Half-Year Results FY2019

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Introductory Remarks

Tim Stacey

Chief Executive Officer, DFS

Welcome

Good morning everyone and welcome to the DFS results presentation for the 22 weeks ended 30th December 2018. I am pleased to be joined here by Nicola Bancroft, our CFO, who will walk you through the financials, but sadly, for the last time, because she has decided to retire. I will save my goodbyes and thank-yous to the end. I am also joined by Mike Schmidt, whom many of you know. He has been our Chief Development Officer and recently also the Chairman of Sofa Workshop and Dwell. Mike will become interim CFO from 1st April and he will join us for the Q&A session at the end.

I will now briefly run through some financial and operating highlights, and I will shortly hand over to Nicola to take you through some of the details on the numbers.

Financial and operational performance on track

In terms of our financial and operational performance, we are firmly on track. We are pleased with the performance of the group in the first five months of our new financial year, with all of our brands recording like-for-like revenue growth. If you look over the course of the last 12 months to December 2018, compared to the last full financial year, you can see good performance and revenues, nearly £966 million, which are up 10.9%. That has been driven by underlying growth of 4.1% and also four additional months of Sofology ownership year on year. That has driven an underlying EBITDA of £84 million, up 10.4%, and underlying PBT of £44 million, up 14%. The group has continued to generate cash flows of £74 million, and that is an 88% conversion ratio.

In terms of operational highlights, I will bring out a few examples now just briefly and provide more detail later on. I will start with our partnership with a leading AI provider, Satalia, where we have been using data and predictive learning to really develop our supply chain systems. We have also had a continued step-change in our mobile websites, across all brands but particularly in DFS. We continue to open showrooms and here is an example of our latest Sofology store in Plymouth, one of the first stores on the south coast, and that is trading incredibly well. Finally, we continue to launch some great partnerships with brands such as Joules, and our yellow Chesterfield here, the Windsor, is one of our great favourites.

I will now hand over to Nicola and I will return later to talk about our new strategy.

Financials

Nicola Bancroft

Chief Financial Officer, DFS

Financial overview

Thanks Tim, and good morning to you all. Aligned with our previous results announcements we have presented, we have shown our performance over the last 12 months, which we believe is the right way to look at our performance, as well as our half-one performance,

which, just to reiterate, is a five-month period. We have also called out our performance including Sofology on a pro forma basis to include their results for the full five months of the prior year.

I am going to kick off with a high-level overview of our performance over the first five months of this financial year. Revenue of £422.3 million was up 29.1% on the previous year. Adjusting to include Sofology for the full five months of the previous year, the growth rate was 9.9%. This reflects what we believe is a solid performance in a challenging market with all brands in growth. Underlying EBITDA of £32.8 million was up 31.7%, with Sofology performing well and contributing £6.1 million of EBITDA for the period. Underlying PBT was up 50.9% and these results were in line with our expectations.

Now moving on to our performance over the last 12 months, when comparing to our last set of annual results to July 2018, our underlying revenues were up 4.1%, adjusted for Sofology. All brands grew their revenues, with DFS and Sofology both up £16 million and Dwell and Sofa Workshop collectively up £6 million. Underlying EBITDA of £84 million was up 10.4% and PBT up 14.1% to £43.7 million.

Looking forward and based on our projected capital requirements, we are proposing that we maintain our interim dividend of £0.037 per share.

Drivers of group revenue growth

Looking at our top line, group like-for-like revenue adjusted for Sofology was up 6.6% and this growth was driven by strong online performance, with that channel up 22.6%. We believe this was a good performance but do recognise that this was bolstered by purchases likely to have been deferred from the hot weather period in the final quarter of the previous financial year.

We were particularly encouraged by all brands managing to grow their like-for-like revenues. DFS, our largest business, grew total revenues by £16 million, or 4.4% like for like. This was driven by online revenues growing at 21.1%, as well as growth in revenues from our showrooms.

Sofa Workshop and Dwell grew their revenues by £6 million through a combination of like-for-like growth and a weighted average of 14 additional showrooms, year on year.

Sofology, benefitting from the reintroduction of TV advertising, which annualised in November 2018, grew like-for-like revenues by a total of 14.2%, with online growth of 42.1%, as well as double-digit growth in showroom revenues.

