

Financial review

RESULTS UNDERPINNED BY TIGHT COST MANAGEMENT



SEGMENTAL PERFORMANCE

The financial statements for the period ended 3 September 2016 included 53 weeks. In the notes that follow, all comparative income statement numbers for the 2016 financial year use the results for the 52 weeks of trading to 27 August 2016. Management believes that comparing like-for-like 52 week periods demonstrates the underlying performance of the business. Comparative cash flow numbers reflect the full 53 weeks to 3 September 2016 and the comparative balance sheet is also at that date.

UK

Gross transaction value for the UK segment was broadly level with last year at £2,350.0 million and reported revenue decreased by 0.7% to £1,892.9 million. Sales benefited from growth in digital performance and strong trading prior to Christmas, supported by the strategy to drive non-clothing sales such as beauty, gifting and casual dining categories. Performance after the Christmas period slowed as the mix of sales moved away from beauty and gifting, towards a more volatile UK clothing market.

We continue to see digital growth and positive trends in mobile, which now represents 55% of UK digital orders, an increase in penetration of c.10% on the year.

As we have continued to add choice in concessions and moved further into non-clothing categories, own bought mix declined from 76.6% last year to 75.3%, with a consequent dilution to gross margin rate, offset by benefits from reduced markdown.

EBITDA before exceptional charges decreased by 10.1% to £174.0 million reflecting the impact of lower store sales and sales mix towards lower margin divisions. Operating profit before exceptional costs decreased by 22.0% to £74.0 million, as depreciation expense rose as expected.

International

In the International segment, gross transaction value of £604.1 million was 11.1% higher than last year and reported revenue increased by 9.5% to £442.1 million. Both metrics have been impacted by stronger Euro and Danish Kroner exchange rates, benefiting Group like-for-like sales by 2.3%. On a constant currency basis, International gross transaction value declined by 0.8%, as a result of difficult trading conditions within Denmark and Republic of Ireland.

Strategic report

Financial review continued

Table 1: Financial summary

£m	52 weeks to 2 September 2017	52 weeks to 27 August 2016	53 weeks to 3 September 2016	% change (52 v. 52)
Gross transaction value ^{1,2}				
UK	2,350.0	2,352.1	2,386.2	(0.1%)
International	604.1	543.8	552.3	11.1%
Group	2,954.1	2,895.9	2,938.5	2.0%
Statutory revenue ^{1,2}				
UK	1,892.9	1,906.6	1,931.9	(0.7%)
International	442.1	403.8	409.8	9.5%
Group	2,335.0	2,310.4	2,341.7	1.1%
Group like-for-like sales movement ³				2.1%
Group gross margin movement ⁴				(30 bps)
EBITDA ^{1,5,6}				
UK	174.0	193.6	198.6	(10.1%)
International	43.0	39.8	41.1	8.0%
Group	217.0	233.4	239.7	(7.0%)
Operating profit ^{1,6}				
UK	74.0	94.9	98.0	(22.0%)
International	33.5	31.7	33.0	5.7%
Group	107.5	126.6	131.0	(15.1%)
Underlying profit before tax ⁵	95.2	114.1	118.2	(16.6%)
Exceptional items	(36.2)	(12.4)	(12.4)	
Reported profit before tax	59.0	101.7	105.8	(42.0%)
Underlying earnings per share ⁶	6.4p	7.5p	7.8p	(14.7%)
Basic earnings per share	4.0p	6.7p	7.0p	(40.3%)
Dividend per share	3.425p	3.425p	3.425p	0.0%
	2 September 2017	3 September 2016		
Net debt	275.9	279.0		
Net debt : EBITDA (last 12 months) ⁶	1.3x	1.2x		

Notes to the above table and to all references in this statement:

