

Dunelm plc
Preliminary Results 2024

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Transcript



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Nick Wilkinson:

Good morning, and welcome to the Dunelm Prelims presentation covering our financial year to the end of June. My name is Nick Wilkinson, and Alison Brittain, Karen Witts, and I are delighted to welcome you to the office of Peel Hunt in London. Whether you are here in person or joining virtually, I hope you are well, and thank you for your interest in the continuing story of Dunelm.

We'll use this presentation to bring to life how we are developing the business and the results we are achieving. We are, as the saying goes, living through interesting times. For a strong business, this creates exciting opportunities, but our excitement is matched with level-headedness and operational discipline. You'll hear us talk equally about growth and about grip this morning. It's our normal running order. I'll introduce the highlights. Karen will go through the financials and guidance for the next financial year, and I'll be back to share more detail on our plans and how we'll unlock our full potential as The Home of Homes in this next exciting phase of our growth. So, with images from our joyful new Elements collection demonstrating why everyone needs a bit more Dunelm in their lives, let's get started.

Full year results show strong performance as we successfully balanced growth and grip. In terms of growth, sales were up by just over 4%, in contrast to a market in decline. Our level of market outperformance increased versus the prior year, and our addressable market share covering homewares and furniture in the UK now stands at 7.7%. Volume growth exceeded revenue growth, a positive indicator of our ongoing consumer appeal, and we saw growth in both channels and in transactions and traffic in each of those channels.

We also increased the number of active customers shopping with us in the year up by just over 5%, with retained customer frequency also growing. And in terms of grip, our model demonstrated its continued resilience in a challenging environment. Strong gross margins reflect effective ongoing product management and sourcing, and profit before tax of £205 million is the top-end of forecasts and operating margins are slightly up year-on-year. Free cash flow is again strong with an increased announced this morning in the ordinary dividend.

Those of you who have followed us for many years know that behind our strong track record is a winning and unique business model. For those who are newer, and there's a few of you following us now who are newer, it is this which differentiates us from more cyclical and less resilient retailers.

On the right-hand side, the outputs of our model, ongoing growth from a low base in a very fragmented market, we are still very far from being mature in

terms of our growth. Stable margins and sustainable profits, and here we are advantaged by being a product company as well as a retailer, and high cash returns because our growth drivers are capital light. It's this combination of profit growth and cash returns, which we as a management team work very hard to optimise.

On the left-hand side, the core elements of our business model. And the key job for us as a management team is to continuously evolve that model, adapting to changing times while retaining, and indeed amplifying, its advantages. We do this by applying our well-established values, focusing on growth, staying close to our frontline operations, and working hard to make good long-term decisions.

Our non-financial highlights are broad and balanced. We strive to make good decisions to understand the expectations of all of our stakeholders and ensure that what we do is sustainable in all meanings of that word. Doing the right thing for the long term is in our DNA, from our founders.

A particular thank you to all of my colleagues and all of our supplier partners who are listening today for everything they have done, for everything you do, to adapt and develop and to grow with us. Developing our talented colleagues improves retention, enables internal succession, and therefore increases our productivity and business resilience. As technology changes the nature of roles right across the business, we are as committed to lifetime learning as we are to early careers recruitment. Indeed, I'd highlight our data academy and data apprentices as a good example of this. We're also very excited and very committed to our programme to increase levels of ethnic diversity in senior positions.

An area where we are learning with our suppliers is sustainability. Achieving our SBTi targets requires this, and we're helping suppliers to adopt leading data monitoring and planning tools to underpin their better manufacturing programmes. We're doing this in partnership. We want our committed suppliers to build their volumes, and to become an ever bigger part of our business.

And one final highlight I would pull out is the continued momentum of our store level community work. Originating during the pandemic, all our stores now support brilliant local organisations serving their communities. We are proud to be associated with them, and they in turn make our ecosystem more effective, more interesting, and more distinctive.

We are confident, very, in future market share gains. Our clear vision, to be the UK's most trusted and valuable brand in homewares and furniture, brings enormous headroom in our highly fragmented market. We only have a share of 7.7% and our track record of share gains is strong. Our share in FY' 19 was 5% and in the appendix, we've updated for you the graph where we last showed at the November Investor Day showing that our share growth is broad-based across our different product categories.