EBITDA progression

Turning to EBITDA, our underlying EBITDA for the five-month period, has increased 31.7% to £32.8 million. Excluding Sofology, EBITDA grew by £3.8 million, with the main driver being the revenue growth, which resulted in £12 million of additional gross profit. A broadly flat gross margin percentage was the result of FX rate benefits being offset by cost inflation and slightly lower margins in Dwell and Sofa Workshop. Our selling and distribution costs largely flexed in line with revenue. Our property costs have benefited from recent landlord negotiations, which have started to flow through now. Property costs overall though have increased due to the rollout of new stores and CDCs opened in the prior year. Investment in

additional capability to deliver group-wide growth initiatives, along with associated team restructuring costs, drive the increase in administrative expenses.

The Sofology business contributed £6.1 million in the period, a £4.1 million increase on the prior year, reflecting the additional four months of trading and the like-for-like sales growth. The business is trading well and we are seeing the impact of synergies in the numbers, with £1.5 million EBITDA realised in the P&L in the 12 months to December 2018.

We expect to incur £5 million of non-underlying costs across both FY2018 and FY2019 to deliver a run rate of £4 million of synergies by the end of FY2019, as we have previously disclosed.

Cost base

With regard to our cost base, our group EBITDA margin has increased from 8.4% at the last year-end, which included Sofology on a pro forma, full-year basis to 8.7% at December 2018. The DFS brand contribution has increased from 27.4% to 27.7%, which is driven from the revenue growth and the impact of operational leverage. The Dwell and Sofa Workshop brand contribution has decreased marginally from 17.6% to 17.5% due to promotional mix.

The Sofology business, whose brand contribution has increased from 20.3% to 22.6%, is benefiting from both synergies and its growing top line. We see further benefits available to the group from starting to manufacture some Sofology products; we have plans in place to do so in the second half of FY2019. We are also well progressed to deliver synergies on other significant cost lines, as well as through the top line.

In relation to our fixed costs, our rents on the existing estate are generally trending downwards through re-gears. Given the current climate and the renewal dates on our leases, we see further opportunity to reduce our rental bill. We also see further opportunity to leverage the group's scale and, where appropriate, co-locate brands together to ensure we optimise our retail assets. There will also be an opportunity to downsize and in a very small number of instances close some stores.

Across the group we have commenced a number of projects to ensure we leverage our scale across all brands with the objective of improving our brand contribution margins as well as the overall group EBITDA margin.

Investment in infrastructure for future growth

Turning to capital expenditure, our full-year guidance of £24–26 million for FY2019, as stated at our previous results presentation, still stands. We are taking a conservative approach to investment, given the current market environment. However, our levels of growth investment are being maintained. We continue to focus the allocation of capital where there is a proven and positive return and are opening four new showrooms in FY2019, as well as continuing to regularly invest in our web platform and also in our distribution-related technology to drive efficiency improvements. We also continue to invest in our existing estate to ensure it remains in great shape.

Excellent cash generation continues

With regard to cash and net debt, our cash flow for the LTM period to December 2018 has been strong with £74.1 million of free cash flow generated. This represents an underlying EBITDA to cash conversion of 88.2% driven essentially by volume growth. Our cash

conversion remains strong, as we continue to focus our investments on those providing a short payback period.

Closing net debt of £158.1 million at December 2018 represents a significant year-on-year reduction in absolute terms, down from £184.4 million at December 2017. Net debt remains similar to July 2018 reflecting the typical operational seasonality and the timing of the final dividend payment. With increased profitability, however, our gearing ratio has strengthened to 1.9 times from the year-end position of 2.1 times and we continue to target a return to a gearing ratio of 1.5 times or less over the near term as we complete the pay down of the Sofology-related acquisition consideration.

Return on capital

Our lease-adjusted return on capital has increased slightly since our last year-end, increasing from 15.6% to 15.7%. The increase is due to higher operating profits more than offsetting an increase in our capital employed, which has come about from reflecting a full-year impact of the Sofology leases and also the acquired Multiyork leases. We expect our lease-adjusted return on capital employed to grow in the future as we grow our profitability, reduce our rental expense and optimise our retail assets as I have previously alluded to.

Key financial metrics

Finally, looking at our key financial metrics, we currently focus on four which we think will underpin long-term shareholder returns. Firstly, our top line: our underlying gross sales growth. If you adjust to include Sofology for a full year, we have grown gross sales by 4.1% on an LTM basis and our target is to grow our sales by more than the market growth levels, which we expect to be around a 1–2 percent decline in the short term given the current climate.

Secondly: our PBT margin. We have increased this by 127 basis points on an LTM basis. Our target is to continue to grow this through driving efficiencies across the group. This is something that Tim will discuss in more detail later.

