Dunelm Group plc

Preliminary Results | Audio Webcast

20th of September 2023

Transcript

Nick Wilkinson: Good morning and welcome to the Dunelm Prelims presentation covering our financial year ending the 1st of July. My name's Nick Wilkinson. And Karen Witts and I are delighted to welcome you to the Office of Peel Hunt in London and to all of those who are joining virtually. Whether you are here in person or virtual, I hope you're well and feel connected to us and the continuing story of Dunelm. At heart, we are a product and a people company. To understand us, you have to understand our product. This picture is from one of our current seasoned styles called Pride and Joy, and you have to understand our people. Some of them are here today, Alison Brittain, many members of our board and some of the exec team too. But of course, most of my colleagues are working on the frontline stores and in distribution, or engineering and creating our products, digital channels and content.

Karen and I will do our best to bring all this to life for you today, aided by our short video. And yes, there is some joy in our numbers. If you're familiar with these presentations, we'll keep the normal running order, a short overview from me then Karen will go through the FY 23 results and guidance for the year we just started, and I'll be back to update on our plans before we take your questions. So onwards. Strong performance in the year. The environment was, of course, a challenging one with high levels of general inflation, bringing uncertainty to our colleagues and customers as well as to businesses. We focused on executing successfully on the levers within our control. Sales growth was 6% up in both stores and digital, and we grew market share and customer numbers, raising the bar on our customer offer, especially in terms of relevance and value for money. PBT performance in a more normal year than the previous one was good at 193 million, which reflected strong operational grip on gross margins and costs, and we've continued to invest for future growth.

Free cash flow grew in the year to 160 million and we've announced the dividend today to bring our total ordinary in the year to 42 pence per share. We strive to make good decisions, balancing the needs and expectations of our key stakeholders and ensuring what we do is sustainable. Doing the right thing for the long-term is in our DNA from our founders. Rather than go through each of these in turn, I will highlight some of the key achievements with regard to delivering sustainability for our colleagues and on the work we're doing with our suppliers on reducing our impact on the planet.

As I've said, our colleagues are at the heart of our business. The current economic environment has been difficult for many of them, and during the year we increased our support on financial wellbeing. We introduced progressive pay increases, meaning higher rates of increase for lower paid colleagues and additional support funds and help on a range of financial matters. We're also investing in learning and development to help colleagues to grow their careers with us, including in those areas where roles are changing because of technology. One of the advantages of this approach has been improved colleague retention increasing by five percentage points to 87% in the last 12 months. Itself a driver of improved productivity.

With suppliers, we have always built long term relationships, offering them strong partnerships based on mutual growth and respect. Together with them, we're building shared knowledge on topics like circular product design and more sustainable materials and manufacturing. We extended our conscious choice label, which is applied to products that are made with more sustainable materials to 15% of our own brand range. Also, working with suppliers, we've reduced our virgin plastic packaging by a third since FY 20. There's a lot more to do. I'm delighted to say that our targets and baseline have now been approved by SBTi, the Science Based Targets initiative, and I'm pleased with how much we are learning and how engaged our buyers and suppliers are on these important matters. With good long-term decisions, we're able to grow sales sustainably and seize the opportunity for future growth.

FY 23 was a different year of growth in some ways. It was below our long term post IPO average growth rate of 10% and slightly more of that growth coming from market share gains with our markets broadly flat overall in the last 12 months. As the year progressed, sales growth was increasingly driven by volume. We said in our Q4 update that volume came through particularly strongly as the driver of sales in the last 13 weeks of the year, and I can share that the same is true for the first 10 weeks of this year. We are a volume retailer and we'd like to see our sales growth driven by volume.

With robust sales growth and good margin control, we have not hesitated to continue to invest for growth, choosing to maintain the momentum we've been putting into capability building, in data and insight, engineering, performance marketing and product development over recent years. As a result, as we look at our highly fragmented market, we see enormous opportunity. There's never been a better time to be a well resourced and ambitious market leader. So I'll tell you more about our plans for the future later and I'll hand over to Karen.

