Chief Financial Officer's Review

Financial Resources

Generating returns for our stakeholders through effective management of our financial resources.

£1,095.0m

Group revenue

£75.4m

Underlying Group profit before tax*

30.3p

Underlying Basic earnings per share*

Fast Fact

130%

Increase in electric bike sales during the year

Fast Fact

46%

Increase in dash cam sales during the year

Jonny Mason
Chief Financial Officer

> Group revenue in FY17 at £1,095.0m, was up 7.2% and comprised Retail revenue of £938.4m and Autocentres revenue of £156.6m.

Reportable Segments

Halfords Group operates through two reportable business segments:

- Retail, operating in both the UK and Republic of Ireland; and
- Autocentres, operating solely in the UK.

All references to Retail represent the consolidation of the Halfords ("Halfords Retail") and Cycle Republic businesses, Boardman Bikes Limited and Boardman International Limited (together, "Boardman Bikes"), Tredz Limited and Wheelies Direct Limited (together, "Tredz and Wheelies") trading entities. All references to Group represent the consolidation of the Retail and Autocentres segments.

The FY17 accounting period represents trading for the 52 weeks to 31 March 2017 ("the financial year"). The comparative period FY16 represents trading for the 52 weeks to 1 April 2016 ("the prior year").

Alternative Performance Measures

In the reporting of financial information, the Directors have adopted various Alternative Performance Measures (APMs).

* These APMs are defined within the Key Performance Indicators table on page 18.

Group Financial Results

	52 weeks Ended 31 March 2017 £m	52 weeks Ended 1 April 2016 £m	52 week change
Revenue	**1,095.0**	1,021.5	+7.2%
Gross Profit	**558.6**	543.1	+2.9%
Underlying EBIT*	**77.1**	84.5	-8.8%
Underlying EBITDA*	**108.7**	114.6	-5.1%
Net Finance Costs, before non-recurring items	**(1.7)**	(3.0)	
Underlying Profit Before Tax*	**75.4**	81.5	-7.5%
Profit Before Tax, after non-recurring items	**71.4**	79.8	-10.5%
Basic Underlying Earnings per Share*	**30.3p**	33.2p	-8.7%

* Definitions to these Alternative Performance Measures are shown on page 18

Group revenue in FY17, at £1,095.0m, was up 7.2% and comprised Retail revenue of £938.4m and Autocentres revenue of £156.6m. This compared to FY16 Group revenue of £1,021.5m, which comprised Retail revenue of £868.5m and Autocentres revenue of £153.0m. Group gross profit at £558.6m (FY16: £543.1m) represented 51.0% of Group revenue (FY16: 53.2%), reflecting a decrease in the Retail gross margin of 260 basis points ("bps") to 48.6% partially offset by an increase in the Autocentres gross margin of 80 bps to 65.1%.

Total Operating Costs before non-recurring items increased to £481.5m (FY16: £458.6m) of which Retail represented £379.8m (FY16: £363.0m), Autocentres £99.8m (FY16: £94.5m) and unallocated costs £1.9m (FY16: £1.1m). Unallocated costs represent amortisation charges in respect of intangible assets acquired through business combinations, namely the acquisition of Autocentres in February 2010, Boardman Bikes in June 2014 and Tredz and Wheelies in May 2016, which arise on consolidation of the Group.

Group Underlying EBITDA* decreased 5.1% to £108.7m (FY16: £114.6m), whilst net finance costs before non-recurring items were £1.7m (FY16: £3.0m). Group Underlying EBITDA margin, one of our financial targets, was 9.9% (FY16: 11.2%).

Underlying Profit Before Tax* for the year was down 7.5% at £75.4m (FY16: £81.5m). Non-recurring items of £4.0m (FY16: £1.7m) across Retail and Autocentres related primarily to costs associated with the acquisition of Tredz and Wheelies and investment in TyresOnTheDrive.com, the settlement of a historic legal case and organisational restructure costs. After non-recurring items, Profit Before Tax in the year was £71.4m (FY16: £79.8m).

