Chief Executive's report

"Delivering this growth would not have been possible without our loyal colleagues – they all deserve a huge thank you for their commitment and resilience during the year, as well as their unwavering application of our Group core values, 'Think Customer', 'Be Real' and 'Aim High', as we have sought to meet unprecedented customer demand."

TIM STACEY
CHIEF EXECUTIVE OFFICER

IN BRIEF

- Progressed our strategic agenda, responding rapidly to the fast-changing operating and trading environment.
- Gained market share through our integrated retail model, demonstrating the strength of our business model and our ability to attract customers through digital and physical retail channels at scale.
- Significant ESG progress since launch of new strategy in September 2020, with progress across all target areas and a good consumer response to our newly launched sustainable ranges including our partnership with Grand Designs. Formation of Responsible and Sustainable Business Committee to ensure Board oversight of ESG strategy.
- As we enter a new financial year, the Group is very well positioned to build on its market leadership position in sofa retailing and to target further growth as we invest to strengthen our business platforms and extend our retail proposition into adjacent product categories.

Values-led leadership

Our 'Be Real' core value is about accepting each other for who we are and respecting each other as part of one big family. Embracing diversity and inclusion is therefore a key focus for the Group. We've been listening, learning and educating ourselves about different races, genders, abilities, sexual orientations, religions and nationalities, with the aim of being a Group where "everyone is welcome".

Chief Executive's report continued

OVERVIEW

I am pleased to report a strong recovery in FY21 following a challenging FY20 which was impacted by the early stages of the Covid-19 pandemic. The Group delivered record sales and profit and further extended our market leadership. This performance reflects the benefit of our own historical investments in our online capability, showroom estate and business platforms, a favourable environment for consumer spending on homeware products as well as pent-up demand at the start of the financial year.

Delivering this growth would not have been possible without our loyal colleagues and they all deserve a huge thank you for their commitment and resilience during the year, as well as their unwavering application of our Group core values 'Think Customer', 'Be Real' and 'Aim High', as we have sought to meet unprecedented customer demand.

I would also like to thank all our customers for their continued loyalty and patience in relation to extended lead times as we dealt with exceptional levels of demand and faced disruption to our supply chains. Reflecting shareholders' support during the peak of the pandemic in the spring of 2020, I am also pleased that we are able to repay their commitment to the Group with a year of strong profits, a positive outlook, a strengthened balance sheet and a return to dividend payments.

While furniture and homewares markets have grown strongly, our market share also continues to grow, at least in line with the 2%+ rate that we experienced in the first half of FY21, based on our own proprietary data developed with Barclaycard. I believe that these gains are due to the fundamental attractions of our Group, which I set out in our interim results: the Group's market leadership position, which drives multiple economies of scale; our 'channel agnostic' integrated retail model, which allows us to meet fast changing customer shopping habits; and our sustainable business approach, both in terms of our impact on the environment and preserving our long-term success as a Group. With these strong foundations in place, we believe our strong operating performance will continue and we are set to grow further into the medium term.

FINANCIAL RESULTS

Revenue rose 47.4% on the previous year, or 49.6% on a comparable basis (excluding Sofa Workshop, which was sold in September 2020), however our FY20 revenues and profits were severely impacted by the pause in deliveries for the majority of the final quarter to comply with Covid-19 restrictions. A more representative, pre-pandemic comparator period is therefore the pro-forma 52 week period ended 30 June 2019[1] ("Pro-forma FY19"). Against this period, FY21 revenue increased by 7.2% (+9.7% excluding Sofa Workshop). This performance reflects market share gains as well as the ongoing benefit of a shift in consumer spending to home-related categories.

Underlying profit before tax and brand amortisation[1] rose to £105.8m compared to a loss of £63.1m in FY20 and an IAS17 profit of £50.2m in the pre-pandemic Pro-forma FY19. Reported profit before tax was £99.2m compared to a loss of £81.2m in FY20. Driven by strong trading alongside a favourable movement in working capital, net bank debt[1] reduced by £138.7m in the period to £19.0m. Adjusting for the working capital position, which we expect to unwind, our year end leverage ended the year within our targeted 0.5-1.0x range. Reflecting our robust underlying cash generation, significantly reduced financial leverage and our positive start to FY22, we recommend a final dividend of 7.5p per share.

As detailed in our June pre-close statement, the Group recognises revenue at the point of delivery to customers and therefore the strong order intake seen in the final quarter of FY21 will benefit revenues and profits in FY22. We address current year prospects in more detail in the Financial Review.

