CHIEF EXECUTIVE'S REPORT

# *Managing challenging conditions and positioning the business for future growth*

*In financial year 2024 the Group has made good progress improving our gross profit margin rate and reducing our operating costs whilst achieving record NPS scores. This progress has been delivered against a backdrop of very challenging market conditions.*

**Market update and financial overview**
Consumer demand fell significantly in the financial period driven by the cost of living crisis. The level of decline was beyond our initial expectations with overall demand levels reaching record lows. In addition supply chain disruption in the Red Sea that emerged in the second half of the period extended our made-to-order product lead times delaying the recognition of revenues.

We took decisive action through the period as the scale of market decline, now over 20% below pre-pandemic levels in volume terms, became apparent. We accelerated a number of initiatives across our Cost to Operate efficiencies programme reducing our costs by £27.5m year on year. Despite these actions, the Group's profits were unfortunately impacted by the extent of the market decline and the supply chain disruption. Underlying profit before tax and brand amortisation reduced from £30.6m in our FY23 financial period to £10.5m in FY24 and reported profit before tax reduced from £29.7m to a loss of £1.7m.

When formulating our cost-out action plans we have been resolute in protecting and improving our customer facing resources to continue to deliver good outcomes for our customers and record high post purchase and post delivery NPS scores were achieved. With our retail brands clearly positioned and operations now leaner and more effective than ever, the Group is in a strong position to capitalise when the market recovers and deliver strong returns for our shareholders.

**Progress on our three focus areas**
The Group has consolidated its position as the clear market leader having added 4ppts to our market share[1] since 2020.

We have improved our gross margins by 140 bps to 55.8% as we target our historical level of 58%. The growth has been supported by redistributing goods across our supplier base to optimise the cost and quality of production as well as from retail price increases in the final quarter of the prior year.

1. GlobalData August 2024.

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Chief Executive Officer
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We have reduced operating costs across all areas of the business, be it by operating segment or expense type. This has been accomplished by undertaking a rigorous review and reappraisal of the cost base to ensure it is appropriate for both today's market environment and future, stronger market environments. This programme is ongoing with examples of cost reductions to date achieved via improved operating models, utilising AI, enhanced procurement activities, and utilising data/MI to improve operational performance. The savings achieved in FY24 will provide a further uplift into the following year in addition to new initiatives that we have planned. I'm pleased with the progress we have made which has had the end customer impact core to decision-making to ensure we do not hamper our ability to capture demand when the market recovers.

**Strategic update**

Our strategy is to profitably and sustainably grow our core upholstery brands, DFS and Sofology, utilising all channels to create a seamless experience for our customers and to grow our share of the £5bn non-upholstery Home market. This growth is supported by utilising and enhancing our enabling platforms; technology and data, logistics, sourcing and manufacturing, and people and culture.

**Our pillars**

The DFS brand, which has a broad appeal offers a market-leading choice of products. Its trusted, friendly service and digital approach to connect our showroom, web and telesales channels enabling customers to shop their preferred way has continued to improve with post purchase NPS scores reaching record highs of 92.8%.

We have successfully broadened DFS's appeal to a wider range of customers over time. This has been facilitated, for example, by the addition of exclusive brand partnerships and through adapting our marketing strategy to focus more on improved product showcasing supported by improved showroom formats. Our exclusive brand sales now account for over 41% of total sales. The most recent addition to our exclusive brand partnerships in the period was Ted Baker and the three ranges launched have performed very well. We continue to develop new ranges to add to our existing exclusive brands such as the new Carlisle French Connection range. All these factors have supported the brand in consolidating recent market share gains. I'm also pleased to announce that we have recently launched a new exclusive partnership with La-Z-Boy which will be a great addition to our existing brand partnerships.

We adopt good governance practices to ensure our brands play to their relative strengths, targeting their customer segments accordingly to reduce the risk of cannibalising one another's sales.

Our Sofology brand offers an inspiring and exciting range of well targeted products that bring quality, style and luxury within reach and targets a slightly older demographic than the DFS brand.

Sofology over the year as a whole performed broadly in line with the wider market. Following a relatively tough start to the year we adapted the brand's retail pricing and introduced a number of new product ranges to provide an overall refresh to the Sofology proposition. These changes have had an almost instantaneous impact with the brand returning to order intake growth in the final quarter of the year.

To further bolster the brand's potential we plan to commence a refurbishment programme of the Sofology showroom estate in calendar year 2025 to modernise some of the older sites within the portfolio. These will be the first refurbishments carried out across the estate and we will adopt a test and learn approach to ensure we optimise the returns available. When we see a prolonged period of improving like for like performance and as our balance sheet strengthens we plan to continue our showroom roll out to grow the estate from the current 58 showrooms to 65-70 showrooms and have our target locations lined up.

The Home market represents a great opportunity for the Group to expand its addressable market to the wider £5bn Home (non-upholstery) market, first targeting the £3bn beds and mattress sub segment. As announced in our half year update we have completed the development of supporting infrastructure including a drop ship solution and warehouse management system that provide the foundations for growth. We have also expanded some of our exclusive brand partnerships to include beds as well as upholstery. We have decided to temporarily pause further investment into marketing to drive sales and instead focus our investments into our core upholstery offer in this period of weak market demand. Profitability in our Home offer has however stepped up, increasing year on year due to improved gross margins and lower operating costs. We continue to see great potential for the Group to drive incremental profits with limited further incremental investment as we target a 4% share in this market.