And our next market share milestone is 10%. There is no ceiling at 10%. Indeed, you'll note in the category view in the appendix that we carry on gaining share very strongly in those areas where we're already at the mid-teens or high-teens market share. So, 10% is just a milestone, but a notable one nonetheless.

We've gained share at a steady rate over recent years, most recently in a challenging market. But of course, through our history, we've typically gained share in a market that's also been in growth.

In the current environment with customers making different choices about whether and when to release the reins on their spending, our broad value proposition with choice across multiple price quality tiers continues to resonate particularly well. And we continue to evolve strategy, the one we followed for many years, framing new initiatives and investments. I'll share more on these shortly, but now I'll hand over to Karen to continue the story by updating you on the year.

Karen Witts:

Thank you, Nick. Good morning, everyone, and thanks for giving us your time today. I know it is a really busy day, so thanks to those who are here and also those who are joining us virtually.

Let me start by giving you a summary of our full year performance. I'll then take you through the financial review in more detail. As Nick said, our FY '24 results demonstrate a strong performance in a challenging market, which declined year-on-year. Against that backdrop, our full year sales grew by 4.1% to 1.7 billion pounds driven by volume, which is what we wanted. Volume growth of more than 6% included growth from a healthy increase in customer numbers, which supported market share gains. Gross margin of 51.8% was up 170 basis points year-on-year, benefiting from lower freight costs, which offset Red Sea surcharges and a foreign exchange headwind.

In an environment of continued significant wage inflation and with strong sales volumes increasing variable costs, we held our operating cost to sales margin just above 39% through operating grip and efficiency initiatives, whilst also investing in the areas that were on our road map for the year.

The resulting profit before tax of 205 million pounds was 6.6% ahead of the prior year, ahead of top line sales growth and slightly ahead of the volume growth. Free cash flow was 132.2 million pounds with a 62% profit to cash conversion rate. Higher CapEx, a higher effective tax rate, and a working capital outflow, all of which I'll cover later, meant that this was 28.2 million pounds lower than last year. And consequently, net debt of 55.6 million pounds was 24.9 million pounds higher than the previous year.

Our healthy cash flow delivery and our confidence in our business supported a year-on-year increase in the ordinary dividend of 3.6% to 43 and a half pence per share, including a proposed final ordinary dividend for FY '24 of 27.5 pence.

As a reminder, in addition to this, a special dividend of 35 pence per share was paid in April 2024.

Before I go into the detail, I'd like to run through how our operating model has worked in the year to support profitable growth and strong cash returns underpinned by continued market share gains and a stable operating margin. We're capitalising on our advantaged model, which Nick has spoken about. The left-hand side of the page explains how we think about delivering continued market share gains by increasing customer numbers through volume-driven sales growth, and from improvements to both our store and digital propositions. And the right-hand side demonstrates how we think about operating margin discipline, with our approach to both gross margin and operating costs. And this is what we call operational grip.

Our gross margin strength is an important factor when it comes to reliably delivering sustainable profit growth. We use the forward visibility we have on input costs combined with the fact that we own the design IP to most of our product to work with suppliers to maintain the rigorous price hierarchies that underpin our outstanding value proposition to customers.

We manage our operating costs with reference to four factors, volume growth, inflation, investment, and productivity, balancing our investment plans to deliver near term and future benefit with efficiency and productivity initiatives to mitigate upward cost pressures. And I'll illustrate each of these in the context of the FY '24 results in the rest of my presentation.

So how did we do on sales? At 1.7 billion pounds of sales for the full year, we grew in both stores and digital channels. Digital penetration is now at 37%, up one percentage point year-on-year, supported by continued investment and increasing efficiency. Growth was broad based across categories and across demographics. In line with the previous year, we saw slightly higher growth from our younger cohorts and in the London area.

In a pretty soft market, we were very focused on outstanding value working with suppliers in our own designs and using our good, better, best approach to everyday low pricing. This supported robust volume growth.