Retail

	52 Weeks Ended 31 March 2017 £m	52 Weeks Ended 1 April 2016 £m	52 week change
Revenue	**938.4**	868.5	+8.0%
Gross Profit	**456.6**	444.8	+2.7%
Gross Margin	**48.6%**	51.2%	-260bps
Operating Costs	**(379.8)**	(363.0)	+4.6%
Underlying EBIT*	**76.8**	81.8	-6.1%
Non-recurring items	**(3.1)**	(1.2)	
EBIT after non-recurring items	**73.7**	80.6	-8.6%
Underlying EBITDA*	**101.1**	106.0	-4.6%

* Definitions to these Alternative Performance Measures are shown on page 18

Chief Financial Officer's Review

Revenue for the Retail business of £938.4m reflected a like-for-like ("LFL")* sales increase of 3.1%. Non-LFL sales, including five new Cycle Republic store openings since the prior year, and the acquired Tredz and Wheelies businesses contributed £53.3m revenue in the year.

Motoring sales represented 62.0% of Retail sales and LFL grew by 2.0%. Car Maintenance LFL revenues increased by 3.1%, reflecting strong growth in the sale and fitting of bulbs, blades and batteries ("3Bs") and good growth in workshop products, particularly the increasingly popular *Halfords Advanced* range to which we added new products during the year. Our new motorcycling parts and accessories ranges also performed well.

Car Enhancement LFL revenues declined by 2.8% reflecting the continued decline in the market for sat navs. This was partially offset by excellent growth in dash cams, with our range authority and increasingly popular fitting service consolidating our market-leading position in this category. Car cleaning also performed well, supported by new product ranges such as Christmas gift packs. Travel Solutions LFL revenues increased 7.9% LFL, driven by strong growth in roof bars, roof boxes, cycle carriers and child car seats.

Cycling sales grew by 5.1% on a like-for-like basis and 18.2% in total after including new Cycle Republic stores and the acquisition of Tredz and Wheelies. The like-for-like growth was driven by strong performances across each of the sub-categories of bikes, Parts, Accessories and Clothing ("PACs") and repair.

Bike sales were supported by the relaunch of our Apollo and Carrera mainstream cycle ranges and the launch of the exclusive Wiggins range, as well as the cycling promotion and favourable weather in the peak summer period. Cycle Republic sales grew by strong double-digit LFL and we opened 5 new stores.

Revenues for the Retail business (including Boardman Bikes and Tredz & Wheelies) are split by category below:

	52 weeks Ended 31 March 2017 (%)	52 weeks Ended 1 April 2016 (%)	FY17 LFL* revenue movement
Cycling	**38.0**	**34.3**	**+5.1%**
Motoring	**62.0**	**65.7**	**+2.0%**
– Car Maintenance	31.4	32.9	+3.1%
– Car Enhancement	19.0	21.6	-2.8%
– Travel Solutions	11.6	11.2	+7.9%
Total	**100.0**	**100.0**	**+3.1%**

Gross profit for the Retail business at £456.6m (FY16: £444.8m) represented 48.6% of sales, 260 bps down on the prior year (FY16: 51.2%). This movement is explained as follows:

- Circa 80 bps decline from the inclusion of Tredz and Wheelies, which operate in the lower-margin-percentage but higher average selling price category of premium cycling;
- Circa 150 bps from the gross impact of the depreciation of Sterling against the US Dollar; and
- Circa 30 bps decline from the adverse mix impact of faster cycling sales growth and the cycling promotion in the first half, partially offset by the favourable mix impact from service-related sales and the FX mitigation measures, which started to take effect towards the end of the year.

Operating Costs before non-recurring items were £379.8m (FY16: £363.0m) and, improved as a percentage of Retail sales from 41.8% in FY16 to 40.5% in FY17. The breakdown of costs is set out below:

	52 weeks Ended 31 March 2017 £m	52 weeks Ended 1 April 2016 £m	Change
Store Staffing	**110.2**	103.0	+7.0%
Store Occupancy	**138.6**	138.3	+0.2%
Warehouse & Distribution	**45.4**	45.7	-0.7%
Support Costs	**77.4**	76.0	+1.8%
Total Operating Costs before Tredz and Wheelies and non-recurring items	**371.6**	363.0	+2.4%
Tredz & Wheelies Costs	**8.2**	—	—
Total Operating Costs before non-recurring items	**379.8**	363.0	+4.6%

Store Staffing costs increased by 7.0% and reflected the changes in pay rates, principally driven by the uplift from the National Living Wage and Gears pay increments, together with the increase in trading volumes leading to incremental investment in store hours. The opening of 5 Cycle Republic stores also contributed to the increase.

Store Occupancy costs increased by 0.2%, reflecting broadly flat rent and rates costs on the existing estate with incremental costs arising from new Cycle Republic stores.