Karen Witts: Thank you, Nick. Good morning everyone. It's great to see you here and also those of you who are joining remotely. So, let me start with a headline financial summary of the 52 weeks to the 1st of July 2023. I'll go into more detail as we go through the presentation. You will remember that last year was one of those 53 week years, so you will see last year's statutory figures as a memo and I'll talk to performance versus the comparative 52 week period. As Nick said, we were pleased with our performance in what was a challenging year of inflation and cost management for us and ongoing cost of living pressure for our customers. Despite this backdrop, through maintaining our focus on choice, relevance, and value, we achieved record sales of £1.64

billion. A 5.5% increase on the prior year, which you might remember included an extra sale period in the first quarter.

Our gross margin of 50.1% was in line with our guidance and as expected, 110 basis points lower than the prior year. We applied our usual operational grip to create efficiency savings to help offset inflationary pressures in our operating cost base, particularly coming from labour inflation. And even against this backdrop, we continue to invest in growing and digitalising the business. Our profit before tax of £193 million was slightly ahead of market expectations and £16 million down year on year as expected. We are pleased with this performance in a challenging year. It reflects tight control of margins and operating costs. Alongside our ongoing commitment to invest for the future, we also delivered a strong free cash flow performance generating £160 million at an 81% conversion rate. The group ended the year with £31 million of net debt. The board is proposing a final ordinary dividend of 27 pence per share, reflecting our strong performance and confidence in future growth.

This takes the full year ordinary dividend to 42 pence per share, up 5% year on year, and we also paid a special dividend of 40 pence per share during the year. Looking in more detail at sales, customer and market share, we saw good sales growth across our total retail system of the total sales of £1.64 billion. Digital participation was 36%, up one percentage point year on year. Growth was broad based across categories. Our winter warm ranges performed well with customers looking for ways to offset escalating heating costs and our summer living ranges for indoor and outdoor were well received when the weather got warmer. There was plenty of choice for customers as we added around 20,000 new products online. Our two sale events resonated well with customers and we were also able to reduce prices on over 1,000 lines towards the end of the year.

We were pleased to see more volume growth coming through our sales, particularly in the final quarter of the year. Our continued broad appeal was reflected in both customer numbers and market share gains. Our active customer numbers grew by nearly 3%, with particularly strong customer retention, and we saw high growth in 16 to 24 year old customers and from customers in lower income groups. In a combined homewares and furniture market that was broadly flat and against a challenging economic backdrop, we were pleased that we grew our overall market share by 40 basis points to 7.2%. We grew our share of the homewares market by 70 basis points to 11%. Whilst we maintained our 2% market share in furniture, we did grow our furniture sales by 4% year on year as we continued to build our customer offer and operating model ahead of FY 24.

Now, let's turn to gross margin. We exercised tight control of gross margin over the year and delivered a margin of 50.1% in line with expectations. This was 110 basis points lower than the previous year, as expected, reflecting a return to pre-COVID sale and participation patterns and the impact of increases in input costs. With clear buying seasons and with hedging and contracting policies in place, we have decent visibility of FY 24 input costs. We will balance a net tailwind from Freight and FX with a strong focus on our commitment to delivering outstanding value to our customers. And we expect FY 24 gross margin to be around 100 basis points higher than in FY 23. When it comes to operating costs, we controlled costs well in a highly inflationary environment. Operating costs for the year was £622 million. A combination of leverage from sales growth, strong operational grip and a drive for efficiencies helped to offset inflation, mainly wage inflation, of around £20 million and provided headroom for investment with only a modest increase in our cost to sales ratio.

Volume growth added £8 million of cost to distribution and performance marketing. The opening of three new stores and the annualisation of the investments we made in distribution sites last year added a further £7 million. Our productivity and efficiency savings of around £14 million included the removal of excess costs and storage and distribution that we said we would remove. We invested a further £22 million in technology and capability as we continue to build and optimise the digital side of the business, focusing on enhancing the customer proposition and improving efficiency. This helped us to evolve our total retail system and to grow sustainably. We expect wage inflation in particular to be an ongoing feature of FY 24, and we will partly offset this with further efficiencies. We believe that we're benefiting from a consistent and thoughtful approach to investment, and we will continue to look at what we need to do in order to seize the opportunities ahead of us.