Thirdly: continue to generate high levels of cash. As previously stated, we generated over £74 million in the last period. Our focus is to continue converting EBITDA to cash at sector-leading rates of over 70%.

Finally, and largely as a culmination of the previous metrics, we seek to grow our lease-adjusted return on capital employed by having an ever-tightening focus on investment to ensure we are investing in the right places that will drive the highest levels of returns.

I am now going to hand back to Tim, who will discuss our new strategy.

New Strategy

Tim Stacey

Chief Executive Officer, DFS

Approach to strategic review

Thank you, Nicola. I would now like to spend some time walking you through our new strategy and first of all, to provide a quick overview of the approach that we have taken.

To start off with, we have looked at the business from an external perspective, with the goal of ensuring we understand the latest consumer trends, tastes and expectations. We have also looked at our competition, how that is evolving and the threats that we may face going forward. We have spoken with a wide range of stakeholders to obtain feedback on our business to ensure we have a complete picture of what our strengths are and where our weaknesses are. We have then looked internally at our business model, looked at the value chain to understand where we are truly adding value and indeed what we are doing that may not be as important to the customer, so we know what we can improve. We have also carried out extensive customer research, looking at customer segmentation, understanding the role that our different brands play and how we win in each customer segment.

I will go into these in a bit more detail in the following slides but it is worth mentioning on a spectrum of evolution to revolution, we are probably closer to the evolution side of things. We want to build on the great brands that we now have in our group. We want to utilise the amazing people we have and embrace new technologies that are available to us to grow our business and provide great returns for our shareholders.

Our strategy will be based around three key principles. Firstly, we are going to focus on what customers truly value in their sofa-buying journey. Secondly, we are going to prioritise our investments and our resources on those opportunities that we believe will provide the strongest returns. Thirdly, we are going to execute at pace in the right way for customers, our people and our shareholders.

Continuing to build a strong, competitive position…

Today we are in a very, very strong position and we wanted to just stand back and outline that to you in terms of our competitive position. DFS this year is 50 years old and we have had some hard-won business model strengths. We have inherent advantages relative to our competition. With around a 31% market share of the sofa market, we are three times larger than our nearest competitor. We have unrivalled scale. With the acquisition of Sofology, together with Sofa Workshop, Dwell and DFS, we believe that we have complementary brands that address all customer segments. We have well-invested showrooms, websites and supply chain and our vertical integration enables us to have end-to-end control of the customer journey, from design and manufacture to delivery and post-sale customer service, enabling us to optimise quality, reduce lead times, deliver efficiently for our customers and meet shareholder expectations. With our made-to-order business model and supplier credit terms, we operate with negative working capital and generate strong cash flows, as Nicola has outlined. To top it off, we have, in our opinion, the best people in this sector. We treat them well, we reward them well and we have just been voted in the top 25 *Sunday Times* big companies to work for.

What is the so-what? It enables us to drive sector-leading operating margins, to continue to grow our market share, to generate strong cash flows that enable us to keep investing in our business.

In conclusion, we have a very strong business model that is resilient in the tough times and also well set for future growth.

...with an increasing emphasis on the omni-channel customer

There is an increasing emphasis, clearly, in retail on omni-channel. The great news is that our business model is already well set up as we play in every single segment of the consumer-to-customer journey. We also know through independent customer research that consumers start their sofa-buying journey, increasingly, online, with over 85% of customers starting their journey through the web channels. Importantly for a business with a number of showrooms, nearly 90% of customers visit a showroom prior to purchase. The sit and feel test is very important in this market and the number-one reason why customers either choose to buy or not buy a sofa is comfort. Therefore, the combination of the web channels and the showrooms is very important as we go forward.

Changing external market dynamics

We are acutely aware of the changing external market dynamics. Consumer shopping habits, as we all know, are rapidly changing. Consumers are researching and transacting online with ever-growing expectations. Seasonal purchasing cycles are shifting, with new sales periods such as Black Friday emerging, and we are facing new forms of competition that play by a different set of rules and have very significant financial backing. We know we are seeing increased levels of volatility in the UK market as a result of the uncertainty from Brexit and that is impacting on consumer confidence levels. This external context drives our imperative to evolve and adapt our business, providing us with opportunities to grow our market share, and this moves me nicely on to our new strategy.

New strategy for the group

The new strategy for the group is based on the strategic principles we outlined earlier: really understanding what our business model's strengths are, very detailed customer research and really taking into account the new consumer trends that are out there. The strapline for our strategy is quite simple: it is about leading sofa retailing in the digital age.

