Financial review

Our focus is on delivering sustainable profitable growth and driving long-term value

Philip Vincent
Chief Financial Officer

Highlights

- Group revenue growth of 6.2%.
- Underlying operating profit increase of 11.5%.
- Underlying EPS growth of 11.2% to 38.7p.
- Progressive dividend policy maintained with a 3.4% increase to 18.3p.
- Underlying free cash flow up £34.6m to £63.1m.

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Group summary

A summary of the Group's financial performance is as follows:

Year ended 30 April	2019 £m	2018 £m	Change £m	Change %
Revenue	**745.5**	701.7	43.8	6.2%
Operating profit	**75.5**	64.1	11.4	17.8%
Profit before tax	**60.4**	52.7	7.7	14.5%
EPS	**38.6**	32.4	6.2	19.1%
Underlying operating profit	**76.2**	68.3	7.9	11.5%
Underlying profit before tax	**61.1**	57.0	4.1	7.2%
Underlying EPS	**38.7p**	34.8 p	3.9p	11.2%
Dividend per share	**18.3p**	17.7 p	0.6p	3.4%
Underlying free cash flow	**63.1**	29.1	34.0	116.9%

Revenue

Group revenue increased by 6.2% to £745.5m, 6.4% at constant exchange rates.

Group revenue comprised:

Year ended 30 April	2019 £m	2018 £m	Change £m	Change %
Vehicle hire	**517.6**	471.2	46.4	9.9%
Vehicle sales	**227.8**	230.5	(2.7)	(1.1%)

Vehicle hire revenue grew to £517.6m from £471.2m in 2018, mainly driven by the 11.1% increase in Group average VOH.

Group vehicle sales revenue declined by 1.1% reflecting vehicle ageing due to the fleet optimisation strategy and slowing of the disposals cycle. This decline was partly offset by group-wide sales channel optimisation in particular by improved retail penetration in UK & Ireland resulting in higher average proceeds per vehicle.

Underlying operating profit

Underlying Group operating profit increased 11.5% (11.7% at constant exchange rates) to £76.2m and is stated before certain intangible amortisation (£0.7m).

Underlying Group operating profit comprised:

Year ended 30 April	2019 £m	2018 £m	Change £m	Change %
Rental profit	**64.3**	52.5	11.8	22.6%
Disposals profit	**17.1**	19.6	(2.5)	(12.6%)
Corporate costs	**(5.3)**	(3.7)	(1.6)	(41.6%)
Total	**76.2**	68.3	7.9	11.5%

Group vehicle rental profit increased £11.8m including the impact of depreciation rate changes and reflecting strong VOH growth in UK & Ireland and Spain.

The reduction in Group disposals profit resulted primarily from fewer vehicle sales (-£1.0m) and the impact of previous changes to depreciation rates (-£4.9m). This was partially offset by other impacts including sales channel optimisation and the impact of vehicle ageing (+£3.4m)

Underlying corporate costs increased to £5.3m (2018: £3.7m) with 2018 benefitting from certain one-off reversals in costs.

Depreciation rate changes

The accounting requirements to adjust depreciation rates due to changes in expectations of future residual values of used vehicles make it more difficult to identify the underlying profit trends in the business. When a vehicle is acquired it is recognised as a fixed asset at its cost net of any discount or rebate receivable. The cost is then depreciated evenly over its rental life, matching its pattern of usage.

Matching of future market values to net book value on the disposal date requires significant judgement for the following key reasons:

1. Used vehicle prices are subject to short term volatility which makes it challenging to estimate future residual values;
2. The exact disposal age is not known at the point at which rates are set and therefore the book value at disposal date is not certain; and
3. Mileage and condition are the key factors in influencing the market value of a vehicle. This can vary significantly through a vehicle's life depending upon how the vehicle is used.

Inevitably, a difference arises between the net book value of a vehicle and its market value at the date of disposal. Where differences arising are within an acceptable range these are adjusted against depreciation. Where these differences are outside of the range Northgate changes the depreciation rate estimate to better reflect the pattern of usage of the vehicle. The impact of previous rate changes on 2019 operating profit, and the estimated impact on future years of the previous changes, is set out in the table at the bottom of the page.

Interest

Net underlying finance charges for the year increased by 33.0% to £15.1m (2018: £11.3m) as a result of higher net debt. The net cash interest charge for the year was £14.1m (2018: £10.7m) as a result of higher borrowings. Non-cash interest was £1.0m (2018: £0.6m).