During the year, we tested the effectiveness of our brand and performance marketing expenditure and the insight from this is giving us the confidence to increase investment in areas like brand marketing, helping us to increase reach. Whilst our focus remains on making every pound count, because of the characteristics I've described, we expect our operating cost to sales ratio to increase to about 39% in FY 24. I'll now cover PBT, interest, tax and EPS. Net financial expense increased slightly from £4.8 million to £6.1 million, reflecting a higher interest rate environment and growth in our leased property portfolio. Profit before tax for the period was £193 million, £16 million lower than the same period in the prior year, reflecting a lower gross margin rate and a very tough backdrop for costs. We also saw an increase in the effective tax rate from 19.5% to 21.2%, primarily reflecting the increase to the UK headline rate of corporation tax, which increased in April from 19% to 25%.

Diluted EPS of 75p was 9% lower than the same period last year because of lower PBT and the higher tax rate. Let's move onto cash generation and uses of cash. We generated £160 million of free cash flow in the year with a strong conversion of operating profit to cash of 81%. The value of inventory reduced modestly, as we said it would do, from £223 million last year to £211 million. As inventory levels eased, our working capital position stabilised finishing with a very small £4 million outflow due to the timing of payments and accruals. £19 million of the full year CapEx of £22 million related to the opening of three new stores, 10 store refits and our continuing decarbonisation program. We're pleased with the early performance of our newest stores and are learning a lot about introducing smaller stores into our total retail system.

Nick will talk more about this later, but we expect to open five to 10 new stores, including relocations for each of the next two years. We therefore expect CapEx, in each of those years, to be in the range of 30 to 40 million pounds. £38 million of cash tax paid reflects the increased rate of corporation tax, and just to note, FY 22 also included tax receipts relating to research and development claims from FY 21. And after payment of £163 million of dividends in the year, the group ended with £31 million of net debt compared with £24 million in FY 22. Since the year-end, we've successfully renegotiated and extended our RCF for another four years to September 2027, increasing it from £185 million to £250 million to reflect the growth of the business.

Moving on to dividends, the board has proposed a final ordinary dividend of 27 pence per share, in recognition of our strong performance and confidence in the business's future growth prospects. This takes the full year dividend to 42 pence, up 5% year-on-year, and covered 1.8 times by earnings. So within our earnings cover policy of 1.75 to 2.25 times. In April 2023, we paid a special dividend of 40 pence, so we returned £163 million to shareholders in the year. We have a strong track record of shareholder returns and we've returned over a billion pounds during the last 10 years, working within a clearly defined capital allocation methodology.

I'd like to conclude with some guidance for FY 24. We're pleased with another year of good results. These results were achieved despite a challenging macroeconomic backdrop and while some of the headwinds that we've been negotiating have eased or are starting to ease, the inflationary and consumer environment is still complex. Our customers have responded very well to the choice, value, and relevance of products in our range and have been very resilient to date. Whilst we understand that consumer demand is still quite unpredictable, we expect both sales and profit growth in FY24 with the sales growth driven largely by volume. We have more certainty into our input costs in the way that we're managing margin. As I described earlier, we'll balance net tailwinds primarily from lower freight costs with managing the challenges of an ongoing inflationary environment and always with a focus on outstanding value. We expect our gross margin to be around a hundred basis points higher than in FY23. We know that there will be further inflationary impacts on FY24 operating costs, primarily labour related, and we expect to offset a large part of this through continued productivity and efficiency measures. At the same time, we remain committed to investing for growth and to take advantage of the opportunities we see.

In FY24, we will continue to invest to support our store rollout, our continued digitalisation, and our evolving marketing ecosystem. On the back of new insights gained, we'll spend more on brand advertising. As a result, we expect our operating cost of sales ratio in FY24 to increase to around 39%. As we expect to increase new store openings to 5 to 10 per annum in each of the next two years, we will increase CapEx to between 30 to 40 million pounds in each of those years. Because of some non-deductible expenses, our effective tax rate tends to trend slightly above the head line rate, and therefore we expect our effective tax rate for FY24 to be slightly above 25%. So thank you for listening and I will now hand back to Nick who'll give more colour on what we are doing to seize the opportunities within Dunelm.

