Overview

The table below is provided in order to aid understanding of the impact of Worldstores on the performance of the group as a whole. The analysis includes a number of assumptions and judgements, particularly in relation to the allocation of costs between core Dunelm and Worldstores.

<table>
<thead>
<tr>
<th></th>
<th>Existing (£m)</th>
<th>Worldstores transfer (£m)</th>
<th>Total (£m)</th>
<th>Worldstores (£m)</th>
<th>Total Group (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>971.7</td>
<td>12.4</td>
<td>984.1</td>
<td>66.0</td>
<td>1,050.1</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(495.7)</td>
<td>(7.4)</td>
<td>(503.1)</td>
<td>(43.4)</td>
<td>(546.5)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>476.0</td>
<td>5.0</td>
<td>481.0</td>
<td>22.6</td>
<td>503.6</td>
</tr>
<tr>
<td>Operating costs</td>
<td>(362.9)</td>
<td>(2.4)</td>
<td>(365.3)</td>
<td>(33.6)</td>
<td>(398.9)</td>
</tr>
<tr>
<td>Operating profit</td>
<td>113.1</td>
<td>2.6</td>
<td>115.7</td>
<td>(11.0)</td>
<td>104.7</td>
</tr>
<tr>
<td>Financial income and expense</td>
<td></td>
<td></td>
<td></td>
<td>(2.7)</td>
<td></td>
</tr>
<tr>
<td>Profit before tax and exceptional items</td>
<td></td>
<td></td>
<td></td>
<td>102.0</td>
<td></td>
</tr>
<tr>
<td>Exceptional items</td>
<td></td>
<td></td>
<td></td>
<td>(8.9)</td>
<td></td>
</tr>
<tr>
<td>Profit before tax</td>
<td></td>
<td></td>
<td></td>
<td>93.1</td>
<td></td>
</tr>
</tbody>
</table>

The commentary which follows explains the performance of Dunelm and Worldstores separately as far as possible.

Revenue

52 weeks to 30 June 2018

<table>
<thead>
<tr>
<th></th>
<th>Revenue (£m)</th>
<th>YoY Growth (£m)</th>
<th>YoY Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>LFL stores</td>
<td>805.0</td>
<td>+8.2</td>
<td>+1.0%</td>
</tr>
<tr>
<td>LFL online (Dunelm.com) (including lines transferred from Worldstores)</td>
<td>105.4</td>
<td>+28.9</td>
<td>+37.9%</td>
</tr>
<tr>
<td>Total LFL</td>
<td>910.4</td>
<td>+37.1</td>
<td>+4.2%</td>
</tr>
<tr>
<td>Non-LFL stores</td>
<td>73.7</td>
<td>+43.6</td>
<td></td>
</tr>
<tr>
<td>Total Dunelm</td>
<td>984.1</td>
<td>+80.7</td>
<td>+8.9%</td>
</tr>
<tr>
<td>Worldstores businesses</td>
<td>66.0</td>
<td>+13.7</td>
<td>-</td>
</tr>
<tr>
<td>Total Group</td>
<td>1,050.1</td>
<td>+94.5</td>
<td>+9.9%</td>
</tr>
</tbody>
</table>

With this, Dunelm revenue grew by 8.9% to £984.1m. Despite volatile trading conditions throughout the year, like-for-like (‘LFL’) revenue grew by 4.2%. This was primarily driven by continued strong performance online, where revenue grew by 37.9%; over the year as a whole, Dunelm.com accounted for 10.7% of total Dunelm business (13.5% including reserve & collect orders picked up in stores).