Underlying profit before tax

Underlying profit before tax was £61.1m (£61.3m at constant exchange rates), £4.1m higher than in 2018 (2018: £57.0m).

Taxation

The Group's underlying tax charge was £9.5m (2018: £10.7m) and the underlying effective tax rate was 16% (2018: 19%). The statutory effective tax rate was 15% (2018: 18%).

Earnings per share

Underlying EPS was 38.7p compared to 34.8p in the prior year. Statutory earnings per share was 38.6p compared to 32.4p in the prior year.

Underlying earnings for the purpose of calculating EPS were £51.6m (2018: £46.4m). The weighted average number of shares for the purposes of calculating EPS was 133.2m, in line with the prior year.

Exceptional items

During the year there were no exceptional costs incurred (2018: £2.5m).

Dividend and capital allocation

The Group's dividend policy is to ensure that the underlying basic earnings per share will cover the total annual dividend within a range of 2.0× to 3.0×.

Subject to approval, the final dividend proposed of 12.1p per share (2018: 11.6p) will be paid on 27 September 2019 to shareholders on the register as at close of business on 16 August 2019.

Including the interim dividend paid of 6.2p (2018: 6.1p), the total dividend relating to the year would be 18.3p (2018: 17.7p). The dividend is covered 2.1× by underlying earnings, in line with stated policy.

The Group's objective is to build shareholder value by generating returns above the cost of capital. Capital will be allocated within the business in accordance with the framework outlined below, with the first priority being to allocate capital to support the Group's growth ambitions:

1. Core business: maximise profitability and capital efficiency, organic Growth opportunities.
2. Dividend: maintain progressive dividend policy.
3. Growth: core bolt-ons, capital light opportunities, diversification into service solutions.

The Group plans to maintain a balance sheet within a target leverage range of 1.5× to 2.5× net debt to EBITDA, and during periods of significant growth net debt would be expected to be towards the higher end of this range. This is consistent with the Group's objective of maintaining a balance sheet that is efficient in terms of providing long term returns to shareholders and safeguards the Group's financial position through economic cycles.

Depreciation rate changes	Cumulative impact	Year on year impact		
Year:	Group £m	Group £m	UK & Ireland £m	Spain £m
30 April 2013	**5.3**	5.3	5.3	–
30 April 2014	**4.3**	(1.0)	(1.0)	–
30 April 2015	**15.7**	11.4	8.4	3.0
30 April 2016	**12.0**	(3.7)	(5.9)	2.2
30 April 2017	**6.3**	(5.7)	(4.1)	(1.6)
30 April 2018	**2.1**	(4.2)	(2.7)	(1.5)
30 April 2019	**17.4**	15.3	4.1	11.2
30 April 2020*	**12.0**	(5.4)	(1.4)	(4.0)
30 April 2021*	**6.6**	(5.4)	(1.4)	(4.0)
30 April 2022*	**1.2**	(5.4)	(1.4)	(4.0)
30 April 2023*	**–**	(1.2)	–	(1.2)

* These are management estimates based on indicative fleet size and assuming an equalised level of defleeting in each year.

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Cash flow

A summary of the Group's cash is as follows:

Year ended 30 April	2019 £m	2018 £m
Underlying operational cash generation	**283.2**	240.5
Net capital expenditure	**(243.9)**	(311.0)
Net taxation and interest payments	**(15.7)**	(22.2)
Share purchases and refinancing costs	**(3.2)**	(3.3)
Free cash flow	**20.4**	(96.0)
Dividends	**(23.4)**	(23.4)
Net cash consumed	**(3.0)**	(119.4)

A total of £403.5m was invested in new vehicles compared to £486.9m in the prior year. The Group's new vehicle capital expenditure was partially funded by £174.5m generated from the sale of used vehicles (2018: £186.9m). Other net capital expenditure amounted to £14.9m (2018: £11.0m).

All vehicles required for the Group's operations are paid for in cash upfront. The cash flow generation of the Group in any year is therefore influenced by the capital expenditure to grow the business or cash generated by adjusting the fleet size downwards if VOH reduce. If the impact of increasing or reducing the fleet size in the year is removed from net capital expenditure, the underlying free cash generation of the Group was as follows:

Year ended 30 April	2019 £m	2018 £m
Free cash flow	**20.4**	(96.0)
Add back: Growth capex	**42.6**	125.2
Underlying free cash flow	**63.1**	29.2

Net debt reconciles as follows:

Year ended 30 April	2019 £m	2018 £m
Opening net debt	**439.3**	309.9
Net cash consumed	**3.0**	119.4
Other non-cash items	**0.6**	(0.8)
Exchange differences	**(6.0)**	10.8
Closing net debt	**436.9**	439.3

Free cash inflow was £20.4m (2018: £96.0m outflow) after net capital expenditure of £243.9m (2018 £311.0m). If the impact of growth capex in the year is removed from net capital expenditure in each year, the underlying free cash flow of the Group was £63.1m (2018: £29.2m).

