Chief Executive's statement

"We continue to operate successfully in a growing market, taking share, and are the only UK pet business able to deliver an integrated merchandise, services and omnichannel offer."

Our Vet Group transacted more than

£260m

in total customer revenues during the year

We will roll out

40–50

vet practices in the coming year

1 Market data sourced from OC&C Strategy Consultants.
2 Refers to the 16 week period from 26 Jan – 18 May 2017.

◊ FY16 comparative information presented on a 52 week basis. For reconciliation to a 53 week statutory basis see page 179.
† Alternative Performance Measures (APMs) are defined and reconciled to IFRS information, where possible, on page 179.

Market review[1]

The UK pet market has increased its rate of growth over the past two years to a CAGR of 4.5% and was worth £6.8bn in calendar year 2016. This step forward has been driven by faster growth in the veterinary, insurance and accessories segments.

The veterinary market grew at a CAGR of 5.6% over this same period, which is being driven by the widening availability of more complex procedures and diagnostics, supported by increasing numbers of pet owners with insurance. In food, strong growth in Advanced Nutrition continued at a CAGR of 8.9%, balanced with a flat grocery food market where volumes are falling and pricing remains highly competitive. With the accessories market CAGR at 1.9%, this led to an overall pet products market CAGR of 2.1%.

The transition of the market to online has been consistent with our expectations, accelerating slightly compared with historical rates, reaching 11% of the pet market in 2016.

Over the two year period from 2014 to 2016 we have taken share across the pet market both online and offline. Overall we have grown our share of the important strategic categories including Advanced Nutrition, accessories and veterinary. From 2014-2016, our total share of the pet products market increased from 19% to 20% and in the primary opinion veterinary market from 9% to 12%.

Expanding like-for-like growth

Better value for customers

In the Merchandise business our focus is on delivering even better value for our customers. Value includes price, but also innovation, service and advice. The strong sales of dog accessories this year are continuing proof that our range innovation drives a positive customer response. And to improve further on our service to customers, we are refocusing our Steps training programme to ensure more colleagues can develop their expertise at a faster rate in more specialist areas.

We also understand there is a need to provide better pricing to customers. This will involve a move away from promotional offers and vouchers, and towards a simpler, more competitive approach.

We therefore initiated pricing changes in the fourth quarter with the Switch & Save campaign, which highlights the value in our private label foods, Wainwright's and AVA. The prices on our large bag private label dog foods are now 15-25% lower. Initial results from the campaign have been encouraging and since its launch in January 2017 we have seen an average 50% uplift in the volume of products that have seen a price change. We have also seen an increase in new shoppers, alongside the switching of existing customers from branded foods into our own labels. In the current financial year we have launched price reductions across a number of everyday pet essentials and are also starting to reposition prices in branded foods.

Whilst it is early days, we are encouraged by the improvement in the run rate of Merchandise LFL† to 1.0%[2] in the 16 weeks from the start of our price repositioning actions.

Fast growth and embedded upside in our veterinary business

Our Vet Group continues to go from strength to strength; transacting more than £260m in total customer revenues during the financial year. In the first opinion business, mature practices grew their customer revenues at 8%◊, ahead of the market rate of around 5%. We now have over 100 mature practices that are on average delivering income to the Group of more than £160,000 per year. Combined with our maturing practices, this translated into strong total JV practice income of £47.1m, up 24.6%.

The average age of a practice in our Group is less than five years, when maturity is typically reached at eight years post opening; and having already invested the majority of cost required to support their future growth, there is an inherent embedded profit upside in the current portfolio.

Our newer specialist referral centres also performed well and their integration is delivering group benefits through the sharing of best practice and leveraging scale.

In the year ahead, to accelerate growth in the existing practices, we will increase the number of practices with extended opening hours, invest further in marketing to increase brand awareness and customer care plan participation. And we continue to explore opportunities in the market that will deliver growth to our first opinion and referral businesses, whilst retaining a disciplined approach to capital allocation.

Omnichannel capabilities growing

Our online business performed very well during the year, growing revenues at 53%. The convenience of our UK wide store footprint remains, with almost half the revenue of online orders delivered for customer pickup in-store. Alongside our ongoing improvements in website customer experience, there were a number of major initiatives launched this year:

Order in-store: our colleagues can now place an order for all the products in our extended online range from their PetPads. This gives store customers easy access to even more of our range and has already delivered over £2m in revenue since its launch at the end of the financial year, which we believe is driving incremental sales.