We did see some reduction in average item value, which was the output of customers' purchasing decisions. The impact on AIV of pricing was broadly neutral in the year. What we did see was some change in product mix as shoppers used our broad range of categories and product to find the items relevant to their needs in FY '24. For example, as we extended our ranges of Summer Living, customers loved the hanging egg chair for their garden, which was sold at a compelling price point, and picnic wear, which was available in store as well as online, was popular.

We are pleased to report continued growth in market share and active customer numbers. Our combined homewares and furniture market share grew by 60 basis points to 7.7%, representing an outperformance of around eight percentage points in a market that declined. Having grown share from 5% only a few years ago and supported by investment in new stores, digitalisation, and brand marketing, we are confident in our ability to continue to grow share.

Active customer numbers grew by 5.1%, which was an acceleration on the prior year growth of 2.8%. We were pleased that the growth was broad-based across geography, age group, and income levels. And we saw more customers shopping across both channels, we are becoming the home of homes for an increasingly broad population.

Gross margin was 51.8%, 170 basis points ahead of FY '23 and ahead of our expectations at the start of the year. Throughout the year, we benefited from a freight cost tailwind, partly offset by foreign exchange headwinds. We realised the benefit despite having to deal with the impact of disruption to Red Sea routes, alternative routes are longer, and therefore freight companies are applying surcharges to shipments.

For FY '25, those freight rate benefits have now annualised and we will need to manage the currently ongoing surcharge situation. Gross margins have varied a bit over time, but we've generally delivered within a fairly tight range around the 50% mark. And in FY '25, we expect to be within a range of strong outcomes between 51 and 52%, consistent with our tight control of input costs combined with price discipline across quality tiers.

Gross margin management requires input cost grip. We apply a similar grip to operating costs where we've been dealing with sustained high levels of wage inflation in our largely hourly paid workforce. The impact of inflation in FY '24 was an incremental 20 million pounds of cost. We mitigated some of this impact with 11 million pounds of ongoing efficiency savings from store operations, a reduction in storage costs, and the improving efficiency of our performance marketing spend.

Our approach to efficiency and productivity is becoming more programmatic, including a focus on automation both at the front end and the back end of our business in order to improve cost to sales ratios over the medium term. Volume growth of more than 6% meant that variable costs, primarily supply chain costs and performance marketing, increased by 14 million pounds. We have a commitment to investment, driven by long-term thinking. In the year, our investment focus was on accelerating new store openings to six, a step-up in brand advertising to drive awareness using our '*Home of Home*' campaigns and continued improvement in our customer propositions. These investments supported our market share gains and increased customer numbers. Even in challenging conditions, our cost of sales ratio of 39.3%, was in line with our guidance for the year. Although we do not have visibility of national living wage increases, going forward, we expect inflation in our operating cost base to

continue at around three to four percent next year, still driven by wage inflation.

We're also guiding that we intend to deliver volume driven sales again, as this is what we believe contributes to long-term sustainable profitability. Performance marketing costs and supply chain costs will reflect this volume growth. We have plans for further investment in new store openings, five to 10 super store openings per annum, over the medium term. And in addition, we'll also test and learn, by opening some even smaller stores in more urban areas. By maintaining focus on the combination of inflation, investment and efficiency in our total cost base, we've grown profit ahead of sales in FY '24, representing a strong profit before tax margin of 12%.

In a year of higher base rates, our net financing cost of 7.9 million, were 1.8 million pounds higher than the previous year. The main driver of the increase, was interest on IFRS 16 lease liabilities, which grew by a million pounds to 6 million pounds. Our strong cash flows and low level of debt have limited upward pressure in this area. Profit before tax of 205 million pounds, was up nearly 7% year-on-year, driven by the strong gross margin performance. Our effective tax rate of 26.4%, was five percentage points higher than in FY '23. As I explained in our interim's presentation, this was due to annualisation of the increased headline rate of corporation tax from April 2023, higher levels of largely property related disallowed expenditure, and a one-off adjustment to deferred tax. The impact of the higher tax rate led to a 0.8% reduction in EPS.