Net cash consumption was £3.0m (2018: £119.4m). After an adverse exchange rate impact of £6.0m (2018: £10.8m favourable), closing net debt was £436.9m (2018: £439.3m).

Borrowing facilities

As at 30 April 2019 the Group had £439m drawn against total committed facilities of £604m, giving headroom of £165m, as detailed below:

	Facility £m	Drawn £m	Headroom £m	Maturity	Borrowing Cost
UK bank facility	504	343	161	Jul 2021	2.6%
Loan notes	86	86	–	Aug 2022	2.4%
Other loans	14	10	4	Nov 2019	1.0%
	604	**439**	**165**		**2.5%**

The overall cost of borrowings at 30 April 2019 is 2.5% (2018: 2.3%).

The margin charged on bank debt is dependent upon the Group's net debt to EBITDA ratio, ranging from a minimum of 1.5% to a maximum of 3%. The net debt to EBITDA ratio at 30 April 2019 corresponds to a margin of 2% (2018: 2.25%).

Interest rate swap contracts have been taken out which fix a proportion of bank debt at 2.6% (2018: 2.4%) giving an overall cost of borrowings (gross of cash balances) at 30 April 2019 of 2.6% (2018: 2.3%). During the year UK bank facilities were increased by £50m.

The other loans consist of £13.5m of local borrowings in Spain and £0.5m of preference shares.

The split of borrowings (gross of cash balances and excluding overdrafts) by currency is as follows:

	2019 £m	2018 £m
Euro	**297**	328
Sterling	**143**	128
Borrowings before unamortised arrangement fees	**440**	456
Unamortised arrangement fees	**(2)**	(3)
Borrowings (excluding cash and overdrafts)	**438**	453

There are three financial covenants under the Group's facilities as follows:

	Threshold	April 2019	Headroom	April 2018
Interest cover	3×	5.34×	£33m (EBIT)	6.22×
Loan to value	70%	43%	£284m (Net debt)	43%
Debt leverage	2.75×	1.64×	£108m (EBITDA)	1.76×

Balance sheet

Net tangible assets at 30 April 2019 were £548.5m (2018: £530.3m), equivalent to a net tangible asset value of 412p per share (2018: 398p per share).

Gearing at 30 April 2019 was 79.6% (2018: 82.8%).

Return on capital employed was 7.7% (2018: 7.5%).

Treasury

The function of Group Treasury is to mitigate financial risk, to ensure sufficient liquidity is available to meet foreseeable requirements, to secure finance at minimum cost and to invest cash assets securely and profitably. Treasury operations manage the Group's funding, liquidity and exposure to interest rate risks within a framework of policies and guidelines authorised by the Board of Directors.

The Group uses derivative financial instruments for risk management purposes only. Consistent with Group policy, Group treasury does not engage in speculative activity and it is Group policy to avoid using more complex financial instruments.

Credit risk

The policy followed in managing credit risk permits only minimal exposures, with banks and other institutions meeting required standards as assessed normally by reference to major credit agencies. Group credit exposure for material deposits is limited to banks which maintain an A rating. Individual aggregate credit exposures are also limited accordingly.

Liquidity and funding

The Group has sufficient funding facilities to meet its normal funding requirements in the medium term as discussed above. Covenants attached to those facilities as outlined above are not restrictive to the Group's operations.

Capital management

The Group's objective is to maintain a balance sheet structure that is efficient in terms of providing long term returns to shareholders and safeguards the Group's financial position through economic cycles.

Operating subsidiaries are financed by a combination of retained earnings and borrowings.

The Group can choose to adjust its capital structure by varying the amount of dividends paid to shareholders, by issuing new shares or by adjusting the level of capital expenditure.

Interest rate management

The Group's bank facilities and other loan agreements incorporate variable interest rates. The Group seeks to manage the risks associated with fluctuating interest rates by having in place a number of financial instruments covering at least 50% of its bank borrowings at any time. The proportion of gross borrowings hedged into fixed rates was 68% at 30 April 2019 (2018: 73%).