OPERATIONAL UPDATE

One of our fundamental advantages is our increasingly integrated sales model. Our integrated retail ambition puts the customer at the centre of our business and aims to deliver a customer journey that is consistent across all our sales channels. The strength of our digital infrastructure and the Group's integrated approach proved invaluable as we have adapted to the rapidly-changing retail environment. Our digital platforms allowed us to rapidly redeploy showroom colleagues into online sales and customer service roles during those periods when our showrooms were closed.

Due to restrictions around showroom openings in the year, the strength of our online sales was a clear highlight of our integrated approach, and a key point of differentiation versus our specialist competitors. Gross sales[1] via our online channel increased by 184% compared with a year earlier and in lockdown periods our market share gains were particularly elevated.

Our strong profit delivery was achieved despite a number of operational challenges in the year, principally disruption due to the Covid-19 pandemic and external supply chain factors. Our management of Covid-19 benefited from our learnings in the previous financial year, as we were once again required to close and reopen showrooms at different times according to national restrictions, often at short notice. The safety and wellbeing of our customers and colleagues remained our priority throughout. Colleagues have been regularly reminded to adhere to our health and safety "Golden Rules", which remained in place throughout the financial year.

Performance throughout the year was particularly affected by shipping disruption from the Far East and raw materials supply issues relating primarily to foam availability in Europe. We have also faced internal and external manufacturing capacity and delivery constraints and cost inflation due to high levels of demand for our products.

1. Refer to pages 33 to 35 for APM definitions.

Chief Executive's report continued

As we stated in our interim results, in relation to Brexit, limited disruption has been experienced to date and we continue to believe that the Group is well placed in its key markets following the UK's departure from the EU.

REVIEW OF STRATEGIC PROGRESS

The aim of our strategy is to lead sofa retailing in the digital age. The strategy is centred on three interrelated pillars (Drive DFS Core, Build The Platforms and Unlock New Growth) across which we identified initiatives to drive £40m of incremental pre-tax profit as originally set out in 2018.

We are pleased with our strategic progress, particularly in relation to the strength of our digital infrastructure during the pandemic and the growth and integration of the Sofology acquisition. While our FY21 PBT and current FY22 PBT guidance indicates that we are well down the road in relation to our original profit targets, we still see significant growth potential across the Group. We provide a progress update on the individual pillars below.

DRIVE THE CORE

The DFS brand is the largest and most profitable in the Group, accounting for c.80% of Group revenue and brand contribution[1] in the last financial year. The key priority of this strategic pillar is to drive the growth of the DFS brand across all our channels. Key initiatives in the year centred on delivering further enhancements to our seamless customer journey, developing new innovative products and making improvements to our showroom estate and customer service provision.

Our integrated retail investment programme encompasses a range of initiatives including: continuous enhancements to our website with a focus on imagery, page load speeds and checkout; further investment in text chat to deliver an improved customer experience; shared baskets in place to support the customer journey across website and showrooms; improvements to our resourcing and reward models, driving greater efficiency and conversion; and the development of a consistent approach to refreshing our showroom format. Reflecting the strength of our websites, we have begun to focus our efforts on pursuing a range of opportunities to grow our total addressable market by targeting incremental product sales from items, such as beds and homewares, that we are not able to range extensively in our showrooms.

Attractive, exclusive products are a key point of differentiation versus our competitors and we continually refine our use of data and insights to improve our customer targeting, range management and new product development. This allows us to maximise the customer appeal of our product portfolio, ensure there are no gaps in the key style groups, promptly replace any underperformers and increasingly embed sustainability in our ranges.

A product launch highlight in the first half of the financial year was our aspirational 'Halo Luxe' luxury leather range with its own product-led TV advertising campaign. In the second half we introduced our new partnership with 'Grand Designs' for a new range of sofas combining design integrity and a sustainability ethos. We've also expanded our bed offer, featuring exclusive ranges from our brand partners Joules and French Connection, as we target incremental growth from this sizeable market opportunity. Finally, reflecting DFS's status as Team GB's official Olympics homeware partner, we launched the new limited edition Yuttari range to both honour and help provide relaxation for our elite Team GB athletes on their journey to Tokyo.

We're constantly seeking to improve our customer proposition and develop new innovative services to engage customers. Consistent surges in demand as we reopened our showrooms following various national government lockdowns highlight just how much customers appreciate our well-invested showrooms. We believe the combination of digital and physical is the right long-term approach to address consumers within the sofa market.