Now moving on to cash. Cash flow generation was good and we delivered a 62% cash conversion rate. Conversion was lower than last year's 81%, driven by working capital, higher CapEx and increased tax paid. Tax paid in the year increased by 11.4 million pounds, reflecting the higher tax rate. We had a working capital outflow of 18 million pounds, which was a bit higher than we had guided to. We saw payables outflow due to the timing of a regular VAT payment and an impact on inventory, of delays in our main shipping route, which we continue to manage well operationally. Capital investment of 40 million pounds was in line with our guidance and was primarily driven by store openings and refits. We opened six new stores in the year, including one relocation, of which three were traditional superstores, and three were smaller format. We carried out significant refits on 13 existing stores and within that, we continued our decarbonisation programme.

In June 2024, we took advantage of a once-off opportunity to acquire a freehold building next door, to our Store Support Centre in Syston. The building is currently tenanted and is providing rental income, it also secures additional space for our support centre, should we need it in the future. In FY '25, we expect CapEx to increase to 50 to 60 million pounds. We will continue to open superstores, both larger and smaller formats, at a rate of five to 10 per year. And in addition, we will open our first inner London store towards the end of the calendar year.

Just after the end of the financial year, in July 2024, we also acquired a tenanted super store site in an attractive location for 22 million pounds. We expect to convert it to a Dunelm format upon expiry of the existing leases. We still expect the majority of our openings to be leasehold, but we are pleased that we have the financial capacity to purchase freeholds, where we can see sufficiently attractive returns. After total dividend payments in the period of 158 million pounds, the group ended the year with net debt of 56 million pounds and a net debt to EBITDA ratio of 0.19 times.

On the subject of shareholder returns, the Board is proposing a final dividend of 27.5 pence, taking the total ordinary dividend for the year to 43.5 pence per share, ahead of the 42 pence per share relating to FY '23. A special dividend of 35 pence per share was paid in April 2024. Dividend cover of 1.71 times is slightly below our targeted range of 1.75 to 2.25 times, however, our policy allows for the board to agree to this on a temporary basis in order to maintain progression, where appropriate. And in this case, growth from trading was strong and the slightly negative EPS was driven by the fully annualised impact of a corporation tax increase and a non-recurring adjustment. Subject to final approval at the AGM, the dividend will be paid on the 26th of November.

We believe that we have a well-established capital allocation methodology, which prioritises investment for growth and then returns excess capital to shareholders. Since our IPO, we've returned about 1.5 billion pounds to shareholders, through ordinary and special dividends. I think it's worth pointing out that due to the underlying strength of our business, we have a model that delivers, both sustainable profit growth and attractive shareholder distributions, in combination.

Just before I hand back to Nick, I'd like to summarise the guidance that I've given for FY '25. Whilst consumer metrics are looking more positive, we believe that the timing of the sector recovery remains uncertain. Whatever the backdrop, we will focus on outstanding value, choice and relevance, to drive sales volumes. We expect gross margins to be in a 51 to 52% range, as freight benefits have now annualised. We expect inflation in our operating cost base, to continue at around three to four percent, driven by wage inflation. And given the above, we expect operating margins to be broadly stable. Our CapEx range will be a bit higher, at 50 to 60 million pounds. We expect to open five to 10 new stores and we've recently acquired an attractive, currently-tenanted, freehold store property. We expect working capital to be broadly neutral. And finally, we expect our effective tax rate to be fifty to a hundred basis points above the 25% headline corporation tax rate.

Thank you for listening, and I'll now pass back to Nick.

Nick Wilkinson:

Great, thanks Karen. So looking forward then and unlocking our full potential. What will you see? Well, as we focus on unlocking our full potential, we have evolved the three broad focus areas which frame our priorities and investments. In combination, these will allow us to achieve our full potential as The Home of

Homes and to be the UK's most trusted and valuable brand for homewares and furniture.

Talking to each in turn, briefly. Elevate our product, is about redoubling the focus on product development, that includes continued expansion of our curated ranges, more investment in design to increase product differentiation and more cross-category coordination of our collections. Faster product introductions of new trends and the ongoing development and innovation of more sustainable materials and designs. In the year, we repeatedly saw the power of elevated product, one example being strong upholstered furniture collections, like sofas, combined with five-day lead times and a better made-to-order offer, leading to particularly strong growth in sales and share.