Nick Wilkinson: Great. Thank you, Karen. So how are our plans evolving? Let's start with the market, and I think it's helpful to remind ourselves of some of the characteristics of the markets we serve. Firstly, ours is a highly fragmented market with multiple product categories and customer missions. Many of those categories are needs driven and low ticket, especially in homewares. Overall, the homewares market has proved resilient to cost of living pressures and will carry on doing so. Remember, we're a low ticket retailer with an average item price across both channels of £14 and an average basket size of just three to four items. Another characteristic of our market is that consumers are driven by emotional as well as functional considerations and are typically browsing rather than goal seeking for a specific product when they shop. They're doing this online and in stores. Multi-channel shopping is now established as the preference from most consumers and very few see themselves as being an online only or a store only shopper.

All this favours players with the ability to combine advantaged product with direct access to customers. That's always been the case, but now the tools to do it are so much more efficient and effective than ever before. So let's get into specifics. We'll dive into three areas of our plan where we are seizing the opportunity. Seizing the opportunity to strengthen our customer offer, in particular with regard to value and creating joy for our customers. Seizing the opportunity to extend and digitalise our total retail system with more stores planned, and continued and significant technology developments. And seizing the opportunity to evolve our marketing ecosystem with increases in investment and capability.

Value, often talked about in this room. There are a variety of ways in which we are raising the bar on value for customers, and I'll bring some of those to life for you with some examples. One obvious and simple way is by lowering prices, and we've referred to price drops we've done in the spring, and we've also done some more in the first few months of this year. Remember, many of our prices didn't increase last year, so I don't want to overplay the scale of price drops, but this sofa in the picture is a good example of a bulky product which we lowered by £100 on the back of freight costs returning to pre-pandemic levels.

Now, every season, we reset our ranges across our good, best, and better price quality tiers. And we've talked here in the past about doing that with examples in plain dye sheets. Towels is another interesting example of what we've done. We held prices a year ago on our bestselling Egyptian cotton towels despite raw material and freight increases. And at the same time, we introduced a new super soft range at our lowest priced quality tier of goods at £8 for all cotton, 550 GSM weight bath towels.

As a result of the value we're offering, we're seeing our volume share grow in core categories like bathroom textiles. Value is equally important at higher price tiers. In cushions, we've introduced new compositions using beading, sequin embroidery, and wool blends, all handcrafted in India, which has enabled us to raise our prices at the upper tier to new price levels while still offering outstanding value for money in the market. And we're passing on value to customers seeking more sustainable materials, pulling our more sustainable options into lower price tiers to make them affordable for more households.

The teddy bear throws we feature in many of our winter warm campaigns this year are made from 100% recycled polyester. And one final example, we're adding more choice and entering new areas by adding to our online range that's delivered directly from our vendors. We've added about 20,000 products of this type since FY22. It's still a curated product with the same product quality and price focus, and allows us to learn about new areas and form new supplier relationships. Upcoming additions include more choice of nursery furniture and introduction this week of a range of life plants, indoor plants, and pots, which you can see online if you look now.

We've often talked here about value, but less about joy. This year, joy is more important than ever before. It's in our purpose. But this year, while shoppers will work hard to be savvy and look for ways to balance price and quality to meet their budget, they're also looking for their experiences and purchases to be stress free and joyful, an antidote to the graft and worries of making ends meet.

You'll see our efforts to do this and how we talk to customers in store. We track fast and friendly feedback scores for every shop in the estate. You'll see it in how our marketing doesn't take itself too seriously. Even the food and offers in our Pausa cafes are designed with an eye joy. Who could resist a giant coronation jammy dodger with the jam in the shape of a crown? But it's in our core product development that we also offer joy in a way that few other companies would do so. So I've got a short video now to show you of Debbie Drake, our design director filmed at our recent London Press, our product show featuring our autumn winter product.

Debbie Drake: We're in the vaults of the building right underneath and it creates the most cosy environment to showcase our autumn, winter, and Christmas collections. So let's go in and look at Autumn Pride and Joy. As you can see with this collection, we are embracing colour. The whole philosophy about it is to help people find ways of bringing some joy into their homes and into their lives. So colour is just one way. It's also about fantastic products at great values and there's plenty of those to choose from. So you can pick up one or two things that just bring a little bit of smile to your face when you walk into your room, or you can go for a whole cottage core remake. That's entirely up to you. And we don't just want people to buy new things. We're trying to encourage customers to renovate, to upcycle, and to decorate themselves.