If I just unpack that for you: leading, we are the market leader, and we intend to strengthen our position, lead from the front and play to win. Sofa retailing: that's what we do, we have been doing it for 50 years. 95% of what we sell is sofas and we are going to focus on the sofa market using our vertical integration and strengths to win. The digital age: well, we embrace all of the opportunities and the challenges that the digital age presents for consumers and our colleagues. So, leading sofa retailing in the digital age is the strapline that unites us as we go forward.

Leading sofa retailing in the digital age

Our strategy is centred on three inter-related pillars, across which we see £40 million of incremental profit opportunity in the medium term. This is spread broadly and equally across these three pillars.

Firstly, we need to drive the performance of the DFS brand. This is the largest, most recognised and most profitable brand in the group, with very successful and well-invested store estate and online proposition. We are going to renew our focus and energy on this brand across all of our channels.

Secondly, we will build the platforms to enable future profitable group growth. One of the great things about DFS's market-leading operating margins is they are a result of both sales

intensity and operational gearing, driven by scale and expertise. We have strong foundations and we have the opportunity to develop our systems and processes, utilise existing assets and infrastructure to enable further group-wide benefits in the medium term. Good work is already being made in this regard, including the introduction of a new stock management system and in-day customer order tracking. We have also delivered the £1.5 million of synergies with Sofology and that is through a combination of utilising our buying power and sharing best practices across the group.

The third pillar is about unlocking new profitable growth. Clearly, growing the Sofology business will be a priority for us but we will improve the profitability of Dwell, Sofa Workshop and our Netherlands business.

Each of these pillars has three elements to it. In terms of driving the DFS core business we are always thinking in an omni-channel mindset. We want to develop a totally seamless customer journey across all of our channels; that is the first element. The second is we want to continue to seek to enhance our product offer and innovation to ensure we have great products for all customer segments at DFS. Finally, under the driving DFS core, we are going to work very hard on providing great customer service across all of our channels.

In terms of the second pillar, building the platforms, we are going to focus on operating efficiently and effectively and drive cost reduction, especially through our property portfolio, which I will come onto later. We are going to optimise our supply chain, our market-leading two-person delivery network and how we utilise that across the group. Finally, as you all know, we like marketing, so we are going to look at our marketing investment and use data and insight to really drive that investment across all of our group.

In terms of unlocking new growth, I will talk about Sofology in a moment but growing the Sofology business to be a national chain is very important to us. We will improve the profitability in Dwell and Sofa Workshop, again with a combination of online and the right number of showrooms. Finally, we will really go after our international business in the Netherlands.

Today I just want to spend a brief bit of time talking about four of these elements and we will come back to the remaining ones in future presentations.

Drive DFS core

Firstly, omni-channel for DFS. With 50 years of heritage this year, 117 showrooms in the UK and Ireland and a market-leading and winning website, the DFS brand has the sector-leading omni-channel proposition, generating over £700 million-worth of revenues in the last 12 months to December 2018. Our brand is supported by 1,800 highly-engaged, highly-trained sales and customer service colleagues, who enjoy working for us and are very engaged, as evidence by being recognised as a top-25 big company to work for. In addition to the strong promotional and core DFS ranges, we have been developing partnerships with a number of leading lifestyle brands now, which, together, enables us to hold the leading market share with every customer segment that we play in. Our exclusive brands partnerships are now worth 17% of the overall DFS sales.

We have a unique and differentiated sofa offering and during the last 12 months we have engaged with a world-class data science partner, a company called Beyond Analysis, to help us develop new data-led optimisation of our ranges and distribution. We have also recently

set up a new innovation team to develop new customer propositions and we have started trialling ranges through online customer panels before piloting them through our showroom presence. We are very interested in launching all sorts of technology to help our customers on their journey. I think last time we talked about launching augmented reality last year. We continue to invest in our web platform and digital engagement tools; that is starting to see some accelerated growth, with the DFS web channels up 21% year on year in the five months to December 2018. Over recent years, we have made significant investment in the DFS showrooms, opening between our guidance of 3–5 per year, ensuring our like-for-like estate is also well maintained. Having now established strong national coverage across the UK, we are going to focus our investment on increasing the efficiency of our existing estate and on omni-channel technologies to drive the business forward. We will, however, continue to test and learn with the smaller-format showrooms and develop new services to engage customers to provide that seamless customer offer.