We continued to invest in showrooms in the year, scheduling works during lockdowns where possible to minimise disruption on trading. We are undertaking a programme to update our showrooms, which includes space optimisation of Dwell and former Sofa Workshop space, relocation of the administrative area, and an improved layout for customers. These changes typically result in a significant increase in upholstery bays boosting productivity. In FY21 we completed 16 refurbishments and plan an additional 16 in the current year. Our online appointment booking service remains popular with customers and we continue to evaluate our live 'video in store' proposition.

Customer service helps drive our brand reputation and therefore remains a key area of focus, particularly given the twin challenges of the pandemic and supply chain disruption. I highly value our customer service, delivery and repair teams who continue to work incredibly hard on behalf of our customers. We track customer satisfaction by monitoring Net Promoter Scores ("NPS") at various stages of the customer journey. Our post purchase NPS score for the DFS brand remains around its all-time high at 86.4% (FY20 85.7%). In contrast, our established customer satisfaction score declined year-on-year to 30.7% (FY20 42.1%), reflecting the volatile supply chain environment. Based on a survey sent to customers four months after delivery, this June figure captures those customers most impacted by delivery delays caused by disruption to shipping as a result of Covid-19 and raw material supply. We are working very hard to mitigate these factors outside our control and are in the process of centralising our customer service activities to deliver improved service levels from a more efficient and flexible Group-wide platform.

While we've achieved significant progress in the year, we are only two years into our strategy and seeing no shortage of opportunities to extend the market leadership of our core DFS brand.

BUILD THE PLATFORMS

This strategic pillar focuses on Group-wide benefits from utilising existing infrastructure and scaling systems, processes and data. As a market-leading, vertically-integrated business, we are targeting significant efficiency gains from our property, logistics, marketing and manufacturing activities.

In recent results presentations we've highlighted the attractive characteristics of platform-led retailers, which include greater commercial, operational and technical resilience, delivery of valuable customer data and insights and increased scale and reach.

In FY21 our focus was on achieving ongoing cost savings and efficiency targets across our showroom property estate, driving a range of marketing efficiency improvements, and continuing our plans to develop the best two-man sofa delivery company in the UK.

1. Refer to pages 33 to 35 for APM definitions.

Chief Executive's report continued

We continue to make good progress securing property savings, through a combination of rent reductions on leases approaching renewal and downsizing some showrooms. Last year we secured a further £1.3m of annualised savings, bringing the total annualised saving since the program began to £5.6m. We are confident of achieving the £6-8m targeted annual savings by FY23 as previously communicated. We expect to achieve further savings in the medium term as leases expire beyond FY23.

Turning to logistics, we have delivered another year of progress in our objective of building a leading Group-wide logistics platform, The Sofa Delivery Company. Our aim is to improve efficiency, including improved customer service and a more flexible working environment for colleagues whilst also reducing the Group's environmental impact.

Our development plans are on track as we target annualised savings of at least £3m from the end of the current financial year. We are currently integrating our logistics IT systems across the Group, a key enabler for multi-brand order fulfilment, and will complete roll-out of our delivery vehicle routing and inventory management systems across all vehicles in the re-branded fleet by the end of FY22.

Following the completion of our colleague consultation process and the creation of an independent logistics subsidiary, the Sofa Delivery Company is now able to offer Group-wide extended hours delivery to customers seven days a week, increasingly important given customers' busy lifestyles.

Our ongoing marketing transformation programme continues to move ahead at pace. Alongside our focus on data and insights to drive our omnichannel marketing investment, we have recently reviewed our DFS retail brand activities which has resulted in the appointment of a new communications agency, to help support and drive the next phase in our DFS retail brand marketing. Additionally, we are currently reviewing our marketing production and automation capabilities in an effort to secure further efficiencies across our key customer communications channels. Finally, we are leveraging our marketing capabilities across the group, enabling our Sofology marketing colleagues to adopt and adapt our Group econometric modelling platform to help inform their marketing and channel mix investment strategy.

UNLOCK NEW GROWTH

Our third strategic pillar is to 'Unlock New Growth' from commercial initiatives beyond our core DFS brand. Our main priority in the last financial year has been to accelerate the roll-out of the Sofology showroom estate to support its development into a leading nationwide sofa retail brand. This pillar also covers growth opportunities derived from our Dwell homewares brand and our overseas showrooms in Spain and the Netherlands.

SOFOLOGY

We are making good progress in our plans to develop our Sofology brand into a nationwide business. Despite headwinds of shipping delays and foam disruption, Sofology delivered sales and brand contribution[1] growth of c.4% and 20% respectively compared with the pro-forma FY19 pre-pandemic year.

