



A sofa for everyone

DFS Annual report & accounts 2018



Welcome

We are the leading sofa and living room furniture specialists



Strategic report

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The three 'S's that make us different:

We have hard-to-match competitive advantages that are sustainable in the long term.

Scale

Our vertically integrated model, particularly utilised within our DFS brand, brings advantages in cost, customer service and responsiveness.

Our unparalleled scale – we have a Group market share more than three times any other sofa retailer – gives us operating leverage across the value chain.


 See pages 6-9 for our market and business model



Specialism

Our Group's almost 50 years of expertise allow us to recruit, train and retain high calibre colleagues, who provide expert guidance to customers.

To complement our Group's own brands we are the furniture partner of choice for lifestyle brands, giving us broad appeal across customer segments.

 See pages 34-35 for our people



Shareholder returns

We have a clear strategy and a proven ability to achieve above-market growth across the economic cycle, with our flexible cost base allowing us to respond to challenging market conditions.

Our low capital employed and negative working capital yield attractive shareholder returns.

 See pages 26-31 for our financial performance



Highlights

Summary of the year



Financial

Group revenue

£870.5m

+14.1% (FY17: £762.7m)

Revenue before acquisitions

£747.7m

-2.0% (FY17: £762.7m)

Underlying EBITDA²

£76.1m

-7.6% (FY17: £82.4m)

Underlying profit before tax excluding amortisation of brand names

£38.3m

-23.7% (FY17: £50.2m)

Profit before tax

£25.8m

-48.5% (FY17: £50.1m)

Final dividend held at

7.5p

(FY17: 7.5p) giving total ordinary dividend of 11.2p for the year (FY17: 11.2p)

Underlying earnings per share

14.0p

-25.1% (FY17: 18.7p)

Earnings per share

8.9p

-52.4% (FY17: 18.7p)

Leverage³

2.1x

(FY17: 1.75x)



Operational

- Operational and strategic momentum preserved despite fourth quarter environment
- Continued strong growth in Group online revenues
- Successful development of sector-first augmented reality and “complete at home” technologies for Group websites
- Sofology acquired - trading positively with good momentum on releasing synergies
- Further improvement in DFS brand appeal, while partnership brands have grown well
- Three new 10-15,000 sq.ft. DFS stores opened and trading successfully plus small store DFS trials opened in Chelmsford and Guildford
- Completion of UK CDC network, leading to lower costs per order
- International development: Spain trading profitably; Netherlands TV marketing trial continues

Post Purchase NPS¹

84.9%

(2017: 85.2%)

Established Customer NPS¹

35.8%

(2017: 34.2%)



Visit www.dfscorporate.co.uk for more information

1. Net Promoter Score. See page 25
2. See page 96 for definition of non-underlying items
3. Leverage is net debt/underlying EBITDA

Our business

A sofa for everyone

DFS is the leading living room furniture retail group in the UK. Although we are most famous for our DFS operations – the UK's largest and most profitable sofa retailer – we are also the proud owners of the Sofology, Dwell and Sofa Workshop retail businesses.

By trading through four retailer brands we are able to offer tailored customer propositions, with each brand business unit appealing differently to targeted customer segments. However, to help us offer customers great value for money and to grow our profitability we are working to reduce costs through collaboration across our Group, in particular by benefitting from the scale of DFS. Critically, we will only seek such Group synergies where we are satisfied we can maintain the distinctiveness and integrity of each brand's customer proposition.

While our DFS business is the clear UK market leader and drives the majority of Group revenues and profits, Sofology, Dwell and Sofa Workshop are each on a growth journey, and are making clear progress each year towards national scale. We believe that as they mature they will represent an increasingly important part of the Group and will generate attractive returns in future.

Total Group employees

5,500+

Total Group retail stores

232



DFS % of
Group revenue

79%



DFS is the leading retailer of sofas and living room furniture in the UK. It has a leading ecommerce platform operating in English, Spanish and Dutch, and also 124 showrooms in the UK, Ireland, the Netherlands and Spain. In addition to its showrooms DFS operates 20 Customer Distribution Centre warehouses offering an efficient last-mile two-man delivery service.

The DFS business is promotionally led with distinctive and broad reaching advertising campaigns that focus on comfort, quality and value for money. DFS has a leading share with each customer segment that we identify, which means that on aggregate its customers have a national average income and are frequently families with young children.

DFS sells a wide range of fabric and leather sofas across a broad range of styles. Of particular note is the depth of choice of unit types in each product range it sells and the large number of colour and material choices. Products

are complemented by an interest-free credit offer which is independently rated as market leading, British Standards kitemark accreditation, long-term guarantees and comprehensive after-sales service.