- 1 UK operating segment comprises stores in the UK and online sales to UK addresses. International operating segment comprises the international franchise stores, the owned stores in Denmark and the Republic of Ireland and online sales to addresses outside the UK.
- 2 Gross transaction value (GTV): sales on a gross basis before adjusting for concessions, consignments and staff discounts. Statutory revenue: sales after adjusting for these items.
- 3 Like-for-like sales movement relates to sales from stores which have been open for more than 12 months plus online sales.
- 4 Gross margin: GTV less the value of cost of goods sold, as a percentage of GTV.
- 5 EBITDA is earnings before interest, taxation, depreciation and amortisation (including loss on disposal of fixed assets).
- 6 Before exceptional items, comprising costs associated with the Strategic Review and the restructure of Warehouses and Logistics (FY2016: comprising restructure costs in the Republic of Ireland relating to the examinership process, restructure costs associated with streamlining support centre and a charge relating to the cost of writing off intangible systems assets following the launch of the new International website.)

Franchise despatches have stabilised in the year as we have focused on optimising the number of strategic partners and closed out some of those in the low profit, low growth category. During the year we closed nine franchise stores. Four franchise stores were opened together with 27 brand franchise stores - partners selling Debenhams brands in their own branded stores (23 in Australia and four in Vietnam).

International EBITDA increased by 8.0% to £43.0 million as a result of savings achieved through the Irish examinership process finalised in the Republic of Ireland last year and translation benefits on profit generated in Magasin du Nord. Operating profit increased by 5.7% to £33.5 million.

GROUP SALES AND PROFITS

Sales and revenue

Group gross transaction value increased by 2.0% to £2,954.1 million for the 52 weeks to 2 September 2017 and Group revenue increased by 1.1% to £2,335.0 million. Group like-for-like sales increased by 2.1% on a reported basis and decreased 0.2% on a constant currency basis.

The constant currency like-for-like sales performance reflects the mix from stores to digital, with digital sales growth of 12.7%, representing 16.0% of Group gross transaction value (FY2016: 14.7%).

The components of the gross transaction value increase of 2.0% and like-for-like sales growth of 2.1% are shown in Table 2:

Table 2: Contribution to sales growth

UK stores	(1.5%)
UK digital	+1.4%
International	(0.1%)
Like-for-like-sales – constant currency	(0.2%)
Exchange rate impact	+2.3%
Like-for-like sales – reported	+2.1%
Other	(0.1%)
GTV movement – 52 weeks	+2.0%

Operating profit¹

As planned, growth in the beauty, gifting and concession categories, which are dilutive to gross margin relative to higher margin own bought clothing categories, has continued to impact sales mix. However, further progress has been made to tighten stock and improve full price sales, resulting in a 20 bps improvement to markdown. The combination of the sales mix and markdown is an overall 30bps reduction to the Group gross margin.

Operating costs before depreciation increased in line with expectations, increasing 3.3% compared to the same period last year driven by the translation impact of foreign exchange rates, and the growth of digital. Operating cost growth in constant currency was 1.5%. As previously guided, the increase in the National Living Wage rate continues to have an impact, driving c.£10 million additional costs in the year, but this has been largely mitigated through cost efficiencies.

Depreciation and amortisation increased by 2.5% to £109.5 million, reflecting an increase in capital expenditure over the last few years.

As a result of the above, Group operating profit for the 52 weeks to 2 September 2017, was £107.5 million, (15.1%) below last year.

Net finance costs

Net finance costs decreased by 1.6% to £12.3 million reflecting the benefit of lower average debt levels of £257 million compared with £273 million last year.

¹ All items stated before exceptional charges.



Exceptional items

During the financial year, the Group conducted a strategic review and embarked on a new strategic business plan together with a planned restructuring of operations encompassing the following areas:

Strategic review and restructuring

As a result of the strategic review, the Group identified that a number of stores may become unprofitable in the future and so has recognised exceptional store costs of £10.4 million during the financial year. This relates to the impairment of property, plant and equipment and onerous lease commitments.

A £5.1 million charge relates to writing off legacy IT system assets following the launch of the new strategy.

Other exceptional charges of £8.0 million were also incurred in respect of the strategic review including redundancies (including some senior management within the trading division and support centre), professional fees, recruitment costs of key people to help drive the strategy and costs arising from strategic exits from certain international markets.