Warehouse & Distribution costs decreased by 0.7%, driven by cost savings in the first half when the more efficient 3-day-a-week delivery-to-store schedule annualised against the 5-day-a-week model operating at the start of the previous year.

Support Costs increased by 1.8% due to higher depreciation charges on non-store-related capital expenditure and a modestly increased marketing spend. Tredz and Wheelies added £8.2m of operating costs since acquisition. Going forwards these costs will be allocated to the cost categories presented in the table above.

Autocentres

	52 Weeks Ended 31 March 2017 £m	52 Weeks Ended 1 April 2016 £m	52 week change
Revenue	**156.6**	153.0	+2.4%
Gross Profit	**102.0**	98.3	+3.8%
Gross Margin	**65.1%**	64.3%	+80bps
Operating Costs	**(99.8)**	(94.5)	+5.6%
Underlying EBIT*	**2.2**	3.8	-42.1%
Non-recurring items	**(0.3)**	(0.5)	
EBIT after non-recurring items	**1.9**	3.3	-42.4%
Underlying EBITDA*	**7.6**	8.6	-11.6%

* Definitions to these Alternative Performance Measures are shown on page 18

Autocentres generated total revenues of £156.6m (FY16: £153.0m), an increase of 2.4% on the prior year with a LFL revenue increase of 0.6%. Online-booking revenues grew 29.1% in the year. Gross profit at £102.0m (FY16: £98.3m) represented a gross margin of 65.1%; an increase of 80 bps on the prior year, reflecting improved margins across Service, MOT, repair and tyres.

Autocentres' underlying EBITDA* of £7.6m was 11.6% lower than FY16 (FY16: £8.6m), with the upside in gross profit offset by continued cost investments as part of the long-term growth plans. Underlying EBIT* was £2.2m (FY16: £3.8m).

As referred to in the CEO Statement, we are dissatisfied with the financial results for the year and are taking a number of actions to improve performance.

As part of pre-existing strategic plans we have taken the decision to cease participation in a tyre affiliate programme, having determined that it was generating insufficient net profit for the workload capacity that it consumed in our centres.

We anticipate the impact of this to result in a decline in LFL sales in FY18, accompanied with an improvement in gross margin percent, such that there is a net profit benefit year-on-year from this initiative.

Portfolio Management

The Retail store portfolio at 31 March 2017 comprised 479 stores (end of FY16: 472).

The following table outlines the changes in the Retail store portfolio over the year:

	Number	Stores
Relocations	7	Aylesbury, Warrington, Crewe, Chichester, Hull Clough Road, Derby (Kingsway), Sutton Coldfield
Lease re-gears	29	Brentwood, Newcastle-under-Lyme, Erdington, Merry Hill, Pontefract, Carmarthen, Sunbury, Burgess Hill, Harrow, North Shields, Yate, Salisbury, Braehead, Sutton, West Wickham, Croydon (Windmill Rd), Newhaven, Redhill, Newton Abbot, Gosport, Sheldon, Bridgwater, Twickenham, Bournemouth, Bath, Hounslow, Bridgend, Huntingdon, Bradford
Rightsizes	2	Altrincham, Tonbridge
Openings	6	Purley Way (Cycle Republic,"CR"), Birmingham (CR), Wimbledon Plough Lane, Leeds (CR), Edinburgh (CR), Southampton (CR)
Closures	3	Mitcham, Wimbledon Broadway, Hastings
Acquired (Tredz)	4	Cardiff, Swansea (2), Cross Hands

Of the six openings in the Retail portfolio, five were Cycle Republic. Management anticipates opening around five Cycle Republic stores in FY18.

17 Retail stores were refreshed in the year (FY16: 25) and management anticipates refreshing 30 in FY18.

Five new Autocentres were opened and six were closed during the year, taking the total number of Autocentre locations to 313 as at 31 March 2017 (end of FY16: 314). 16 Autocentres were refreshed in the year (FY16: 24).

With the exception of eight long leasehold and two freehold properties within Autocentres, the Group's operating sites are occupied under operating leases, the majority of which are on standard lease terms, typically with a 5 to 15-year term at inception and with an average lease length of less than 7 years.

Chief Financial Officer's Review

Net Non-recurring Items

The following table outlines the components of the non-recurring items recognised in the year:

	FY17 £m	FY16 £m
Organisational restructure costs	**(0.6)**	(1.7)
Costs in relation to a historic legal case	**(0.8)**	—
Acquisition and investment related fees	**(1.7)**	—
Operating lease obligation	**(0.3)**	—
Net non-recurring operating expenditure	**(3.4)**	(1.7)
Acquisition related interest charge	**(0.6)**	—
Net non-recurring items	**(4.0)**	(1.7)

In the current and prior year £0.6m and £1.7m of costs were respectively incurred in relation to separate and unrelated organisational restructuring initiatives across Autocentres and Retail.