As always, really popular with our customers is what we call products with personality, and we really like to inject this into the Natural History Museum collection. Personal favourite of mine, again is the owl plant pot there, and we've also got a big one of ours here, so they're really good statement pieces. Again, checked with the specialists at the museum and to make sure that we're being accurate with that, but it's also really fun.

Hi, everyone. So I'm just going to talk you through some of our Disney range that we've got for our new Disney home collection. So the aim of the project was to create a really subtle Disney home collection that people can buy with Dunelm decor and just make it really transitional within their homes. This range was really inspired by our Elements brand and it just brings bright pops of colour in a really subtle way into your home. And we concentrated on the really iconic Mickey silhouette for this range to create some really iconic retro pieces. And finally, our Star Wars range, which is coming in October, and this is a super exciting range that we worked on. I absolutely loved working on this project. I've got two dogs named after Star Wars characters, so give them a quick shout out. And yeah, this was just aimed at a modern customer with a bit more of an industrial vibe and we've just got some really iconic things in this story.

The advertisements from the Cantina, so this is for the real hardcore Star Wars fans. If you're not a fan of Star Wars, you'll have no idea what this is about. And then, we've got some really obvious pieces like the Darth Vader Welcome to the Dark Side doormat, which will be great for your front door. And then on lighting, we've got some really lovely neon signs that have got some of the quotes on there. So we've got Beware of the Dark Side and Rebel, and then my favourite products of the season, which is the R2D2 lamp, which is just an absolutely fantastic product. So look out for that in October.

Nick Wilkinson: There you go, and you can buy a Star Wars Death Star curtain finial from us. Let's move on. Onto the second deep dive, the total retail system. It's the best way we have, not the most elegant words, but the best way we have of describing one of the key advantages of our business model. It combines the benefits of physical stores with the convenience of online shopping and the reach of our marketing ecosystem. Our digital sales have increased in recent years, and at the same time, our stores remained fundamental to our success, not least by fulfilling an increasingly important role in marketing too and being part of their local communities. We've continued expanding our store estate with three new openings last year and our 180th store in Greenwich, Southeast London opened in the summer.

Now looking forward, we see an opportunity in the next couple of years to accelerate our run rate of new store openings. This reflects recent learnings and improved data and insight capabilities. The typical Dunelm Superstore has approximately 30,000 square foot of trading space, including a 10,000 square foot mezzanine and is in an out of town location. We're delighted with the returns we generate on stores like these in Weymouth, a recent example of a new one of those we've opened. But at the same time, as you can see on this graph, we've opened four smaller stores recently averaging around 15,000 square feet, and we've also opened three full size ones in town centre locations in recent years. And we're seeing the same good returns across these different types of openings with paybacks averaging just under three years.

With this and with better insights to support location planning, we expect to open 5 to 10 new stores, including relocations in each of the next two years. These will be full service Dunelm stores amplifying our online offer and driving local customer awareness to enable them to benefit fully from our total retail system. We will, of course, apply our usual operational grip and discipline to these investments and monitor the progress of the smaller stores in particular.

At the same time as expanding our physical reach, we continue to digitalise our total retail system building and now also optimising to improve our customer offer and increase the efficiency of our operations. We're leveraging our data foundations, building data fluency, and enhancing customer stock and product data quality. And we're doing all this with our own in-house capabilities and with those of our core partners.

On the left side of the table, you can see some of the milestones achieved in the last six months. We are pleased to have increased customer retention as we improve perfect order rates and the quality of our delivery and after sales service communications are also improving, more convenient payment options such as Klarna and better product data support site conversion rates. In addition, new product master data management tools will improve our data quality and allow our category teams to be more efficient.

Over the next 12 months, we'll further improve our website experience with smarter search tools and faster site architecture with micro front ends being deployed in our architecture. We'll continue to expand our product offer with new ranges and made to measure categories like shutters and fitting becoming available online for the first time. And to improve the efficiency of our operations, we'll launch new tools for forecasting and replenishment and optimisations to improve stock handling in our warehouses with both of these initiatives also improving availability for our customers. We'll also increase our personalised communication with customers, and that brings me on to our marketing opportunities.

