Chief Financial Officer's review

The financial year 2015 showed strong performance across all our financial KPIs, including growth in like-for-like, revenues, gross margin, EBITDA and cashflows.

Ian Kellett
Chief Financial Officer

"We are pleased to be making a total dividend payment of 5.4 pence per share, at the top end of our commitment."

Group revenue

£729.1m

↑ 9.6%

(2014: £665.4m)

Underlying EBITDA

£121.3m

↑ 9.6%

(2014: £110.7m)

Sales and revenue

Total revenues in FY15 grew by 9.6% to £729.1m (FY14: £665.4m), with good performance across all three business segments; Food, Accessories and Services. Like-for-like sales grew by 4.2%, driven by strength in Advanced Nutrition, Health & Hygiene, VIP club, Services and omni-channel.

Total Merchandise revenues, which includes Food and Accessories, grew by 8.3% to £666.1m (FY14: £615.1m).

Food revenues grew strongly by 9.8% to £359.3m (FY14: £327.3m), reflective of excellent performance in dog and cat Advanced Nutrition, dog treats and premium wet cat food. Advanced Nutrition revenues grew by 17.2% to £145.4m (FY14: £124.0m), with our flagship private label Wainwright's a key contributor, growing by 44.1% to £40.1m (FY14: £27.8m). This compares to the Advanced Nutrition market in the UK growing at around 14%*. Grocery dog food performance was weaker following our Autumn space re-allocation to Advanced Nutrition, but sales densities improved post the space re-allocation.

Accessories revenues grew by 6.6% to £306.8m (FY14: £287.8m), driven by Health and Hygiene sales, a strong Christmas range, and dog collars and leads. We saw some weakness in Cat Litter as a result of new range changes, and in Aquatics, reflecting a weaker market and the re-allocation of this product space when Services are retrofitted to stores. We have also experienced weak trading and sales in our equestrian business, Ride-away, which declined year-on-year.

Services revenues grew 25.2% to £63.0m (FY14: £50.3m), reflecting both new openings and the growing maturity of our vet practices and Groom Rooms. Growth in our Joint Venture veterinary practices was ahead of the UK veterinary services market, generating fee income of £28.2m (FY14: £21.6m), growth of 30.7% on the prior year.

* Market data sourced from OC&C Strategy Consultants.

Gross margin

Group gross margin expanded by 40bps to 54.2% (FY14: 53.8%), attributable to significant expansion in our Services margin, as well as good progression in Merchandise margin.

Gross margins within Merchandise were 56.3%, an expansion of 19 bps on the prior year (FY14: 56.1%). This has been achieved primarily through the Food business; from the strength of our private labels such as Wainwright's, the decreased participation of lower margin grocery food, improved terms negotiations, and a lower level of discounting across the year as our marketing to VIP customers becomes more targeted. Accessories margins were at a similar level to the prior year as we continued our price investment in large accessories, increased promotions across Aquatics and saw a changing mix in cat litter. We have also experienced challenge to the Accessories margin from omni-channel promotional activities, as well as the weakness in the Ride-away business.

Gross margin within the Services business expanded by 630 bps to 32.6% (H1 FY14: 26.3%). Of the £7.3m growth in Services gross profit, the main contributors have been the maturation of our vet practices, incremental synergies of £2.6m from the Vets4Pets integration, and a benefit in grooming from both maturity and measures to increase profitability. Adverse movements within Services gross margin came from our continued investment in live pet care and welfare within stores.

In the coming year we expect to see a modest accretion in Group gross margin, reflecting the positive impacts of our maturing vet business and higher margin product categories, whilst allowing for further price investment in opening price point categories and the dilutive impact of a high proportion of new Groom Rooms. We do not expect any further synergy benefits from the Vets4Pets acquisition.

Chief Financial Officer's review
continued

Operating costs
Selling and distribution expenses of £257.9m were broadly constant as a percentage of Group revenue at 35.4% (FY14: 35.2%). Occupation costs (rent, services charges and other costs) declined as a percentage of sales as we continue to benefit from a benign rental market and the offset to our rental costs from the retrofitting of vet practices to stores. Income from vet practice retrofits and sublets contributed more than £8.1m to our gross property rental costs of £66.5m in FY15 (FY14: £61.9m). Colleague costs of £136.5m (FY14: £120.9m) increased as a result of our new store rollout and 'learn to earn' Steps training programme, coupled with our industry leading retention rate. Marketing costs also increased as we invested in our brand through TV advertising and sponsorship.

In the year ahead we will invest further in our brand and marketing, and in the hardware and software required to support the seamless shopping strategy. We expect colleague costs to grow ahead of the rate in FY15 as we provide additional holiday pay, maintain retention and ensure we maintain our reputation as one of the best companies to work for in the UK.

Administration expenses of £40.7m were 5.6% of revenue (FY14: 5.2%), reflecting an additional £2.5m of costs associated with being a publicly listed company and £1.7m of IFRS2 share based payment charges.

Underlying EBITDA
Underlying EBITDA of £121.3m, which excludes £1.7m of IFRS2 share based payment charges, represented a 9.6% increase on the previous year (FY14: £110.7m). Margin was equal to the prior year as we incorporated the first year of costs associated with being a public company, which totalled £2.5m.

Our underlying EBITDA margin was supported by the increased participation of the Services business, which represented 8.6% of Group revenues in FY15 (FY14: 7.6%). Despite the considerable immaturity of our vet practices and grooming salons, the Services business has a higher EBITDA margin to that of the Group and this support will enable us to invest in the future growth of the Group.