Other than the clearance of discontinued showroom models and customer returns the DFS upholstery proposition is wholly "made-to-order", with finished goods only being produced once a binding customer order is received. Products are made either in our five UK factories or through a limited number of manufacturer partners located in the UK, Italy, Eastern Europe and the Far East.

Showrooms typically range in size of retail space between 10 and 15,000 sq.ft. and are located very commonly on major retail parks that are easy for customers to access. Because of its significant advertising spend, DFS is frequently an anchor tenant on these parks and attracts significant footfall in the sector as a destination retailer.

Sofology % of
Group revenue

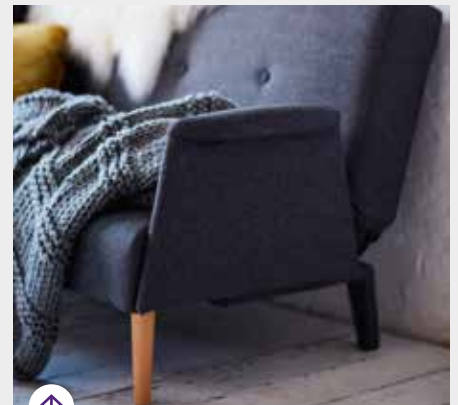
14%



Sofology is the third largest retailer of sofas in the UK, despite having only a partial national footprint with its 41 stores. In contrast to DFS its marketing approach is not promotionally led, focusing instead on emphasising its product design, comfort and no-commission sales approach. While its brand has mass-market appeal, its customer base tends to be slightly more affluent than average and tends to have older children or be empty-nesters.

Like DFS, Sofology is a sofa and living room specialist with a broad range of upholstery products in fabric and leather and a range of living room accessories such as tables and rugs. Its range is differentiated from the market through emphasis of a number of design-led on-trend products, while also maintaining a broader range of attractive mass-market designs.

Sofology's showrooms tend to be very modern in appearance and will typically have 12,500 – 20,000 square feet of retail space across a ground floor and mezzanine. In addition to its stores Sofology operates six warehouses providing last mile two man delivery service.



SOFA WORKSHOP

Sofa Workshop is a premium retailer of exclusively British-made furniture, based in Godalming and operating 31 stores. Its customers tend to be high income families with older children who may have left home. The product range is distinct through exceptional quality and also through offering customers the option to bespoke much of the range in both dimensions and fabric coverings. Its products are made-to-order in a number of UK based partner workshops.



dwell

Dwell sells stylish, modern furniture, lighting and home accessories online and from 36 stores, mostly collocated alongside DFS showrooms. Its customers tend to be affluent and slightly older families in the 35-55 age range. In contrast to the rest of the Group, Dwell operates a stocked model allowing very short customer lead times.

Dwell and
Sofa Workshop
combined % of
Group revenue

7%

Chair's statement

A weaker market presents challenges and opportunities



Ian Durant
Chair of the Board



2018 highlights

- Acquisition of Sofology brings a significant addition to the Group
- Tim Stacey to succeed Ian Filby as Chief Executive
- Full year dividend held at 11.2 pence per share

Overview

My first full year as Chair has seen two important developments for the Group. In November 2017 we acquired Sofology – a significant addition to the Group which extends our stable of furniture brands. More recently we have announced that Tim Stacey will succeed Ian Filby as Chief Executive later this year to lead the Group forward in the next stage of its development.

In last year's report we noted that the trading environment for the Group had become markedly tougher, with weaker consumer confidence impacting sales particularly in the second half of last year. The start of this year saw some improvement in this picture and at the time of our half year results our expectations for the full year continued to be that the Group would deliver modest EBITDA profit growth. However, continued economic uncertainty for consumers, compounded by some exceptional hot weather over key trading

periods in the final quarter, resulted in sales and profits for the full year falling below our expectations.

While retailers will inevitably feel the short term effects of external factors, we are focused on evolving our strategy to acknowledge the long term structural changes in our market and the changing expectations of our customers, including the role that online and, in particular, mobile technology plays in their interaction with us. The number of retailers entering CVAs or administration in recent months serves as a stark reminder of the dangers of failing to keep pace.

Over the medium term, the current weakness in the market does present the Group with opportunities, which we can exploit through an unrelenting focus on understanding and satisfying the needs of our customers. It also requires a sharp focus on the returns from our capital expenditure.



Full year dividend

11.2p



People

I am delighted that after an extensive and demanding process an internal candidate has been appointed as our new Chief Executive, and this illustrates how Ian Filby has built a team with growing strength and depth during his tenure. Ian has been an exemplary leader over the last eight years and his continued availability and support over the coming year will be invaluable as Tim Stacey develops the senior management structure which is now in place. Tim has already met with many external stakeholders as part of his induction to his new role and will present his assessment of our strategy to shareholders with the half year results early next year.