After a decline in the previous financial year, revenue in LFL stores also increased, with growth of 1.0% reflecting:

- Better availability throughout the financial year, with no repeat of the supply chain disruption seen in FY17
- Improvements in product ranges with more new lines and a stronger seasonal offering
- Benefits from investment in existing stores, including six major refits
- Favourable weather conditions through the first half, and especially the first quarter
- Adverse weather conditions in the second half

Non-LFL revenue reflected the impact of our ongoing store expansion programme, with ten new openings in the year (of which one was a relocation). We ended the year with a portfolio of 169 superstores and three stores in high street locations. We anticipate a smaller number of new openings in FY19, with two new superstores committed (both relocations) as at the date of this report.
The Worldstores businesses, comprising Worldstores.co.uk, Achica.com and Kiddicare.com, were acquired midway through FY17. During FY18 we divested Achica.com and made the decision to transfer continuing lines from the Worldstores and Kiddicare ranges to Dunelm.com, prior to winding down the Worldstores.co.uk and Kiddicare.com sites in the first quarter of FY19. As a consequence, sales attributed to Worldstores businesses will be minimal in FY19.

Gross Margin
Gross margin decreased by 90 basis points to 48.0% (FY17: 48.9%). Excluding the dilutive impact of lower margins earned by the Worldstores businesses, core Dunelm gross margin was 48.9% in FY18 and 49.8% in FY17. Key factors causing the year-on-year decline in gross margin were adverse foreign exchange impacts and a higher level of clearance of discontinued lines (including a year-end adjustment to increase our obsolete stock provision by £2.6m).

Setting aside the year-end adjustment described above, core Dunelm gross margin showed year-on-year growth of 40bps during the final quarter of the year. This gave positive momentum going into FY19, when we also expect to benefit from improved foreign exchange rates. We anticipate that these benefits will more than offset the margin dilution from transfers of further Worldstores lines to Dunelm.com.

Operating Costs before Exceptional Items
Operating costs before exceptional items in FY18 were £398.9m, an increase of £43.0m or 12.1% compared with the prior year. The total included £33.6m of costs relating to Worldstores businesses (FY17: £29.2m).

The main drivers of the £38.6m increase in core Dunelm operating costs include:
- Store portfolio growth - nine new superstore openings (net of one relocation), increasing selling space by 6.1%
- Online - digital marketing and fulfilment costs grew broadly in line with Dunelm.com sales
- National Living Wage - upward cost pressure in excess of inflation, partially mitigated by productivity initiatives

We will redouble our focus on productivity and overhead cost control going forward.

Exceptional Items
We have treated as exceptional those non-recurring costs which relate to the acquisition, integration and/or disposal of the Worldstores businesses. During the year, these exceptional items totalled £8.9m, comprising the following:

<table>
<thead>
<tr>
<th>FY18 (£m)</th>
<th>FY17 (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value adjustments in respect of acquired inventory</td>
<td>0.5</td>
</tr>
<tr>
<td>Acquisition costs</td>
<td>1.3</td>
</tr>
<tr>
<td>Welcome payments for continuation of supply</td>
<td>7.3</td>
</tr>
<tr>
<td>Retention and redundancy payments</td>
<td>1.2</td>
</tr>
<tr>
<td>Loss on disposal, asset write-offs, impairments and accelerated amortisation</td>
<td>5.8</td>
</tr>
<tr>
<td>Other integration costs</td>
<td>1.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8.9</strong></td>
</tr>
</tbody>
</table>

Management retention and redundancy payments were made in the year in accordance with contractual agreements. There are no further payments due to be made.

We have reviewed the websites and other intangible IT assets of both the existing Dunelm business and the acquired Worldstores businesses. Having determined our technology plans going forward, we have written off certain technology assets and useful economic lives of others have been reduced resulting in accelerated depreciation.
Financial Review

CONTINUED

During the year we took the decision to develop the Kids and Nursery category under the Dunelm brand, rather than the Kiddicare standalone brand. As a result, the Kiddicare brand acquired as part of the Worldstores acquisition was deemed to be fully impaired. As well as this, aged Kiddicare stock and various other intangible assets relating to the development of a new Kiddicare website were also written off.

As a result of the sale of the Achica business, certain costs relating to the sale and subsequent restructure of the business have been classified as exceptional. These costs include the write-off of assets relating to Achica and onerous contracts. The proceeds from the sale of the Achica business were £0.6m.

Other integration costs include professional advisory support and costs associated with the transfer of the London head office to a new location.