Then, connecting that product to more customers with more stores and continued digital development, marketing optimisation and personalisation. We have seen particularly big wins when we improve cross-channel experiences. Our gift cards are our mundane, but good example of this, removing an old offer, which came with significant cross-channel friction has seen our gift card sales increase by over a hundred percent. And the final pillar, is our work to harness our operational capabilities, our skills and our scale, and increasing our technology capabilities to realise, over time, process improvements and better productivity. The fact that we now expect wage inflation to persist means that there are more attractive returns to be had from investments in automation. And the fact that many other product verticals are more advanced in this regard means we can adopt the most appropriate established technologies to meet the specialist requirements of our products.

These areas bring compounding benefits as we grow our overall system, attracting more customers and increasing our share of their purchases. We're excited, but we're also, as I said, level-headed. We are thoughtful to ensure that business change further strengthens our advantaged model and our key points of difference, to build a deeper moat around the business. And of course, all initiatives need good grip and execution. So to bring to life the breadth of opportunity we have, I'll talk to just a couple of examples in each of these three areas.

So starting with product. Lighting's a category where we have plans to elevate our offer, to be better and to be bolder, we see headroom for both market growth and share gains. Driving this, will be our in-house design capability that allows us to coordinate lighting with our core textile collections and with our cross-category labels like Elements or the Natural History Museum collaboration we've been running now for several years. The pictures show various examples of recent and in-flight developments, we've added more choice, 20% more lines, year-on-year, across all of our quality and price tiers, so good, better, and best ranges. And I often talk about textiles when it comes to product mastery, but in lighting, we are getting stronger and stronger all of the time, so with more five-star reviews and reductions in our returns rates. At the same time, we are

growing our knowledge of sustainable materials to allow us to offer more modular, circular product designs that can be repaired and recycled.

A second example in the area of product. Made to Measure blinds, where we've chosen to invest in bringing hard blinds, custom manufacturing, in-house, so that we are vertically integrated. On the right-hand side, you can see an image from our state-of-the-art curtain factory, where we now also make made-to-measure roller blinds. Elsewhere, Made to Measure venetians are manufactured in the Midlands at the Sunflex business, which we acquired two years ago. And we'll move shutters, made-to-order shutters, into our own production facility too, with a launch to consumers timed for later this year. We're doing this because we see scope for growth by having more differentiated and advantage product. In this case, it gives us the opportunity to specify materials and designs to shorten lead times compared to competitors who are importing from overseas. And furthermore, the ability to improve our own factory utilisation by better matching demand and supply, brings significant efficiency benefits. Made-to-measure is an exciting opportunity. In this example, product elevation required greater control of the end-to-end supply chain, which will then enable accelerated growth, market share gains and returns.

Moving to the next pillar, to connect that product to more customers. With good foundations in our front-end digital architecture and an effective customer data platform, we can now advance through optimisation and experimentation in areas like product discovery. So an example, we're introducing new technology to our site to deploy our partner's expertise in AI, to enable advanced search query understanding and personalisation of results. We're also working on other tech to improve recommendations and browsing. These are some examples, on the right, of zero search results reducing, we think we can get this to below one per cent, it's currently high single digits. And more personalised results based on customer insight. We're moving from a first generation search platform to an advanced one, but of course, others will do the same. What's distinctive to us, is the combination of own brand products with smarter technology. This will increase the appeal of browsing on our site and customers who use search when they browse on our site are four times more likely to convert.

This is a good example of what I call a one per cent sales building block, a small but not insignificant incremental driver, but also an improved customer experience that further strengthens our customer proposition and our operating model.

So, onto stores. The new news on stores, and you just heard it from Karen, is that we now see a runway of five to ten superstore openings per annum, for the medium term. We'd previously only guided for this for two years. Additionally, we're starting to explore smaller stores in urban catchments, so you'll see more openings of superstores, more 30,000 square foot selling space superstores in large catchments. and more smaller superstores in smaller towns, and in the white space between existing stores in densely populated areas. The supply of

larger sites is limited, Peterborough, which opens shortly, is a resite that's taken over six years to come about, so we are patient, but we're also ready to be opportunistic and happy to use our balance sheet, as Karen described, when the returns are right.