Strategic warehouse restructuring

During the financial year, the Group carried out a strategic review of its warehouse operations which has led to a restructuring of these facilities. As a result, the Group announced the closure of its distribution centre in Northampton and a number of regional warehousing facilities and recognised exceptional closure costs of £8.8 million relating to accelerated depreciation of assets, dilapidations, onerous lease commitments and redundancy costs.

Exceptional charges of £3.9 million were incurred during the financial year relating to one-off transition costs including staff time, training and inventory moves totalling £3.5 million and asset write offs of property, plant and equipment of £0.4 million. Part of this restructuring is warehouse automation which is an ongoing project over the next two years.

Of the £36.2 million charge, £19.2 million is cash related, of which £8.5m was incurred in the year.

Profit before tax

Underlying profit before tax before exceptional items decreased by 16.6% to £95.2 million (2016: £114.1 million). Reported profit before tax after exceptional items decreased by 42.0% to £59.0 million.

Taxation

Taxation excluding the impact of exceptional items decreased from £21.6 million last year to £17.2 million, principally due to a decrease in reported profits and a decrease in the effective tax rate. The effective tax rate decreased to 18.1% from 18.9% last year, due to a reduction in the headline corporation tax rates.

Profit after tax

Profit after tax but before exceptional items decreased by 15.7% to £78.0 million. Profit after tax after accounting for exceptional items decreased by 40.8%.

Earnings per share

Underlying basic and diluted earnings per share, before exceptional items, decreased by 14.7% to 6.4 pence. The basic weighted average number of shares in issue increased from 1,227.4 million last year to 1,227.8 million and the diluted weighted average number of shares increased from 1,227.9 million to 1,229.0 million.

Cash flow and uses of cash

Debenhams is cash generative and has clear priorities for the uses of cash. The first priority is to invest in our Debenhams Redesigned strategy. Second, we pay our shareholders a dividend. Third, as we communicated in October 2015, we have a medium-term financial leverage target for net debt to EBITDA of 0.5 times.

Operating cash flow before financing and taxation reduced from £113.7 million to £75.6 million as a result of lower EBITDA and exceptional payments relating to FY2017 (£8.5 million) and FY2016 (£7.4 million).

Cash flow generation, the uses of cash and the movement in net debt are summarised in Table 3 opposite.

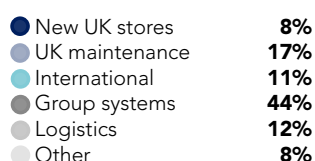
Capital expenditure

Capital expenditure was £124.8 million during the year compared to £126.5 million last year. The small decrease reflects the capital investment in new stores and modernisations last year, not repeated this year, offset by an increased focus on warehouse automation this year. Investment in new IT systems continues to be a key focus with 44% (£55 million) of total capital spend being spent in the year.

Read more on
pages 104-105

Table 3: Cash flow, uses of cash and movement in net debt

£m	52 weeks to 2 September 2017	53 weeks to 3 September 2016
EBITDA	217.0	239.7
Working capital	(0.7)	2.5
Exceptional items	(15.9)	(2.0)
Cash generated from operations	200.4	240.2
Capital expenditure	(124.8)	(126.5)
Operating cash flow before financing and taxation	75.6	113.7
Taxation	(16.3)	(11.0)
Financing	(11.1)	(15.3)
Dividends paid	(42.0)	(42.0)
Other movements	(3.1)	(4.6)
Change in net debt	3.1	40.8
Opening net debt	279.0	319.8
Closing net debt	275.9	279.0

Figure 1: Capital expenditure**Table 4: Key balance sheet items**

£m	2 September 2017	3 September 2016
Intangible assets	991.9	962.1
Property, plant and equipment	654.9	670.2
Inventory	317.8	326.3
Other assets	108.7	149.6
Trade and other payables	(523.3)	(516.3)
Other liabilities	(398.7)	(394.5)
Net retirement benefit surplus/(obligations)	80.9	(4.1)
Net deferred tax liabilities	(38.7)	(30.4)
Net debt	(275.9)	(279.0)
Reported net assets	917.6	883.9

Inventory

Stock levels continued to be managed tightly during the year, reflecting the ongoing strategy to plan the business prudently.