Mobile case study

I just wanted to call out one specific element that is really important in the DFS omni-channel journey; that is our mobile site. With over 85% of customers starting their sofa-buying journey online, mobile has increasingly become the first engagement tool for the DFS brand. We have been optimising our mobile site. We have launched a new, AI-driven, automated customer service chat bot, which enables our customers to get the answers to the questions that they have. We have also set up, in the summer, a mobile engagement team, so a group of 20 people engaging in text chat with customers on our mobile site. All of these things combine to help us have a very good rating from ForeSee independent research on our customer satisfaction on mobile at 75%. That is way above the industry benchmark of 68%. Mobile traffic continues to grow; it is now over 60% of all traffic that comes into the DFS website and that is growing. We continue to seek changes to improve the operation of the website and we have driven up average order value over the last few years. You can see on this graph here since financial year 2016 we have managed to increase the mobile commerce average order value by over 11%.

Build the platforms

Coming onto the second example, under build the platforms, regarding our property portfolio specifically, in the past few years we have already leveraged DFS's existing store estate to introduce 33 Dwells and 10 Sofa Workshop showrooms. This creates a national presence for these brands without increasing group property costs. It is an example of leveraging the platforms.

Due to the footfall that DFS generates and drives to the retail parks, we are in a very strong position in terms of being an anchor tenant on many of the parks that we operate. During financial year 2018, so last year, we started to reduce our underlying property costs through lease and renegotiations and we secured £1.2 million of annualised savings. Over the next five years, we are targeting a further £5–7 million of annualised cost savings across the 42 leases that will expire over that period.

Of the £1 million annualised savings targeted for this financial year, we have already secured £0.8 million in the first half of the year. We do also see further opportunities to co-locate our brands to ensure we optimise this as a fantastic asset for the business.

Unlock new growth

Sofology

The third example I give, under the 'unlock new growth' pillar is all around growing our Sofology business. The development of Sofology to become a national chain is a clear priority for us, building on its very strong and distinct customer proposition. We have put in place a new leadership team, we have made great progress on the synergies and are very pleased with the brand's trading performance, with strong top-line growth based on its distinctive omni-channel proposition. Total revenues for the five-month period on a pro forma basis were up 20.4% year on year, like-for-like revenues at 14% and EBITDA for the five-month period was £6.1 million. We have opened five new showrooms in FY2018 and more recently in 2019. They are trading well and provide us with confidence to open more, given the significant gaps in the Sofology network. Interestingly, we see clear potential, they have 42 showrooms at this moment in time, of up to 65–70. Out of the top 50 locations where DFS operate, Sofology are only in 22 of those locations so we have clear insight and data as to where to go next. Yes, there is a little bit of cannibalisation with a DFS nearby but it is not material. We have identified a number of new sites already and we plan to phase the openings as and when the right property deals arise from landlord negotiations. We are also going to continue working together with the Sofology teams to develop best practice in terms of omni-channel, sharing all the ideas that we have together. We are targeting over £300 million worth of revenue for the brand in the medium term and we will generate industry-leading EBITDA margins.

Netherlands development

Finally, under 'unlock new growth', as an example, I want to update you on our DFS Netherlands business. Following on from the national TV campaign and various promotions that we have put in place in the Netherlands that we ran through FY2018, we have been testing additional marketing and promotional campaigns. We have also been working with the teams to refine our product offering to further adapt it to the Dutch market. The trading results are increasingly encouraging and across the 50 weeks from the start of our TV campaign, like-for-like sales have increased by nearly 30%. That is inclusive of the trading through the hot weather period that they experienced as well last summer. Now, having gained further insights from these campaigns, we believe that we will see a reduced operating loss in this financial year of between £1–1.5 million and we are targeting a break-even position in the near term based just on the existing portfolio. Before we further commit capital, we want to see evidence of sustained progress but we are pleased that our learnings and investment to date are showing encouraging signs. We therefore intend to continue to develop our Netherlands business and we will keep updating you, next time at the full-year results.

September 2019 and March 2020: more details to follow

As I mentioned earlier, we will cover the other elements of the strategy in more detail at the next set of results. That is around the DFS product innovation and development of our customer proposition. Under the building the platforms, we will talk to you about our investments in the supply chain and how we are driving our marketing efficiency. Finally, we will update you on Dwell and Sofa Workshop.