So turning to the next slide, the third and final of our deep dives is into our marketing ecosystem, which refers to our brand marketing, our digital performance marketing, and our local community presence. We continue to develop at pace and are learning lots along the way. Some of our more recent learnings have come from a greater understanding of consumer attitudes to the home and home shopping, and we've recently conducted a significant piece of work giving us more insight into the customer opportunity for this next phase of our growth and who we will target.

We observed some differing attitudes to home spend compared to pre-pandemic and have gained an updated view of the groups where we have the most headroom for attracting new customers and growing shopping frequency. The four themes on the right side of this slide give you a broad overview of some of the high level findings. Firstly and encouragingly, the home remains front of mind for consumers albeit we are more aware of the variety of reasons consumers have for their interests and how well our brand meets those needs. While for some the home is a place for family, others' style and creating a venue for entertaining ranked much more highly.

We see varied attitudes towards value also. While important for everyone, there are increasing differences between consumers in terms of price sensitivity and attitudes to credit. With these insights, we can target our customers with marketing content more effectively and with more personalisation. The lower two boxes speak more to our brand marketing opportunity. We've grown strongly in the southeast and with younger consumers over recent years, but there's still a lot more to do and we remain significantly less one in London and amongst younger customers than we do nationwide. At the same time nationwide, even for customers who know us well, we are top of mind in less than half of the categories that we now offer.

It's still early days in applying these insights, but as we begin to integrate them into our customer database and our marketing approach, the better we can attract new customers and grow frequency. As we've shared in previous presentations, our best customers are multi-category, multi-channel shoppers, shopping five times as often, and spending seven times as much.

So two developments of note to share this morning, continued building an optimisation of personalisation and a step up in our brand marketing beginning this autumn. In terms of personalisation, we are combining data from multiple sources, including demographics and previous purchasing behaviour to begin a more targeted and personalised level of marketing, including optimising the time at which we send communications to you and customer specific product recommendations within marketing emails. We're also testing a more customised website where paid search will lead you to a personalised dunelm.com landing page with a greater range of options beyond the specifically searched for product. We continue to make progress in the quality of data stitching in our single view of customers across both of our channels. The same payment system that we rolled out online last year is now running at almost 50 of our stores, the remaining ones following by the end of this calendar year, and cross-channel payment tokens are now flowing into our customer database from these migrated stores. It's worth just framing why personalisation as capability we are so focused on. The combination of advantaged own brand product and direct to customer access is essential access of our business strategy. The more we can tailor content, especially the products we show to a customer, then the more effective our marketing. Doing that at scale, informed by genuine customer insight and with the content generation becoming more efficient due to AI, that is very exciting.

Our brand marketing, we simply want to establish our presence and the quality of our offer in more categories to become, if you like, the home of homes. We have the insight and confidence to do this, as Karen mentioned, from the rigorous incrementality testing we did last year. Our new brand campaign is launching this autumn. You can see a still from the film on the slide, and it's on screens from next week. Which draws an end to the three deep dives, I hope you enjoy them and you get a sense of why we are so confident as a team for the future opportunity. I'll describe in summary FY23 as a good year for performance with strong sales, robust profit and excellent free cash flow. But it's the strategic progress that excites us most by continuing to invest across all of our growth levers and in our colleagues' wellbeing and capabilities, we are so well placed to seize the growth opportunities afforded by our fragmented market, of which we have just a 7% market share.

Customers are seeking value at all price tiers. Whilst some are searching for a low price at necessity, others are now feeling more confident than they were a year ago. In this environment, our brand value proposition and its breadth of largely owned brand products and multichannel offer is resonating very well. Focus on operational grip, as you would expect, continues to be a feature and critical to our success, and we expect to see slightly increased gross margins and at the same time, as we reset our ranges, to offer outstanding value for money. In terms of operating costs, it'll be another year of mitigating some of the inflationary effects we are seeing and in parallel continuing to invest in our offer, our retail system, and in our marketing. Trading so far this quarter has begun well and as a result of this and of all of our plans, we are confident for the future and the year and years ahead. Thank you so much for listening.