Total stock value decreased by 2.6% to £317.8 million. Terminal stock of 2.8% was in line with our historical range of 2.5% to 3.5%.

Dividends

An interim dividend of 1.025 pence per share was paid to shareholders on 5 July 2017 (2016: 1.025 pence) in respect of the 26 weeks ended 4 March 2017 which equated to £12.6 million of shareholders' funds (2016: £12.5 million).

The board is fully behind the Debenhams Redesigned strategy and the long-term benefits it brings. The board is recommending a final dividend in line with last year of 2.4 pence per share which will be paid on 19 January 2018 to shareholders who are on the register on 8 December 2017. The total dividend for the year is 3.425 pence (2016: 3.425 pence), in line with our dividend policy of maintaining a dividend cover of around 2.0x.

Net debt

The Group's net debt position as at 2 September 2017 of £275.9 million improved by £3.1 million from the same point last year (2016: £279.0 million).

The ratio of net debt to EBITDA of 1.3 times compares with 1.2 times at the end of the previous year, on a 53 week basis. The small increase in the ratio is a result of the movement in profits this year.

The Group's Revolving Credit Facility of £320 million is in place until June 2020, with an option to extend until June 2021. In addition, the Group has a £200 million 5.25% Senior Bond in place until July 2021.

Pensions

The Group provides a number of pension arrangements for its employees. These include the Debenhams Retirement Scheme ("DRS") and the Debenhams Executive Pension Plan ("DEPP") (together "the pension schemes") which both closed for future service accrual from 31 October 2006. On an accounting basis, the net surplus on the Group's pension schemes as at 2 September 2017 was £80.9 million (3 September 2016: net deficit of £4.1 million). The surplus was driven by a growth in asset value.

On 6 October 2017, the actuarial valuation of the Group's pension schemes at 31 March 2017 was completed, concluding that DEPP was fully funded on a technical provisions basis and on a technical provisions basis DRS had improved since the previous actuarial valuation but remained in deficit. Therefore the Group agreed a recovery plan for DRS which is intended to restore the scheme to a fully funded position on an ongoing basis. Under that agreement, the Group agreed to contribute £5.0 million per annum to the pension schemes for the period from 1 September 2017 to 31 March 2022.

The agreement replaced an agreement made in 2015 under which the Group agreed to contribute £9.5 million per annum to the pension schemes for the period from 1 April 2014 to 31 March 2022 increasing by the percentage increase in the retail price index ("RPI") over the year to the previous December. Additionally during October 2017, the Group agreed to continue to cover the non-investment expenses and levies of the pension schemes, including those payable to the Pension Protection Fund.

Read more on
pages 124-127

OUTLOOK AND GUIDANCE

The Group is providing the following guidance for FY2018, together with updated guidance on the outlook for the exceptional charges relating to the delivery of the strategy.

Group gross margin	(25bps)
Total costs	+1% to 2%
Depreciation & amortisation	c.£115 million
Net finance costs	£11–£13 million
Taxation	c.20%
Capital expenditure	c.£150 million
Net debt	c.£280– £300 million
Exceptional costs	c.£20 million

Impact of currency depreciation on sourcing costs

Gross margin guidance reflects the expected impact of sterling depreciation in relation to the sourcing of own bought goods denominated in US dollars. As previously indicated, our hedging protection smoothed the impact of sterling depreciation in FY2017 and we are currently hedged for FY2018 at an average rate of c.\$1.30 : £1, approximately 15% below FY2017. The Group continues to invest in supply chain improvements which are helping to mitigate some of the additional currency-related costs. In relation to those costs we are unable to offset, we intend to

maintain our competitive position, reacting to market conditions as appropriate.