Driving our key financial metrics

In terms of driving our key financial metrics that Nicola outlined earlier, we intend to be transparent about our progress and monitor and report using a number of measures to demonstrate the impact of our strategy over the following years. In relation to driving the DFS core business, we will track and report our DFS core like-for-like growth, which is a combination of our showroom and our online business. We will also report against our brand contribution margin, which we expect to see growing. In relation to building the platforms, we will report on our operating cost reductions and efficiency achieved and also the revenue and the cost benefits we will get through our data-led initiatives. Finally, with regards to unlocking new growth, we will be tracking the revenue from the non-DFS brands and also the brand contribution from each of our businesses. We will also look at lease-adjusted return on capital employed. The combination of these measures in the way we lay down our strategy will drive the metrics that Nicola outlined earlier: growing our underlying sales ahead of the market, increasing our PBT margin, generating strong cash and in the end growing our lease adjusted return on capital employed.

Market drivers

Turning now to an outlook and looking at market drivers, a quick update on the market environment. Historically we have always tracked three key drivers that we believe influence the underlying activities in the sofa market and they are in order. Firstly, consumer confidence as measured by the GFK consumer confidence index. Most purchases in the sofa market are discretionary. Our customers are not usually sitting on the floor but they do need to feel good about the future before they commit to a purchase. The average levels here across 2018 are down year on year and actually have weakened markedly since November 2018, to around –13%, I think, in February 2019.

Secondly, housing transactions. Our survey suggests that 20% of sofa purchases are driven by new home purchases. The fact that the number of housing transactions is down over 2018 by 2.5% year on year implies a drag of 0.5% on the sofa market. Finally, the third element is around unsecured lending, which actually continues to be strong. Overall, when we stand back, the combination of these factors means that we believe that the market for 2019 is similar, or slightly weaker, than last year. We are expecting a –1% to –2% market decline, again with a clear unknown impact from our favourite topic: Brexit.

To give you a sense of the headwinds that presents, a 1% impact of market growth or decline would feed through to our revenues by the same amount and reduce PBT by around £4 million. We believe that we have the self-help actions in place, as outlined earlier in our strategy, to offset some of this but we have to acknowledge the challenge that that presents.

Briefly, as I mentioned the Brexit process, clearly we have a live situation and we have included in our results statement some additional detail around the effects that a no-deal exit could have. We feel better positioned than many but we are cognisant of the risk that we cannot mitigate around: things like consumer confidence and potential impact of border delays impacting on our made-to-order model.

Whilst I would encourage you to read our written statement, we also believe that we have put in place the protections that we feel we can in order to be prepared for the eventualities.

Summary and outlook

So, to sum up then: we are really pleased with our performance in the first half of the financial year, the five-month period to December 2018, but we do recognise that inevitably we will have benefited from some of the deferred purchases from the last quarter of our last financial year, that May, June and July warm period. However, I do believe that, looking at the data reported by other market participants, I think we have traded well relative to others and are growing our market share. What is driving that is our online channels that continue to perform well across all brands. We believe that Sofology has significant growth potential from a national roll-out. We believe we have the right strategy, which balances the need to invest and drive our DFS business, number one, build our group platforms, number two, and unlock profitable new growth, number three.

The environment since Christmas has, however, been a little bit tougher. We have seen a weaker sales intake across all of our brands. Looking forward, assuming current market conditions continue, we remain on track to hit our profit expectations for this financial year, and our profit outlook remains unchanged.

Nicola Bancroft

Before I end the presentation, I would just like to say a personal and huge thank you to this lady on my right, that is Nicola Bancroft, who is retiring at the end of this financial year. Nicola has been an integral part of the DFS senior leadership team since she joined the business just over six years ago and has been instrumental in taking us from a private equity company to where we are today. As well as being crucial to the business' success, she makes it a fantastically fun place to work, with a laugh that you would not believe. I have had the pleasure of working alongside her, probably for nearly 20 years I think as she has put up with me through my career at Boots and then latterly at DFS, and she is genuinely the most warm-hearted and lovely person you'll ever meet. You will be very sadly missed but we are inviting her back for all the Christmas parties. So, Nicola, on behalf of the board, our chairman is here and some of our NEDs, we would like to say a huge thank you to you for everything you have done, and as I say, you are always welcome back, especially for presents.

There endeth the presentation.

Q&A

Jonathan Pritchard (Peel Hunt): Morning, two if I may, and ironically on a couple of things you did not talk about. Within the core business store opening programme, there was clearly a trial of smaller stores. Has the trial thrown up anything interesting? Will we see more rolled out? Is it just below Sofology in the sort of capital allocation pecking order?

And then just an update on Spain, please.