Of the above exceptional items, £1.6m were net cash outflows in the period. We do not expect to report exceptional items in FY19.

Operating Profit before Exceptional Items

Group operating profit before exceptional items for the financial year was £104.7m (FY17: £111.7m), equating to 10.0% of sales (FY17: 11.7%). Included within this is a net negative impact from the Worldstores businesses, which we estimate at £8.4m. This impact will reduce significantly in FY19 as Worldstores trading is absorbed fully into the core Dunelm business.

Operating profit after exceptional items was £95.8m (FY17: £94.8m) reflecting the lower level of exceptional costs in the current year.

EBITDA

Before exceptional items, earnings before interest, tax, depreciation and amortisation were £139.6m (FY17: £142.2m). This represents a 1.8% reduction on the previous financial year. The EBITDA margin achieved was 13.3% (FY17: 14.9%).

After exceptional items EBITDA was £134.7m (FY17: £128.2m).

Financial Items

The Group incurred a net financial expense of £2.7m in FY18 (FY17: £2.4m). Interest and amortisation of costs arising from the Group’s revolving credit facility amounted to £2.2m (FY17: £2.0m) and net foreign exchange differences on the translation of dollar denominated assets and liabilities amounted to a further £0.5m expense (FY17: expense of £0.6m). Interest earned on cash deposits was £nil (FY17: £0.2m).

As at 30 June 2018, the Group held $164.0m (FY17: $140.0m) in US dollar forward contracts, of which $121.5m were due to mature in the next 12 months (FY17: $107.6m), representing 76% of the anticipated US dollar spend over the next financial year. US dollar cash deposits amounted to $7.3m (FY17: $0.3m).

PBT

After accounting for interest and foreign exchange impacts, profit before tax (excluding exceptional items) for the financial year amounted to £102.0m (FY17: £109.3m), a decrease of 6.7%.

Profit before tax and after exceptional items was £93.1m (FY17: £92.4m).

Taxation

The tax charge for the year was 21.3% of profit before tax, a premium of 230bps compared with the statutory rate of 19.0%. This included an unusually high level of disallowable asset write-offs largely relating to the acquired Worldstores brands.

In future, we expect the tax charge to trend approximately 100 bps above the headline rate of corporation tax, principally due to depreciation charged on non-qualifying capital expenditure.

PAT and EPS

Profit after tax was £73.3m (FY17: £73.1m).

Basic earnings per share (EPS) for the year ended 30 June 2018 was 36.3p and in line with last year, or 40.1p before exceptional items (FY17: 43.1p). Fully diluted EPS increased slightly to 36.2p (FY17: 36.1p). Before exceptional items this measure decreased to 40.0p (FY17: 42.8p).

Operating Cash Flow

In FY18 the Group generated £98.5m (FY17: £79.5m) of net cash from operating activities, an increase of 24%. Cash elements of exceptional costs were £1.6m (FY17: £11.3m).

Net working capital increased by £20.3m over the year (FY17: £26.2m increase). Despite the expansion of our store estate, we reduced year-end inventory by £6.6m through a combination of delayed inflow of Christmas merchandise and lower cover levels on continuing lines. However, payables reduced by £31.4m due to a combination of factors including the later timing of Christmas stock flows and the lower level of capital investment in progress at year-end.

Capital Expenditure

Gross capital expenditure in the financial year was £44.0m compared with £60.5m in FY17. During the year, we opened ten new stores (£13.8m), and invested £10.6m in refits. We continued to invest in technology infrastructure to improve our website and open up new sales channels (£14.3m). We relocated our London Support Centre and invested in a new bespoke curtains manufacturing site, as well as acquiring one freehold property.

We expect capital expenditure in the next financial year to be lower. We anticipate fewer new store openings. We intend to complete a small number of major store refits as well as other specific upgrades across the estate to introduce concepts which have a proven return (estimated £5-10m in total). We will continue to invest in technology and web development as we move the Dunelm.com website to the Worldstores technology platform and introduce Click & Collect (estimated at £15m). In total, we are planning capital investment, assuming no freehold acquisitions, of £30-35m in FY19.