And in London, you'll start to see us open more small stores of about 5,000 square foot. This is part of developing our channels to better serve our target customers in inner London boroughs, where we have significant white space to fill. We're opening our first store in Inner London in the first half of this year and we'll test other locations in due course. We're not including these small store openings in our five to 10 guidance, which relates to superstores only.

Moving on now to a couple of examples from our third focus area, harnessing our operational capabilities. Most of you will appreciate that we have a unique supply chain, described here on the right-hand side with a high proportion of stock held by our committed supplier partners in their UK warehouses, efficient and interconnected logistics flows to get product to stores and homes, and also that we operate our own two-person home delivery service with our own vans and colleagues delivering furniture and other large items to people's homes. Across this network we have ongoing programmes of what I would call continuous improvement to maximise the utilisation of our capacity and to improve labour productivity. And in the coming years you can expect us, and our logistics partners, to gradually bring more automation into our processes.

Wage inflation makes this more attractive, as I mentioned earlier. That's true for all retailers and our specific opportunity is to do this in ways that further leverage our unique operating model and that are optimal for the physical characteristics of both homewares and furniture. We've made upgrades recently to our robotic materials handling in one of our main Stoke warehouses and work is in progress on simple automation in those parts of the network with the highest labour costs, in particular, small parcel packing in Stoke operated by our partner GXO.

Click and Collect supply chain optimisation is an interesting area as we expand our online range, the proportion that customers could collect and store dropped to just about a quarter of our full assortment. But now with better systems integration, we've got this back up to 50% and our goal is to have most UK held stock available for next day store Click and Collect in the short term.

Across our supply chain, we have discovery and testing underway for more improvement opportunities. Technology is moving rapidly, but tech alone is never the answer is the combination of technology and business change well executed that leads to improvement and we're increasingly confident in our capability and capacity to do this successfully.

Scaling our commercial operations is a case of making foundational change to how we manage product data, how we forecast demand, and how we replenish our stores and DCs. And here we are introducing new technology and ways of

working to develop our commercial advantages. Introducing machine learning, automating low value tasks, replacing spreadsheets with the right tools for our colleagues. We are midway through a major change programme to our forecasting and replenishment systems and it's going well. Our day one goal is to maintain current levels of performance and we are far enough into the rollout to be very confident in that regard. Then over time we will improve efficiency from our stock holding and in-store labour point of view. Beyond that, to optimise our smaller store footprints, there's development work to do in our process and tools for managing space, grade and range planning. This level of commercial optimisation sets us up to manage our growing scale, for example, bigger ranges, the number and diversity of channel stop points that we operate and the speed of product development. In other words, these developments are not just about efficiency, but they support our capabilities and our proposition to customers.

In summary, to bring things to a conclusion, I've talked you through some examples of various improvements that we'll make to elevate our product, to better connect that product with our customers and to leverage our operational skills and scale. These priorities and investments give us a clear line of sight for how we'll gain share in our fragmented addressable market and reach our next market share milestone of 10%. Because our focus areas compound on one another, and because we have an advantaged business model, we're able to grow when times are challenging as well as when they are more benign.

So what are we seeing? In terms of the consumer, we are seeing the same as most commentators, gradually improving indicators of confidence and discretionary spending power. But we are yet to see a meaningful change in consumer spending patterns in our markets and therefore the timing of a more positive trading environment is still unclear. We are of course confident in our ability to grow market share as we did in FY '24 with strong plans underpinning progress on sales volumes, market share and stable operating margins. We've made a solid start to the new year against a particularly strong quarter last year.

As I've described with three clear focus areas, framing our investments and priorities. We have a good line of sight to continued market share gains and of course we'll carry on combining that growth and grip, investing in attractive opportunities with good returns and at the same time continuing to generate strong cash flows. We're excited, but as I said at the very beginning, we also enjoy being disciplined and level-headed.