The colleagues in our shops, warehouses, offices, and delivery and service vehicles are dedicated, enthusiastic and proud of the Group's market-leading position. We will continue to support their efforts by building on the extensive training which they receive and improving the information systems to allow the Group to become ever more agile and well informed.

Board

Following the departure of Gwyn Burr earlier in the year, I am pleased to welcome Alison Hutchinson to the Board. Alison has taken on the role of Remuneration Committee Chair from 1 October 2018. My thanks also go to Luke Mayhew for the admirable role he has played in the interim leading the Committee through this year's remuneration review.

Julie Southern has announced her decision not to stand for re-election at this year's AGM and an active search is now underway for her successor as a non-executive and Chair of the Audit Committee.

During the year, the Board has maintained an active agenda with a particular focus on operational performance, strategy and risk. The Governance section of this report on page 42 provides further details of the activities of the Board and its committees.

Dividend

The Board has carefully considered the balance between regular dividends supported by the performance, expectations and capital needs of the Group and the return of capital where there is a surplus. We anticipate that value created over time will be delivered to shareholders through a combination of ordinary dividends, special returns and capital growth.

Notwithstanding the current subdued sales environment, our longer term expectations for the future earnings and cash needs of the business have enabled the Board to recommend maintaining a final dividend of 7.5 pence (FY17: 7.5 pence), taking the full year ordinary dividend to 11.2 pence (FY17: 11.2 pence). The Financial Review on pages 26 to 31 provides further information on our dividend policy.

Looking forward

The Group continues to face a particularly uncertain UK consumer market in the run up to Brexit in March next year; the associated risks around this are discussed more fully in the Chief Executive's review on page 22 and Risks on page 14.

The Board considers that the Group can look through short term market uncertainties and remain committed to the growth of the Group with some confidence. The executive team has begun the new financial year with great enthusiasm and recognises the opportunity to build upon the unique capabilities of the Group as the UK's largest upholstery retailer (and manufacturer) under the leadership of Tim Stacey.

Ian Durant

Chair of the Board
3 October 2018

Market overview

We are the clear leader in the living room furniture market



The living room furniture market is large and still fragmented despite ongoing market share gain and consolidation by leading players.

Market opportunity

Large potential customer base

The DFS Group has a specialist focus on the retail upholstered furniture segment within the living room furniture market. The UK living room furniture market was estimated by GlobalData to be valued at just less than £4.5 billion in 2017, of which around two thirds by value represents sales of upholstered furniture. We also offer a selected range of beds, dining and other furniture and home accessories giving access to other segments in the UK furniture market.

UK living room furniture market valued at

£4.5bn

Clear leader in the segment

The DFS Group, through its DFS, Sofology, Dwell and Sofa Workshop brands, is the clear leader in the living room furniture market with 22.5% share by value (as estimated by GlobalData for 2017). We see three broad categories of companies actively competing in the living room furniture retail market: Specialist Chains such as DFS, Sofology, ScS, Harveys, Furniture Village and Oak Furniture Land; Independents that are typically single store operations; and General Merchandisers such as Ikea, John Lewis, Next, Argos, Debenhams and all other retailers including DIY chains and supermarkets.

Living room furniture market share 2017

22.5%

Steady growth trends over long-term periods

Between 1995 and 2017, the UK upholstered furniture segment of the furniture market has grown by 2.3% per annum on a compound annual growth basis, driven by a c.7 year replacement cycle and underpinned by demographic trends.

We believe over shorter timeframes the segment is principally driven by three key factors: consumer confidence, housing market activity and consumer credit availability.

In addition to these market drivers we do see from time to time some material volatility in market demand levels caused by particularly hot or cold weather and significant public events.



Upholstery purchasers

A proportion of customers have always claimed they are 'closed' to the DFS brand i.e. they would not consider a purchase from a DFS retail store. Dwell, Sofology and Sofa Workshop allow us to target these groups of customers.

dwell SOFA WORKSHOP sofology

32%

would not consider purchasing from DFS



dwell SOFA WORKSHOP

dfs sofology

68%

would consider purchasing from DFS

Through DFS we seek to offer a sofa for everyone, which means for the majority of consumers DFS is considered versus external competitors and also Sofology, Sofa Workshop and Dwell.

In 2017 and 2018 the market has been in gentle decline, influenced by weaker consumer confidence following the UK's referendum vote to leave the EU.

Key market drivers

Consumer confidence

Levels of consumer spending, particularly for big ticket items, are influenced by general consumer confidence. While levels of consumer confidence have been impacted by the outcome of the EU Referendum and the status of subsequent negotiations on the withdrawal process, as of August 2018, they remain in line with 2017 and well above the lows seen in 2008.