Free Cash Flow (FCF)

We measure FCF as net cash from operating activities less net cash used in investing activities. FCF was £52.9m in the year (FY17: £14.2m), reflecting the improved operating cash flow and lower capital expenditure year-on-year.

Banking Agreements and Net Debt

During the year the Group amended and extended its syndicated Revolving Credit Facility (‘RCF’). The RCF was increased to £165m and extended until March 2023. The terms of the RCF are unchanged and are consistent with normal practice. They include covenants in respect of leverage (net debt to be no greater than 2.5× EBITDA) and fixed charge cover.
EBITDA to be no less than 1.75× fixed charges), both of which were met comfortably as at 30 June 2018. In addition, the Group maintains £20m of uncommitted overdraft facilities with two syndicate partner banks.

Net debt at 30 June 2018 was £124.0m (0.89× historical EBITDA before exceptional items) compared with £122.1m in FY17 (0.86× historical EBITDA). Daily average net debt in FY18 was £112.4m (FY17: £92.2m).

Capital and Dividend Policy
The Board targets an average net debt (excluding lease obligations and short-term fluctuations in working capital) of between 0.25× and 0.75× historical EBITDA. This policy provides the flexibility to continue investing in the Group’s growth strategy and to take advantage of investment opportunities as and when they arise, for example freehold property acquisitions.

The Board targets ordinary dividend cover (by which we mean the Group’s earnings per share in a given financial year divided by the total ordinary dividends declared in respect of that year) of between 1.75× and 2.25×. The Board will consider special distributions if average net debt over a period consistently falls below the lower limit of the target range (0.25× EBITDA), subject to known and anticipated investment plans at the time.

The Group’s full capital and dividend policy is available on our website at https://corporate.dunelm.com.

Dividends Paid and Proposed
An interim dividend of 7.0p per share was paid in March 2018 (FY17: 6.5p). It is proposed to pay a final dividend of 19.5p per share (FY17: 19.5p), subject to shareholder approval. The total dividend of 26.5p represents an increase of 1.9% over the previous year, giving a dividend cover of 1.5× before exceptional items (FY17: 1.6×). This cover level is outside our policy, as described above; however, the Board has confidence in the strategic plans of the business and believes that ordinary dividend cover will revert to the policy range in the medium term. The final dividend will be paid on 7 December 2018 to shareholders on the register at the close of business on 16 November 2018.

Share Buy-backs
The Group’s policy is to purchase shares in the market from time to time to satisfy the future exercise of options granted under incentive plans and other share schemes. During FY18 no shares were purchased (FY17: 500,000). At the year-end, 914,635 shares were held in treasury (FY17: 1,150,642), equivalent to approximately 37% of options outstanding.

Tax Policy
The Group maintains a straightforward and transparent tax policy. The aim is to comply with all relevant tax legislation and pay all taxes due, in full and on time. While actively managing its tax affairs, the Group will only engage in tax planning where this is aligned with commercial and economic activity and does not lead to an abusive result. We would normally expect our corporation tax charge to be higher than the statutory tax rate, as noted above. HMRC has recently reconfirmed the Group’s low-risk tax status. Further details of the Group’s tax policy are available on our website, https://corporate.dunelm.com.

During the year, total tax contributions paid to HMRC in the form of corporation tax, property taxes, PAYE and NIC and VAT were £142.3m (FY17: £132.6m).

Treasury Management
The Group Board has established an overall Treasury Policy, day-to-day management of which is delegated to the Chief Financial Officer. The policy aims to ensure the following:

- Effective management of all clearing bank operations
- Access to appropriate levels of funding and liquidity
- Effective monitoring and management of all banking covenants
- Optimal investment of surplus cash within an approved risk/return profile
- Appropriate management of foreign exchange exposures and cash flows

Key Performance Indicators
In addition to the traditional financial measures of sales and profits, the Directors review business performance each month using a range of other KPIs. These include measures shown on page 14.

David Stead
Interim Chief Financial Officer
12 September 2018