Tim Stacey: Okay, I will do the small-format one first. We have learned that the 2,500 square foot model is too small for what we want, so the 5,000 square foot model is what we are after. We have just opened a new store, just before Christmas, in White City. It is another one of our trials; it is about 6,000 square foot. We are persisting with the trial to find out how we work the profitability of that model in an omni-channel world. But I think you are right, Jonathan, actually we know, from a Sofology point of view, in terms of use of

capital and the results that we are getting out of standard showrooms for Sofology that we can generate much quicker returns, more certain returns, from Sofology. So it has kind of dropped on the league table of priorities.

In terms of Spain specifically, the business is relatively small in the grand scheme; it is probably around £4 million revenue, £3.5 million revenue, trading at break even, slightly profitable. I think we have seen in the last couple of months a little bit of softening of the ex-pat business, as you would expect from the Brexit uncertainty. However, interestingly, the proportion of Spanish customers is growing to nearly 30%, so we do see that as a longer-term burn and we will wait and see how Brexit plays out before we make any further decisions about that business.

Michael Benedict (Berenberg): Hi, could you give us a sense of your online AOV versus in-store AOV?

Tim Stacey: Yes, I do not think we declare that too much do we, Mike?

Mike Schmidt: Not outwardly, no.

Tim Stacey: No, so what we would say is that the online AOV is lower than our showroom AOV for obvious reasons. In a showroom, you can illustrate to customers very clearly the benefits of a power recliner versus a manual recliner. That is difficult when it is online, so what we are working on is growing our online AOV. That has been very successful. That is about using things like the text chat team. When a customer is in the basket and they have added various products, the text chat team will start to engage and talk about the benefits of whatever it might be. So we are improving our average order value online but yes, it is naturally lower than the showroom AOV.

Caroline Gulliver (Jefferies): Hi, I just wondered if you give us a little bit more colour about the customer reaction to the augmented reality that you have introduced and also just a little bit more colour about some of the AI that you are using in the various systems in the business.

Tim Stacey: Yes, definitely. The augmented reality which we launched, I think we talked about that in October last year, is now across nearly 50 ranges in DFS. The thing that it does is it drives an increased conversion because you can effectively place it in your living room and so start to visualise what the sofa might look like in your living room. So we are seeing, for every range that we put augmented reality on, an increasing conversion. At the moment, the technology is only available on the latest Apple phones and not on Google. As customers start to upgrade their iOS software, we will see an increasing penetration but we are very encouraged by the impact of augmented reality.

In terms of AI, we work with a company called Satalia, who are a leading AI company and actually they are looking at data and initiatives across all of our business. They have focused initially on supply chain, so really is about adaptive learning, really working on the routing systems and learning how the data changes that for customers in a positive way. However, they are now also looking at our showrooms and the profiling of our colleagues in store. They are also starting to look at the impact of our marketing. We are really proud to work with them; they are excellent partners.

Niraj Amin (UBS): Two questions from me, please. The first question is on Sofology. So you have captured £1.5 million of the synergies, so far, annualised; can you share with us some examples of future synergies that you have to gain to get to the extra £4 million?

Tim Stacey: Yes, there are a number there. One of the big numbers is around our marketing: because of DFS's scale in terms of buying TV, or press, etc. we can use that buying power to help Sofology unlock some synergies there, so we are looking at that as number one.

Number two, in terms of improving the gross margins of Sofology, we can start to use our own factories in the UK to manufacture some of their best-selling products. So we are starting to move some models across to some of our own manufacturing, which will help the end-to-end profitability. One of the reasons why the DFS margins are higher than Sofology is we wrap in the profit from our manufacturing in there as well, so we will start to look at which are the most appropriate models to put in. However, we are confident we will get to the run rate of £4 million, by the end of this financial year.

Niraj Amin: And the second question was on the store estate for the DFS core. How well invested do you think that is and how much more cost do you think you need to put in to deliver the growth that you want from the DFS core business?

Tim Stacey: I think we mentioned earlier, in terms of platform, it is a well-invested business. If you go to many of our showrooms across the country, they are in pretty good shape, actually. The fabric of the building, the lighting, everything, we have been investing continually. We see that as maintenance capital. I think it is really important that, as a brand that shows up in an omni-channel world and if you go back to that data point, customers start online and then come into the showrooms for the sit, the experience in the showroom has to be strong and consistent. I think we have not got huge amounts of investment we will be putting into our showrooms; I think we start from a strong base. I think we need to improve the layout and the consistency, but these are not hugely expensive things to do. It is just about executing, operating in a good way.