**Our platforms**

Our enabling platforms play a pivotal role in supporting the Group to deliver value. This is achieved through a number of means such as sourcing efficiently utilising the Group's scale, developing our market-leading delivery services and providing our highly motivated colleagues with data to drive insight and improved decision-making across the business.

**Sourcing and manufacturing:** We are aiming to improve our gross margins to our long term historical pre-pandemic level of 58% following a reduction across 2021 and 2022. This reduction resulted from rising input costs, freight rates and Bank of England base rates that were not fully passed on with a profit mark up. In addition, lower market volumes impacted the efficiency of our own and external manufacturing operations. We expect to deliver cost of goods savings through redistributing goods to optimise the cost and quality across our supplier base and in addition we expect further uplifts through reducing interest rates over time. We took the decision to close the smallest of our three manufacturing sites and one of our two wood mills in the first half of the financial period and redistributed production across the remainder of our supplier base. This resulted in cost savings that contributed to the 140 bps gross margin improvement in the period. These types of decisions are never straightforward and have significant impacts on our colleagues and other stakeholders. Following a consultation with 215 colleagues, we were able to retain 44 colleagues including at our recently formed sewing hub and we supported the remaining workforce through a comprehensive outplacement support service.

**Technology and data:** Our investments continue to centre heavily on utilising technology and data to improve the efficiency of our operations and the customer experience. We have recently undertaken the process of moving away from a number of legacy systems and implementing Google's contact centre AI platform in Sofology. This will help enable us to utilise AI in the future to further improve our customer service levels and optimise costs. To date we have automated the process to take customer payments over the phone as well as deliver a full self service customer delivery proposition. We see numerous opportunities ahead to reduce the number of customer contacts to enable our teams to focus on the more complex service situations. In the second half of the year we also successfully launched our proprietary Intelligent Lending Platform used in DFS, into Sofology. This has broadened the number of lending partners available to Sofology, increasing the probability of customers obtaining the credit that is right for them, reducing the time taken to deal with credit applications and reducing the cost to the Group of providing credit to customers.

**Logistics:** Last year we completed the remaining integration activities to combine and rationalise the logistics assets from the DFS and Sofology brands. Now the Sofa Delivery Company, which fulfils deliveries for both brands through utilising the same systems, distribution centre network, fleet and workforce is performing very strongly with key performance indicators such as vehicle fill, labour productivity and delivery failure rates all improving. This has both driven down costs significantly and improved the customer experience with post delivery NPS scores reaching record highs. We believe that we have created a valuable asset and there are additional opportunities available to further refine and improve performance.

**People and culture:** Our colleagues are the Group's most important asset. Ensuring the Group is a great place to work that has an open, collaborative and inclusive culture where people can be their best is key to our future success. We are constantly looking to evolve and improve our colleague experience and we have been focusing over the last year on colleague development. We have launched a number of programmes to help our people thrive and grow, for example by running a management academy programme within the Sofa Delivery Company to upskill over 150 colleagues, launching a Group leadership academy programme with monthly workshops attended by over 300 aspiring leaders and via developing finance academy courses led by subject matter experts. To help ensure everyone feels

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welcome we have established six colleague networks and partnered with Diversity in Retail, enabling us to collaborate with other businesses and benefit from adopting best practices. We are constantly seeking to raise standards and I'm pleased to say we have achieved accreditation in the Inclusive Employers Standard.

**Sustainability**
In June this year we submitted our Net Zero strategy to the SBTi. We decided to shift our Net Zero target to before 2050, aligning with climate science and the UK government targets. I'm pleased to say that this year we have secured commitments from our manufacturing partners that cover 59% of our Scope 3 emissions to commit to developing their own science-based Net Zero plans.

Whilst making up a relatively low proportion of our total emissions I'm nevertheless proud that the consolidation of our delivery fleets, AI route planning tools, and driver efficiency training, as well as removing gas from our retail estate has delivered a significant reduction in our Scope 1 emissions. We are already making great strides to ensure our business can make the most of the opportunities of a circular economy to deliver sustainable performance for the Group (see pages 32 to 51 for more details).

**Conclusion and outlook**
I want to sincerely thank all of our colleagues for their enthusiasm and continued commitment to delivering a great service to our customers in what has been a very challenging period for the Group given the market conditions.

Despite the challenges that the business has seen, we are optimistic for the future and see signs that market growth could soon return. We expect recent improvements in housing transaction data and strengthening consumer balance sheets to lead to increased upholstery market demand across the FY25 financial year. In addition, thanks to the success we have had growing our gross margin and improving our operational efficiency, we expect to deliver profits in line with market consensus[1], weighted to the second half.

It is clear that the upholstery market has a long road to recovery given the 20% decline on pre-pandemic levels that we have seen. Despite the challenges we have faced, we remain confident that the business is well positioned to capitalise on market recovery. Given our strong market leadership position, the operational leverage in the business, our well invested asset base and negative working capital cycle we expect to deliver strong returns for our shareholders.

**TIM STACEY**
Chief Executive Officer
25 September 2024

1. Company derived market consensus for underlying profit before tax £23.2m.