Going forward, IFRS2 shared based payment charges will be considered part of ongoing operating expenses, as we move to our second year of being a public company and we will no longer report an underlying EBITDA measure.

£m	FY15	FY14
Operating profit	96.8	78.8
Depreciation and amortisation	22.8	20.0
Reported EBITDA	**119.6**	**98.8**
Related party fees	–	1.2
IFRS share based payment charges	1.7	0.1
Exceptional items	–	10.6
Underlying EBITDA	**121.3**	**110.7**

Underlying EBITDA is calculated as Group underlying operating profit under IFRS (which includes amortisation of landlord and developer contributions received), plus depreciation and amortisation. Excludes exceptional items, related party fees, and IFRS2 related share based payment credits and charges. FY14 exceptional expenses of £10.6m were attributable to costs associated with the Initial Public Offering (£9.4m), and costs associated with the integration of the Vets4Pets business (£2.3m) net of a significant VAT refund (£1.1m).

Finance expense
Net finance expense for FY15 was £9.8m. As a result of our declining leverage profile and following our recent refinancing at more favourable rates, we expect net finance expense for FY16 to be £5.5–6.0m. Capitalised fees associated with the previous facility will be reflected as an exceptional charge to the income statement of approximately £4.3m in FY16.

Taxation, trading profit & EPS
Underlying total tax expense for the period was £19.1m, a rate of 22% on pre tax profit. Whilst the UK corporate tax rate for the period was 21%, the principal reason for the difference relates to items of capital expenditure for which depreciation is non deductible.

An exceptional tax credit, and cash receipt of £4.3m, related to the release of a provision made in the prior financial year in respect of interest deductability on debt associated with the pre IPO capital structure.

Trading profit for the period, which includes IFRS2 share based payments, was £67.9m (FY14: £38.6m). Basic earnings per share were 13.5 pence (FY14: 0.5 pence).

Working capital

The underlying cash working capital improvement for FY15 was £5.8m (FY14: £9.6m).

An increase in inventory of £2.4m is mainly reflective of our investment in new food ranges and new store openings. Of the increase in trade receivables of £9.5m, the majority relates to temporary loans made to Joint Venture vet practices, whereby the Group funds initial setup costs until commercial funding is drawn down by the practice. The trade payables* increase of £17.7m reflects both growth across the Group and our efforts to drive a wide range of efficiencies and improvements.

We expect a moderate working capital outflow in the coming financial year due to the additional trading week in the period and resultant outflow of trade payables.

* Trade payables includes trade and other payables, with balances associated with fixed assets, tax and interest removed, and financial instruments. Excludes £25.2m of IPO related payables in the FY14 balance.

Borrowings and net debt

The Group's underlying net debt position at the end of year was £192.0m, representing a leverage ratio of 1.6x underlying EBITDA, a reduction from the FY14 position of 2.3x. Whilst the net debt position is ahead of expectations, our underlying deleveraging plan remains unchanged, at an average of 0.5x per annum from our prior year position of 2.3x reflective of the anticipated working capital outflow in FY16 and our dividend commitment.

Post year end, we announced the closing of a new financing agreement for a five year, £260m revolving credit facility, which is currently drawn to £235m. This replaced the Group's previous £325m of drawn facilities, with the differential balance between the two facilities being settled from the Group's existing cash resources. At current leverage, the facility carries a rate of LIBOR +1.5%.

£m	Leverage
Gross Debt	325.0
Cash	(133.0)
Net debt	**192.0**
Underlying EBITDA	121.3
Leverage	**1.6x**

Capital expenditure

Capital investment in the period totalled £33.2m (FY14: £30.0m), reflecting our increased Services retrofit programme, where we incur the capital outlays for grooming salons and store refurbishment, as well as investment in mezzanine floors across the estate which drive space and rental efficiencies in both new and existing stores.

On a cash basis, capital expenditure in the period was £30.4m (FY14: £26.3m).

We expect capital investment for FY16 to be approximately £40m, reflecting investment in our seamless shopping strategy, additional mezzanine floors as we optimise new store openings and retrofit services to the existing estate, and store refurbishment as part of the services retrofit programme.

Cash flows

Cash flow generation was once again strong. The Group generated £125.3m in underlying operating cash flow* during the period (FY14: £108.7m). Underlying free cashflow** before interest, tax and acquisitions was £92.8m (FY14: £92.4m), representing a cash conversion rate of 76.5% (FY14: 83.5%).

Cash returns on invested capital*** improved to 22.6% (FY14: 21.7%) as a result of our profit growth and working capital improvement.

* Excludes £25.2m of trade payables movement related to the IPO.
** Excludes £1.7m of IFRS2 share based payments and £25.2m of trade payables movement related to the IPO.
*** CROIC excludes goodwill on KKR acquisition, £1.7m of IFRS2 share based payments and £25.2m of trade payables movement related to the IPO.

Dividend

The Board has recommended a final dividend of 3.6 pence per share, leading to a total dividend of 5.4 pence per share, in respect of the 2015 financial year. The final dividend will be proposed by the Directors at the 2015 AGM and is in addition to the interim dividend of 1.8 pence per share, paid to shareholders on the 16 January 2015. The ex-dividend date will be 13 August 2015 and, if approved at the Company's forthcoming AGM, will be paid to shareholders on 14 September 2015 to those shareholders on the register at the close of business on 14 August 2015.

The Board is targeting a progressive dividend payment policy of 40% of earnings, reflective of the positive outlook for the business.

Ian Kellett
Chief Financial Officer
3 June 2015