car Maintenance, as well as further improvements in customer feedback scores. Under new leadership, Autocentres has a clear strategy centred on building trust, and the early signs are encouraging, including an improved sales performance through the year. There is plenty more to do and FY16 will be the busiest year of investment activity under our Getting Into Gear Retail plan.

All reference to FY15 performance in this review is in respect of the proforma 52 weeks to 27 March 2015, unless otherwise stated.

SUMMARY OF GROUP RESULTS

Sales of £1,004.9m were up 6.9%, with like-for-like ("LFL") revenue growth of 6.8%. Group gross margin fell by 40 basis points to 53.2%. Total operating costs rose by 5.7% primarily as a result of the strong sales volumes, the logistics transition and investments made in key areas of the business. Investment in the expansion of Autocentres continued as the business added nine centres (with seven closures, making a net addition of two) and in Retail we opened four *Cycle Republic* shops.

Group earnings before non-recurring items, finance costs, depreciation and amortisation ("EBITDA") were up 8.7% to £109.9m. Group earnings before finance costs, tax and non-recurring items ("EBIT") were £84.6m, which compares with £77.8m in the prior year. Profit before tax and non-recurring items was £81.1m and earnings per share before non-recurring items were 32.7p, up 11.4% and 13.8% respectively.

The cash flow performance was robust with increased operating cash flows more than offsetting the impact of our capital expenditure programme and the *Boardman Bikes* acquisition. Group inventory levels were reduced marginally, despite the addition of *Boardman Bikes* and continued strong Retail sales growth. Net debt at the end of the year was down £37.8m at £61.8m, with a non-lease-adjusted net debt: EBITDA (52 week) ratio of 0.6:1 versus 1.0:1 in the prior year.

The Board has recommended a final dividend of 11.0 pence per share (FY14: 9.1 pence) which, if approved, would take the full-year dividend to 16.5 pence per share. If approved, the final dividend will be paid on 28 August 2015 to shareholders on the register at the close of business on 7 August 2015. The Board continues to look to maintain a c.2x dividend cover over the medium-term, growing full-year dividends broadly in line with earnings per share growth. Based on the proposed final dividend, the ratio of interim and final dividend payments has moved in line with the target of c.30:70.

OPERATIONAL REVIEW: RETAIL

Halfords Retail produced another year of strong sales performance with sales up 6.8% to £857.9m. LFL growth of 7.0% and online growth of 14.3% reflected the improvements made in the range of products and brands available, customer-centric offers, colleague engagement, and training. Weather conditions were favourable for Cycling during the summer and for Car Maintenance during the fourth quarter but the main driver of the better performance has been the actions taken by management and colleagues. Cycling was the highest growth category with sales up 11.4% and continues to be the largest element of Retail sales. However, FY15's performance was more broad-based with Car Maintenance sales up 8.5% and Travel Solutions sales increasing by 5.4%.

Within Cycling, all elements were in growth. Premium Bikes was the standout performer with LFL growth of 24.9%, following growth of 29.9% in the previous year. Children's Bikes sales were also strong with 13.3% growth, particularly driven by older children's bikes, with sales up 40.5% due to an enhanced range and a successful "Does

Anything Beat a Bike?" Christmas marketing campaign. Representing approximately one half of premium-cycle sales, Cycle-To-Work revenues grew by 15.4%. Sales of Parts, Accessories and Clothing ("PACs") grew by 8%, which was lower than we would have liked; it remains an opportunity that we are well-positioned and determined to take. Shortly after the end of the year we launched a range of *Boardman* clothing. Cycle Repair sales were up 17.8% with second-half sales up 27.3%, helped by the roll-out of the new operating model, which is now in over 400 stores.

The strong performance of Car Maintenance products and services was primarily driven by Parts and Workshop. The sale and fitting of bulbs, wiper blades and batteries ("3Bs") again represented the largest single element of the category and the fitting of these parts grew by 13.6%. Just before Christmas the number of 3B fitting jobs exceeded 100,000 in a single week for the first time and the week between Christmas and New Year saw the highest ever sales of both batteries and blades, helped by the 3-Gears training programme, which means we have more multi-skilled colleagues in our stores. Workshop sales were aided by the very successful Halfords Advanced 200-piece socket set, complete with lifetime guarantee.

Car Enhancement LFL revenues decreased by 0.5%. Sat Nav and Audio sales continued to reflect structurally declining markets, but Car Cleaning revenues grew by 12.6%, boosted by new gifting ranges and a focus on brands of choice.

Travel Solutions LFL revenues increased by 5.4%, driven by Travel Equipment, due to strong product and promotion offers, and Child Car Seats, with the investment in training resulting in a significant increase in the number of our accredited car seat fitters.