Following a pause in planned openings in FY20 as we assessed the impact of the pandemic on the property market, we opened five showrooms in FY21, with new outlets in Hove, Stockport, Swindon, Cambridge and Maidstone, to give a total of 50 UK showrooms. In the current year we anticipate opening a further eight showrooms.

Sofology has a reputation for fun, style and sustainability, and we're committed to retaining the brand's aspirational appeal in a Group context. Following on from our successful Owen Wilson campaign, Sofology's latest advertising sees Helena Bonham Carter encouraging customers to 'bring imagination to life' in the way they make their homes.

New product launches in the year included the Pioneer 'eco' sofa in the first half, featuring zero foam, 100% recyclable springs, sustainably sourced timber, fabric made from recycled yarns plus a 20-year guarantee. Just before the year end, Sofology introduced 'Loop', a flexible, sustainable upholstery rental service, whereby customers can select a stylish, fully recyclable sofa on a 6-18 month rental plan with options to renew as required. At the end of the customer agreement, each part of the sofa can be repurposed or recycled, ensuring nothing goes to landfill. We have also recently introduced three exclusive sofa ranges from the Paloma Faith Home range, including the aptly named Rock N Roll model.

We continue to see the opportunity to grow the Sofology brand to 65-70 outlets in the medium-term, targeting revenue of c.£300m at a pre-tax profit margin of 5-7%.

DWELL AND INTERNATIONAL

As detailed in last year's results, we restructured Dwell's operations to enable its wide range of attractive products to be sold more seamlessly to DFS customers, as well as online.

Dwell's integration into the DFS brand operating structure resulted in the elimination of the operating losses incurred in the previous year and a more efficient real estate footprint as we integrated Dwell's offer into the DFS showrooms and progressed the closure of Dwell's remaining standalone retail outlets. Dwell's sourcing expertise and supplier relationships are also contributing to the development of DFS's extended homeware offer.

With a total addressable market of c.£5bn, we see the beds and non-upholstery living room market as a particularly attractive growth opportunity for the Group. We are able to leverage many of the Group's assets, including manufacturing capability for upholstered furniture, web and logistics platforms, marketing expertise and brand partnerships to develop a truly compelling bedroom offering. Sales of beds through our online channels were particularly strong in the year and we continue to develop our showroom proposition in selected key locations.

We continue to review our growth options for our international business, which includes six showrooms in the Netherlands and two in Spain.

INVESTOR EVENT

Reflecting upon the operational volumes currently in the business and our focus on looking after our customers and colleagues to drive long-term value creation, the Group has decided to defer the investor event planned for November 2021 until Spring 2022. This event will provide investors with a detailed update on the development of our various platforms alongside an opportunity to view the latest evolution of our DFS and Sofology growth strategies. We also look forward to providing more details on our manufacturing investment, as well as our plans to grow our sales of living room furniture and beds.

1. Refer to pages 33 to 35 for APM definitions.

Chief Executive's report continued

ESG

We remain guided by our Group purpose, which is to bring great design and comfort into every living room, in an affordable, responsible and sustainable manner. FY21 has been a year of progress on a range of fronts for our key stakeholders, as detailed below.

Whilst the achievement of our record financial results is undoubtedly a highlight, this performance would not have been possible without the strength, resilience and spirit of our people. The Group has a unique culture underpinned by our core 'family' values of 'Think Customer', 'Aim High' and 'Be Real'. Rising to challenges at work and at home, our colleagues have enabled the Group to emerge from the pandemic much stronger than when we entered. On behalf of the management team and the Board, I would like to thank all our colleagues for their sterling efforts in the year.

We launched our ESG strategy in September 2020, with a strong focus on the Environment based on our "Sofa Cycle" approach and have made solid progress against our Phase 1 targets in the last 12 months. One of the highlights of the financial year was our first ESG Supplier Conference in March, which is available on our Group corporate website. As well as featuring contributions from 'thought leaders' such as CDP Co-Founder and environmental expert James Cameron, the Conference set out our intent to work with our suppliers to innovate and develop new ways of making our products and our business even more sustainable and transparent. In June 2021, the Group undertook a formal materiality assessment, supported by a third party expert, in order to identify and prioritise all of the Group's sustainability risks and opportunities.