Caroline Gulliver: One more from me: could I ask for a bit more colour on your quite substantial marketing budget, in particular how much is now sort of traditional TV marketing versus social media and digital marketing? Then how do you think about it as we go through a tougher time economically, in terms of what you may or may not cut or where you may or may not prioritise that budget?

Tim Stacey: That is a good question. We see marketing as an investment, not a cost; that is the first thing to say. It is a fascinating thing about DFS because everybody looks at it from the outside and goes, 'Wow, your marketing budget is really high.' But interestingly, it drives huge amounts of returns. So we work with MediaCom and very expert econometricians there to look at every single pound that we invest across all of the different channels. So we know for every pound that we invest, whether it's in TV, in press, in digital, radio and cinema, we can see the return curves across every single element, and we optimise it to the nth degree. I guess if I stood back over time what has happened is, like all businesses, we have gravitated more towards the digital channels, particularly around search, more and more into social, less in display, so more applied. What we are now doing, working with our AI partners and also with MediaCom very closely, is to try and really target customers who are giving the

buying signals in market. We call it signals and segments. We understand what segment of a customer you are and now, as we have a portfolio of brands, we can show you the right brand for you in the digital world. However, believe me, TV still plays a really key role in our market to drive that awareness of the brands and we have proven that, interestingly, through Sofology. By being back on TV in those five months, versus one month, you see the impact on the like-for-likes. So we will optimise, always, weekly, daily, but I think the shift will be more towards digital.

Mike Schmidt: Just to add to that, from the finance perspective, one of the interesting and helpful additions that you have in that shift towards the digital environment, digital marketing, is the change in the booking lead times that we see coming through as well. Clearly we have a market that we know can move up and down, fluctuate up and down depending on how distracted consumers are, the weather and such like. I think certainly one of the advantages as we increase the level of targeting is the ability to turn on, turn off or increase, decrease the level of marketing spend in the shorter-term time periods. So I think, as Tim was saying, broadcast absolutely remains a standard volume, but that is booked far further ahead in advance. On the digital side of things, certainly, I think we can flex up and down a little bit more.

Speaker: I think last time around you said that online was at worst 9.5 percentage points dilutive to your margins. Is that still the case or is it improving with improving AOVs?

Tim Stacey: It is improving. Absolutely, it is improving all of the time with improving AOVs. I think it is one of the benefits in the returns of the mobile engagement team that is coming through at the moment. I think, actually, when we look at the profiles of the customers that come through in the online channels, though, I think as we touched on last time, they are markedly different compared to the customers that we know are converting in our showrooms as well. So we actually believe that the impact is less than that, as we touched on last time. However, again, I think as we look at it, I think we certainly see benefits coming through from the growth in sales and online, incremental profits coming through from the growth in sales online, we believe.

Tony Shiret (Whitman Howard): I just wondered what sort of like-for-like in the second half is your guidance predicated on. That is the first question.

Mike Schmidt: I think we will look broadly at the market expectations, and I think in order to meet market expectations around revenues for the second half of the financial year, I think we would say 2% total growth, so like-for-like growth within that is a little bit less than that.

Tony Shiret: Okay, so the second part, I guess, is you obviously have a bit of flex in your marketing budget. Have you got any plans for other cost containment in the short term if things start to go pear-shaped?

Tim Stacey: Yeah, I think one of the pillars that we have talked about is around our operating costs in property and within there, there are some flexible costs, discretionary costs that we can look at. We are aware and are tracking weekly what is happening in the market, so we have a level of flexibility. I think, as Mike has alluded to, some of the flexibility when it comes to marketing is not as flexible in the short term, because you have the TV booking but there are a number of other things that you can put in the short term. However, we are comfortable with where we are from a PBT point of view for this financial year.

Tony Shiret: How much would the LFL have to move by for you not to be comfortable?

Mike Schmidt: Broadly, Tony, I think we clearly have given our guidance around our expectations and we are comfortable with our expectations for the full year. I think, likewise, we do recognise that we cannot control the market environment and I do not think you can necessarily give a specific answer to that question. I do not think it is a reasonable thing to expect us to be specific on. I think we do have a degree of tolerance, as we have touched on before in our model, to allow us to cope with the market environment. I think the broader point is the business over the long term is fundamentally resilient: very, very strong fundamentals. Actually, over the longer term, I think we believe if there is a tough environment it is the environment that we gain share most of all in.

Tim Stacey: Thank you very much everybody for coming along. I am sure you can say goodbyes to Nicola at the end. Thanks very much.

[END OF TRANSCRIPT]