Foreign exchange risk

The Group's reporting currency is, and 65% of its revenue is generated in, Sterling (2018: 59%). The Group's principal currency translation exposure is to the Euro, as the results of operations, assets and liabilities of its Spanish and Irish businesses must be translated into Sterling to produce the Group's consolidated financial statements.

The average and year end exchange rates used to translate the Group's overseas operations were as follows:

	2019 £:€	2018 £:€
Average	**1.14**	1.13
Year end	**1.16**	1.14

The Group manages its exposure to currency fluctuations on retranslation of the balance sheets of those subsidiaries whose functional currency is in Euros by maintaining a proportion of its borrowings in the same currency. The exchange differences arising on these borrowings have been recognised directly within equity along with the exchange differences on retranslation of the net assets of the Euro subsidiaries. At 30 April 2019 62% of Euro net assets were hedged against Euro borrowings (2018: 71%).

Going concern

Having considered the Group's current trading, cash flow generation and debt maturity including severe but plausible stress testing scenarios, the Directors have concluded that it is appropriate to prepare the Group financial statements on a going concern basis.

Philip Vincent
Chief Financial Officer

24 June 2019

Financial review continued

GAAP Reconciliation

About our non-GAAP measures and why we use them

Throughout this report we refer to underlying results and measures. The underlying measures allow management and other stakeholders to better compare the performance of the Group between the current and prior period without the effects of one off or non-operational items.

Underlying measures exclude certain one-off items such as those arising due to restructuring activities and recurring non-operational items, including certain intangible amortisation.

Exceptional items are explained in the Notes to the accounts.

A reconciliation of GAAP to non-GAAP underlying measures is as follows:

	Group 2019 £000	Group 2018 £000
Operating Profit	**75,491**	64,077
Add back:		
Restructuring costs	**–**	2,499
Certain intangible amortisation	**709**	1,767
Underlying operating profit	**76,200**	68,343
Profit before tax	**60,406**	52,738
Add back:		
Restructuring costs	**–**	2,499
Certain intangible amortisation	**709**	1,767
Underlying profit before tax	**61,115**	57,004
Profit for the year	**51,418**	43,232
Add back:		
Restructuring costs	**–**	2,499
Certain intangible amortisation	**709**	1,767
Tax on exceptional items and certain intangible amortisation	**(545)**	(1,145)
Underlying profit for the year	**51,582**	46,353
Weighted average number of Ordinary shares	**133,232,518**	133,232,518
Underlying basic earnings per share	**38.7p**	34.8p
Operating profit	**75,491**	64,077
Add back:		
Fleet depreciation	**185,794**	176,600
Other depreciation	**5,522**	5,585
Net impairment	**–**	(380)
Loss on disposal of assets	**274**	415
Intangible amortisation	**1,366**	2,171
EBITDA	**268,447**	248,468
Net replacement capex	**(201,304)**	(185,886)
Steady state cash generation	**67,143**	62,582

	UK&I 2019 £000	Spain 2019 £000	Corporate 2019 £000	Group 2019 £000
Underlying operating profit (loss)	**35,396**	**46,086**	**(5,282)**	**76,200**
Exclude:				
Adjustments to depreciation charge in relation to vehicles sold in the period	**(10,762)**	**(6,374)**	**–**	**(17,136)**
Corporate costs	**–**	**–**	**5,282**	**5,282**
Rental profit	**24,634**	**39,712**	**–**	**64,346**
Divided by: Revenue: hire of vehicles	**315,559**	**202,065**	**–**	**517,624**
Rental margin	**7.8%**	**19.7%**	**–**	**12.4%**

	UK&I 2018 £000	Spain 2018 £000	Corporate 2018 £000	Group 2018 £000
Underlying operating profit (loss)	33,114	38,960	(3,731)	68,343
Exclude:				
Adjustments to depreciation charge in relation to vehicles sold in the period	(9,608)	(10,002)	–	(19,610)
Corporate costs	–	–	3,731	3,731
Rental profit	23,506	28,958	–	52,464
Divided by: Revenue: hire of vehicles	283,543	187,644	–	471,187
Rental margin	8.3%	15.4%	–	11.1%

	Group 2019 £000	Group 2018 £000
Net decrease in cash and cash equivalents	**(13,616)**	(5,507)
Add back:		
Receipt of bank loans and other borrowings	**–**	(113,902)
Repayments of bank loans and other borrowings	**10,651**	–
Net cash consumed	**(2,965)**	(119,409)
Add back: Dividends paid	**23,431**	23,365
Free cash flow	**20,466**	(96,044)
Add back: Growth capex	**42,641**	125,145
Underlying free cash flow	**63,107**	29,101