Expected impact of exceptional costs in FY2018 and FY2019

The Group gave guidance in April 2017 that exceptional costs over the period of implementing the Debenhams Redesigned strategy would amount to approximately £50 million spread over three years, of which approximately half would be cash costs. In FY2017, the Group has incurred exceptional charges relating to the programme of £36.2 million, of which the cash impact charged in the year was £8.5 million.

Debenhams expects to incur the bulk of the remaining exceptional charge in FY2018, with an additional cash outflow of approximately £15 million in the current financial year. The balance of exceptional costs will be charged in FY2019.

How we will measure progress

The Group has clear growth ambitions in our Destination categories. Targets in the categories of beauty, food, destination and growth in mobile revenues will be measured as part of senior management remuneration. Additionally, the Group will report on progress in some important operational measures that will support the successful delivery of the Debenhams Redesigned strategy, including full price sales growth and customer net promoter score. Finally, the Group will target improved returns on investment and progress in total shareholder return in line with our intention to deliver value to our shareholders.

Uncertain trading environment

We are making good progress with implementing our new strategy, Debenhams Redesigned, and are pleased with the results from our initial trials against a background of rapid change in the business. There is a lot to do but the early signs from our activity to date confirm that we are moving in the right direction.

The environment remains uncertain and we face tough comparatives over peak. Nevertheless, we are well prepared for the important Christmas trading period and our diversified business model means that Debenhams is in good shape to withstand a more volatile market background. We believe our strategy will set Debenhams on course for a successful and profitable future.

Matt Smith
Chief Financial Officer
26 October 2017

Viability statement

The aim of the Viability Statement is for the directors to assess the prospects of Debenhams to meet its liabilities, taking into account its current position and principal risks.

Debenhams has developed an annual three year strategic plan, which considers the Group's cash flows, dividend cover and other financial key performance indicators over this period. The three year strategic plan takes into consideration sensitivities that encompass a wide spectrum of potential outcomes including changes in like-for-like sales, margin rate, costs, capital expenditure forecasts and franchise store opening plans.

These scenarios are designed to explore the resilience of Debenhams to the potential impact of the Principal risks set out on pages 28 to 30, or a combination of those risks. The directors paid particular attention to the following principal risks:

- Economic environment
- Currency and hedging
- Competition for customers; and
- Business strategy & transformation

The three year strategic plan is reviewed each year by the directors. Once approved by the board, the plan is cascaded across the business and provides the basis for setting strategic priorities and detailed budgets that are subsequently used by the board to monitor and evaluate performance.

The directors have assessed the viability of Debenhams over the three year period to 29 August 2020. This period has been selected because it reflects the pace of change in retail; uncertainty surrounding the UK's decision to exit the European Union; aligns with the Group's plans under its Debenhams Redesigned strategy and its three year planning process; and presents the board and the readers of the annual report with a reasonable degree of confidence whilst still providing an appropriate longer-term outlook.

The board is in agreement that Debenhams is a viable business and the viability statement can be found in the directors' report on page 79.

In making this statement the directors have considered the resilience of Debenhams, taking account of its current position and historical financial performance, the principal risks facing the business in severe but theoretical scenarios, and the effectiveness of any mitigating actions. This assessment has considered the potential impacts of these risks on the business model, future performance, solvency and liquidity over the period.

As noted in note 21 of the financial statements on page 115, the Group's revolving credit facility is due to expire in June 2020 and contains an option to request an extension to June 2021. The directors have no reason to believe that future financing facilities will not be available when the current facility expires.

The financial position of the Group, including information on cash flow, can be found in the financial review section on pages 31 to 36. In addition, the financial statements include notes on finance costs (page 106) and financial risk management including treasury policies on interest rate, liquidity, currency and credit risk pages 117 to 121.

STRATEGIC REPORT

The strategic report was approved by a duly authorised committee of the board of directors on 26 October 2017 and signed on its behalf by:

Matt Smith
Chief Financial Officer
26 October 2017