Online Retail revenues grew by 14.3% and represented 12.2% of total Retail sales (FY14: 11.3%). The growth was aided by the continual developments and enhancements being made to the online proposition, as well as an increased extended range, with customers now able to access around 160,000 products online. The importance of our store network and service overlay is highlighted by the strength of Click & Collect, with over 90% of orders picked up in store.

Total in-store service income increased to £26.7m, with the majority of revenues flowing from 3Bs fitting and Cycle Repair.

OPERATIONAL REVIEW: AUTOCENTRES

Total Autocentres revenues were up 7.6% and, on an LFL basis, up 5.3%, improving during the year from 4.3% in the first quarter to 6.6% in the final quarter. Gross margin reduced by 109 basis points in the year due to the tyre sales mix. Core Service, MOT and Repair margins were marginally up in the year. Operating costs increased by 6.7%, with the vast majority of the increase coming from new centres opened in recent years and the balance due to pay rises, enhanced training and investments in supporting functions. EBITDA increased marginally to £7.6m.

Nine new Autocentres were opened and seven were closed, taking the total number of Autocentres locations to 305 at the end of the year. 10-15 new centres will be opened in the year ahead and sub-optimal centres will continue to be closed as a matter of course.

HALFORDS BUSINESS REVIEW

RETAIL

Halfords' mission is to Help and Inspire Customers With Their Life on the Move within the following categories: Supporting Drivers of Every Car, Inspiring Cyclists of Every Age and Equipping Families for their Leisure Time.

Equipping Families for their Leisure Time gives the flexibility to extend the range, introduce innovative products and leverage space. However, the vast majority of management's focus is currently on Supporting Drivers of Every Car and Inspiring Cyclists of Every Age as these markets are significant and, with strong execution, management anticipates sustainable opportunities for growth.

The Retail strategy, Getting Into Gear, is based on the following five elements designed to significantly enhance the customer experience:

1. **Service Revolution** — up-skilling colleagues' capability to bring about a step change in customer service
2. **The 'H' Factor** — reasserting the business' proposition authority to Support Drivers of Every Car, Inspire Cyclists of Every Age and Equip Families for Their Leisure Time
3. **Stores Fit to Shop** — investing to raise the Halfords store estate to a standard the business is proud of
4. **21st Century Infrastructure** — providing systems and infrastructure to support increasing service and sales levels
5. **Click with the Digital Future** — creating a service-led, modern digital proposition

On pages 14 and 15 we have set out our progress on these five priorities.

AUTOCENTRES

A refreshed Autocentres strategy was launched in the year under new leadership, with a focus on building trust with our customers. Trust in the automotive service and repair sector is key to attracting and retaining customers. Investment during the year was focused on new centre openings, including a new concept trial in Croydon, and technology, including the latest diagnostic equipment to keep Autocentres at the forefront of capability and also a mobile-optimised website with online booking capability. The plan also includes closer working with the Retail stores. During the year Autocentres started using Halfords batteries and oil in its centres and running a consistent Halfords 5-point winter checks campaign in stores and centres. Trust Pilot is used as a measure of monitoring the service improvements and as of May 2015 this had increased significantly to around 8.5 out of 10. The early signs are encouraging but there remains much to be done.

COMMUNITY ENGAGEMENT

We continue to take steps to increase our community engagement and have set out our progress in a number of case studies throughout this annual report. See pages 5, 9, 17 and 36.

CURRENT ACTIVITY

The year ahead will be a busy one, both for product developments and further progress under the strategic plans in Retail and Autocentres.

In Retail there will be new bike ranges, including *VooDoo* in June, a children's range in the autumn and *Boardman* in the fourth quarter, as well as filling gaps within ranges, including the introduction of several premium women's bikes. During the year, we will also re-lay our cycling departments, at the same time rationalising the range and refreshing the merchandising. Cycling department colleagues will receive a face-to-face training course throughout the summer, aimed at further equipping colleagues with the capability to sell customers the right bike and the right accessories. Within Auto, there will also be new product launches, including tool sets, in-car connectivity solutions and an extended range of in-car dash cams. Merchandising enhancements, including a wider roll-out of electronic vehicle registration look up screens and enhanced 3B displays, making product selection simpler, will also be implemented.

Also within Retail is the launch of a marketplace initiative online. This enables Halfords customers to access thousands of additional Auto and Cycling products through *Halfords.com*. These products are delivered direct from the vendor to the customer, without Halfords needing to hold the inventory.

In Autocentres we remain committed to new centre openings, with 10-15 planned for the year, along with the commencement of a roll-out across the wider estate of the low-cost but high-impact learnings from the Croydon concept centre trial. In addition, productivity, utilisation and customer retention are focus areas.

And the best until last: on behalf of the Board I would like to thank all colleagues for their fantastic contribution, support and commitment to the further progress and strong performance made in Halfords this year. It has been a pleasure to work with you over the past year. I would also like to welcome Jill McDonald, our new CEO, and we all look forward to working with her in the years ahead.

Dennis Millard
Chairman
4 June 2015