Our first subscription service: 'Subscribe & Save flea treatment' exclusively for VIP members, allows customers to receive a single flea treatment through the post each month, which acts as a convenient reminder to treat their dog or cat. The convenience of this plan has proved very popular with customers, with subscription sales now representing 16% of our total licensed medicine revenues. We plan to extend subscription with another licensed medicine launch in the coming months.

Having seen such a positive customer response to these developments, we will continue to invest and improve our omnichannel offer and develop our subscription platform in the coming year.

A more personalised approach through VIP

We have seen more successes in the VIP club this year, having launched the VIP App, which removes the need for customers to physically carry the VIP card to swipe and build points for their nominated charity. We have increased the overall VIP swipe rate of the VIP card at tills to 68% of store revenues (prior year 64%), and expect the rate to be stable going forward.

We are successfully encouraging our VIPs to spend more, the longer they are members of the VIP club. And we are encouraging our VIPs to shop multiple brands, with nearly 500,000 members purchasing both products and a service, a number which has grown by 14% compared with the prior year. The benefits of multibrand shoppers are very clear; a customer who purchases online or in our stores, but does not use any services spends around £140 a year. Whilst a customer who also uses either of our vet and grooming services will spend over £180 on products, plus an additional £200 per year on services. This reflects the increased loyalty and shopping frequency of services customers.

Space rollout and footprint development

We delivered our rollout targets for the year, having opened 15 new superstores (total 434), 50 vet practices (total 438) and 50 grooming salons (total 290). Paybacks and returns on our new and maturing units remain in line with our expectations.

In the year ahead, our vet practice and grooming salon rollout will continue at a similar pace, with openings of 40-50 vet practices and 40-50 grooming salons. We expect to open around ten superstores, lower than in the previous year, as we come closer to our UK rollout target of 500 stores and maintain a disciplined approach to approving suitable new sites.

Supporting margins

As planned, Group gross margin declined by (35) bps◊ to 54.2%; driven by the dilutive mix impact of newly acquired specialist referral centres and increase in overall Services participation, which has a lower gross margin than the Merchandise business. In operating costs, the first year of the National Living Wage, our slower top line growth and gross margin dilution contributed to pre-exceptional EBITDA† margin declining by 38 bps◊ to 15.6%.

In the coming year, we will invest in product pricing, and widen our marketing campaigns, to drive sales. We will also see an increase in cost pressures that impact both gross and operating margins, including Sterling depreciation, another step up in the National Living Wage, and the Apprenticeship Levy.

Introducing our new Group Chief Financial Officer: Mike Iddon

Mike joined Pets at Home in October 2016 as Group Chief Financial Officer.

Mike was the Chief Financial Officer of New Look from 2014 until 2016. Prior to this, Mike held a number of finance roles at Tesco plc over a period of 13 years, with his final position as Group Planning, Treasury and Tax Director. Before this he held finance roles with Kingfisher plc and Whitbread plc. He qualified as a Chartered Accountant with Arthur Andersen.

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In order to mitigate some of these pressures, we have already begun to implement a comprehensive simplification programme, which will deliver operational cost savings over the coming year. These will be achieved through efficiencies in store, a simplification of processes in our distribution centre, a reduction in the number of products we stock; and energy savings from the installation of LED lights and energy management systems across the store estate. This will mitigate some of the overall cost challenges, alongside the profit and margin support provided by our growing Services business and private label products, but overall, we expect to see a decline in Group gross margin. This reflects the coming year as one of repositioning the business, which we are confident is the right path for the future success of the Group.

Outlook

We operate in a resilient market, which is forecast to grow at c4.5%[1] over the next five years. Whilst in the near term we are repositioning the Merchandise business and investing in the customer, we are seeing results from our actions and believe this will deliver profitable growth benefits in future years. We will also continue the fast pace of top line and profit growth in our veterinary business. We remain a cash generative business, with a priority to invest in our core capabilities.

Ian Kellett
Group Chief Executive Officer
25 May 2017