During the year a court case was settled relating to activities during FY12, resulting in costs of £0.8m.

Acquisition costs of £1.7m (FY16: £nil) in the period related to the costs associated with the purchase of the entire share capital of Tredz and Wheelies, and the minority investment in TyresOnTheDrive.com. The interest element relates to the unwinding of the discounting applied to the contingent consideration due on the acquisition of Tredz, which will be paid in the first half of FY18.

The operating lease obligation of £0.3m in FY17 related to rectification work unique to one of the Group's retail stores, which was required to make good an area of land upon which the store is located.

Net Finance Costs

The Net Finance Costs excluding acquisition related interest charge for the year was £1.7m (FY16: £3.0m). The primary driver of the lower costs was £1.4m income (FY16: £0.1m expense) in relation to points on foreign exchange forward contracts.

Taxation

The taxation charge on profit for the financial year was £15.0m (FY16: £16.3m), including a £0.9m credit (FY16: £0.3m credit) in respect of non-recurring items. The effective tax rate on profit before tax and non-recurring items of 21.0% (FY16: 20.5%) was higher than the UK corporation tax rate (20.0%) principally due to the effect of non-deductible depreciation and amortisation charged on capital expenditure. For FY18 we anticipate the effective tax rate to be circa 20%.

Earnings Per Share ("EPS")

Underlying Basic EPS* was 30.3 pence and after non-recurring items 28.7 pence (FY16: 33.2 pence, 32.5 pence after non-recurring), an 8.7% and 11.7% decrease on the prior year. Basic weighted-average shares in issue during the year were 196.6m (FY16: 195.2m).

Dividend

The Board has recommended a final dividend of 11.68 pence per share ("DPS") (FY16: 11.34 pence), taking the full year ordinary dividend to 17.51 pence per share, an increase of 3.0%. If approved the final dividend will be paid on 25 August 2017 to shareholders on the register at the close of business on 4 August 2017. Including the 10.00 pence special dividend paid in February 2017 the total full year dividend is 27.51 pence.

We continue to target coverage of around 2 times on average over time. However, the impact of adverse FX movements will reduce cover initially until fully mitigated, which will take some time.

Capital Expenditure

Capital investment in the year totalled £36.1m (FY16: £40.3m) comprising £29.5m in Retail and £6.6m in Autocentres. This total includes £1.8m of assets capitalised through the acquisition of Tredz & Wheelies in May 2016.

Within Retail, £11.5m (FY16: £13.4m) was invested in stores, including 17 store refreshes, 9 of which were also store relocations or right-sizes, 5 new Cycle Republic stores as well as general capital spend relating to training rooms, roofing, flooring and heating. By the end of FY17, 114 (FY16: 87) stores were trading in either the latest or preceding refresh format. Additional investments in Retail infrastructure included a £12.5m investment in IT systems, such as continual development of the online Retail proposition, the 'Dayforce' integrated people management solution, development of the 'iServe' till hardware and software project, and a Cycle Republic website.

The £6.6m (FY16: £8.2m) investment in Autocentres comprised the opening of 5 centres in the year (FY16: 11) along with an investment in refreshing centres and new equipment.

On a cash basis, total capital expenditure in the year was £34.4m (FY16: £38.5m).

In FY18 we anticipate capital expenditure to be circa £40m, split broadly half on store refreshes and half on IT investments. We anticipate the Group depreciation and amortisation charge to be circa £33m for FY18.

Inventories

Group inventory held as at the year-end was £191.1m (FY16: £157.9m). Retail inventory increased to £189.8m (FY16: £156.6m) comprising c. £14m from the impact of foreign exchange, c. £13m stock build for Easter and new ranges (such as e-bikes, launched in the final week of the year) and £5.9m Tredz & Wheelies inventory. Autocentres' inventory was £1.3m (FY16: £1.4m).

Cash flow and Borrowings

Operating Cash Flow** during the year was £90.0m (FY16: £103.7m). Free Cash Flow*** of £37.7m (FY16: £45.4m) was generated in the year. Group Net Debt* was £85.9m (FY16: £47.9m), with the Net Debt to Underlying EBITDA ratio* at 0.8:1.