Given ESG is a rapidly advancing subject, with increasing Board time dedicated to it, the Group has established a Responsible and Sustainable Business Board Sub-Committee, which will meet at least three times per year. Responsibility Champions have been appointed at all levels of the business, ESG Working Groups established for each brand and external expert partners are in place to support us. We have recently introduced our Phase 2 ESG targets, which include an increased focus on Social criteria and incorporate our work on diversity and inclusion.

ENVIRONMENTAL

Sustainability is a key element of our business model, and having launched our ESG Strategy in September 2020, we've come a long way in a short amount of time and are excited about the opportunities ahead. With the Group's 'Sofa Cycle' based on the circular economy concept, sustainability is increasingly embedded across the Group.

A key focus in FY21 was on our finished products and the resources used in manufacturing them. We have driven positive change, particularly in relation to the sustainable sourcing of some key materials in our sofas. Phase 2 targets expand our focus to cover textiles and material certifications.

SOCIAL

The wellbeing of our colleagues has remained a top priority during the last financial year. We continued to follow various government rules and regulations in our various markets during the period and regularly reminded our employees to observe our five Covid-19 'Golden Rules' to keep colleagues and customers safe. As we anticipate a hopeful return to more 'normal' lives, we've been surveying all our employees on their ideal working conditions as well as providing extensive wellbeing support. During the summer we've also been refurbishing our Group Support Centre and Sofology head office in preparation for a more flexible hybrid working approach.

Our 'Be Real' core value is about accepting each other for who we are and respecting each other as part of one big family. Embracing diversity and inclusion is therefore a key focus for the Group. We've been listening, learning and educating ourselves about different races, genders, abilities, sexual orientations, religions and nationalities, with the aim of being a Group where "everyone is welcome." For example, in the second half of FY21 we celebrated the range of international languages spoken across the Group, International Women's Day and Pride month. With our 'Everyone Welcome' ambition in focus, I'd like to issue a warm welcome to our newly appointed Non-Executive Director, Loraine Martins OBE, FRSA. Loraine brings tremendous experience of supporting employers to develop equality, diversity and inclusion in the workplace.

GOVERNANCE

The Group continues to be rated highly by external assessors for the strength of its governance, maintaining a robust corporate governance framework, practices and policies to manage and deliver long-term success for the Company, including (but not limited to) Board composition, Audit Committee structure, executive compensation and whistleblowing.

CURRENT TRADING

As detailed in our year end trading statement, strong customer demand in the final quarter of FY21 was already expected to underpin revenues and profits in the first half of FY22. Order intake has also remained strong in the current financial year to date, well ahead of our previous scenario of +7% growth on FY19, resulting in an order bank that continues to grow and which in absolute terms is very significantly ahead of normal levels. This order intake provides significant resilience, and confidence in our outlook. However the constraining factor on our reported short-term financial performance will be our pace of conversion of the order bank which depends on both our supplier partner manufacturing capacity and also the capacity of our proprietary logistics operations. We believe the Group is well placed to achieve the medium scenario of our range of FY22 profit outcomes identified back in June.

We already have increased output capacity significantly in FY21. We continue to strengthen our operations, increasing warehouse capacity and resourcing levels, to meet customer demand. Notwithstanding this, it should be recognised that the short-term operational environment continues to be exceptionally uncertain and difficult, given well-reported logistics disruption, cost inflation pressures and unplanned Covid-19 absences.

We believe that we have the right plans in place to mitigate these impacts, underpinned by our scale, operating experience and long-standing relationships, and we are focused on delivering good customer service, protecting our colleagues and creating long-term value.

CONCLUSION AND OUTLOOK

Our record profits delivery in the last financial year is a fitting tribute to all the hard work of our colleagues and testament to the resilience and flexibility of our integrated business model. Despite numerous operational challenges during the pandemic I'm proud that we have remained focused on our strategic agenda to lead sofa retailing in the digital age and are on track to achieve the incremental £40m of profit benefits set out in 2018. We also see further growth opportunities into the medium-term derived from extending the reach of our retail brands and optimising our operating platforms.

As we enter a new financial year, the Group is very well positioned to build on its market leadership position in sofa retailing and to target further growth as we invest to strengthen our business platforms and extend our retail proposition into adjacent product categories.

We emerge from the pandemic stronger than ever. This strength is underpinned by our fantastic teams who have worked with dedication, care and enthusiasm despite the many and varied challenges we have faced. I want to personally thank every single colleague for their unwavering support and look forward with huge optimism, fuelled by the position the business is now in and most importantly the spirit, commitment and loyalty of our people.

Tim Stacey

Chief Executive Officer
23 September 2021