* Definitions to these Alternative Performance Measures are shown on page 18

** Operating Cash Flow is defined as Underlying EBITDA plus share based payment transactions and loss on disposal of property, plant and equipment, less working capital movements and movements in provisions.

*** Free Cash Flow is defined as Operating Cash Flow (as defined above) less capital expenditure, net finance costs, taxation and fair value gain on derivatives.

Financial Targets

We continue to apply four key financial targets, which we reaffirm and appraise ourselves against below:

	DESCRIPTION	FY17 PERFORMANCE
1	**Grow sales faster than the markets** in which we operate. We continue to anticipate that the motoring market will grow at an average rate of 2-3% per annum and the cycling market at an average rate of 3-5% per annum over the medium term. We will aim to beat whatever those growth rates are.	In Retail we gained share in both motoring and cycling. In Autocentres we gained share on a total sales basis, whilst the operational changes had a short-term impact on like-for-like performance.
2	**Maintain Group EBITDA % margin roughly flat** as we continue to invest for sustainable growth. The impact of adverse FX movements will reduce margin initially, until fully mitigated, which will take some time.	Group EBITDA margin was 9.9% (FY16: 11.2%). Excluding the impact of adverse foreign exchange movements, EBITDA margin was broadly flat in FY17 compared to FY16.
3	**Grow the dividend per share every year**, with coverage of around 2 times on average over time. The impact of adverse FX movements will reduce cover initially, until fully mitigated, which will take some time.	The Board has proposed a final dividend of 11.68p, which would take the full year dividend to 17.51p, an increase of 3.0% on the previous year.
4	**A debt target of 1.0x Underlying EBITDA with a range of up to 1.5x** to allow for appropriate M&A. We anticipate moving towards the debt target over time.	We have moved from 0.4x to 0.8x net debt to Underlying EBITDA in FY17 through the consistent application of our capital allocation priorities which resulted in M&A of circa £22m and a special dividend of circa £20m.

Brexit

The decision of the UK to leave the European Union ("Brexit") presents significant uncertainties to the Group as a result of the impact on the wider UK economy. The main areas in which Brexit is likely to impact the Group are as follows:

- Impact on foreign currency exchange rates – the value of Sterling fell by nearly 20% since FY16. The Group buys a significant proportion of its goods in US Dollars; between $250m and $300m a year. At a spot rate of £1:$1.25 the total FX headwind pre mitigation is nearly £50m of annual cost inflation compared to the FY16 average rate flowing through cost of sales of $1.60. Our hedging programme means that this phases into our P&L roughly as follows: circa £14m in FY17, a further circa £25m in FY18 and a further circa £10m in FY19. Good progress is being made on FX mitigation, through supplier negotiations, operational efficiencies and pricing. We are seeing prices rise in the cycling market, both from suppliers into retailers and then onto customers. Some of our prices have also risen, but we continue to look to maintain good value against the competition. It is early days and we are yet to see how wider cost inflation impacts on consumer spending more generally, however we are encouraged by the limited volume impact observed to date. We continue to anticipate that we will fully recover the FX impact over time.
- Prolonged uncertainty over exit terms and continued weakness in Sterling could lead to a slowdown in the UK economy, and consequent loss of consumer confidence, impacting trading conditions for the Group. However, Halfords has strong positions in fragmented Motoring and Cycling markets, and a service-led offer that differentiates us from our competitors, physical and online. Much of our sales are in needs-based categories that are more resilient to macro-economic cycles and our discretionary categories, such as cycling, camping and travel solutions, could benefit from an increase in the number of people choosing to stay at home rather than holidaying abroad; a trend that we observed in 2009.

Principal Risks and Uncertainties

The Board considers risk assessment, identification of mitigating actions and internal control to be fundamental to achieving Halfords' strategic corporate objectives. In the Annual Report & Accounts the Board sets out what it considers to be the principal commercial and financial risks to achieving the Group's objectives. The main areas of potential risk and uncertainty in the balance of the financial year are described on pages 42 to 47 and note 21 of the Annual Report and Accounts. These include:

- Economic risks; including market risks
- Business strategy risks
- Competitive risks
- Compliance
- Supply chain disruption
- Product and service quality
- Information technology systems and infrastructure; and
- Dependence on key management personnel

Specific risks associated with performance include Christmas trading as well as weather-sensitive sales, particularly within the Car Maintenance and Cycling categories in the Retail business.

Jonny Mason
Chief Financial Officer
24 May 2017