Consumer confidence¹

Sep 2018	-7.0
2017	-8.8
2016	-3.3
2015	3.1
2014	-2.6
2013	-18.6
2008-12	-26.0

1. GfK Consumer Confidence average of individual scores for each year

Housing market

Independent research conducted on our behalf suggests that c.20% of upholstery purchases are triggered by a house move. Housing market transaction volumes are well above levels seen between 2008-2012 albeit are trending lower than in 2017 and are still at levels significantly beneath the 2006 peak.

Housing transactions p.a. ('000s²)

2018 YTD	-3.9%
2017	1,224
2016	1,230
2015	1,226
2014	1,223
2013	1,067
2008-12	893

2. HMRC – number of residential property transactions completions with a value over £40,000 for England and Wales, seasonally adjusted

Consumer credit

Upholstered furniture typically has relatively high unit prices and thus the availability of consumer credit can facilitate purchases and upselling. Consumer credit availability has improved since 2010 lows, and although the rate of growth over 2018 is lower than in recent years it continues to be significantly positive.

Net unsecured lending growth³ (%)

Jul 2018	8.5
2017	10.0
2016	10.1
2015	7.7
2014	5.9
2013	3.6
2009-12	-0.5

3. Bank of England – 12 month average growth rate of total (excluding the Student Loans Company) sterling net unsecured lending to individuals (in %) seasonally adjusted



Growing role of online

With furniture products largely either made-to-order or dispatched from a central stock-holding, physical retail space in the market has always primarily had a role as a showroom.

As web technology has improved, the web has however gained an increasingly important role in customers' journeys with survey data now suggesting that over 80% of UK customers conducted research online before placing an order. With online usage growing, technologies such as colour rendering, room planning apps and augmented reality are now helping customers visualise products in setting as a key element of their research journey.

Notwithstanding this, customers continue to find it difficult to judge true appearance, quality and comfort online. Most customers therefore want to take a

"sit and feel" test in a showroom before committing to what may commonly be one of their largest household expenditures on a single item that year. Evidencing this trend is the growing tendency of online startup retailers to move to opening showrooms.

While in other product categories online retailers have seen some success by offering a "no quibbles" returns policy, the cost of reverse logistics in this category can be extreme. For a customer order of a sofa home delivery can typically cost between £50 and £100, making it a material operating cost for all retailers.

Given common fulfilment across retail channels and a make-to-order approach, retailers can be somewhat agnostic about whether a customer places a specific order online, by phone or in store, however we believe over 80% of transactions in the segment are still concluded in a store with customers typically seeking the reassurance of face-to-face advice, particularly on higher value purchases.

We believe this cross-channel customer behaviour will favour retailers with a strong omnichannel proposition, and particularly those that can deliver a consistent, well-invested proposition in each channel.

Our business model

Substantial scale and end-to-end control of the proposition brings competitive advantages

What we do

1

Design & inspire

We inspire consumers to consider a purchase through sustained advertising and inspirational website content.

We curate our ranges carefully, supported by a specialist in-house design team that drives our innovation.



UK based
design studios

2



Retail

Each brand has a national network of well-invested showrooms staffed by well-trained and highly motivated sales teams.

Our leading websites, apps and call centres serve to complement our physical presence.

2

Showrooms

232



Creating value for stakeholders

Customers: Unrivalled range, spanning styles, price points, in-house and Exclusive brands, supported with exceptional service and 15 year guarantees.

Employees: Outstanding training, attractive pay and rewarding career paths.

Suppliers: Longstanding, mutually beneficial partnerships.

Group average post-purchase NPS

>80%

DFS employees over five years' service

44%

DFS customer orders sourced from British factories

c.40%

UK factories

5

Manufacture

We are one of the largest manufacturers of upholstered furniture in the UK.

Our three finished goods and two sub-component factories each benefit from a highly experienced workforce.

3



Service

We back our products with a comprehensive installation service, a long-term structural guarantee and a team of over 200 upholsterers to address any after-sales issues.

We make our products more affordable through interest-free credit and demonstrate quality through established independent accreditations.

4



Upholsterers

200+



Shareholders: Attractive growth and cash returns.

Community: Charitable contributions, employment and apprenticeship opportunities, and taxes.

Cash returns to shareholders since March 2015

>£90m

Raised for charitable causes in FY18

>£4m

Our strategy for growth

Continued investment in stated growth levers

Our ambition

Using the strength of the DFS platform we will grow our retail brands to drive incremental profit before tax and continued strong cash generation.



Enhance our omnichannel proposition and maintain online leadership

dfs.co.uk is the clear market-leading online platform in our sector, accounting for over 40% of upholstery segment web traffic, and a proven track record of growing margin-enhancing sales through this channel. Across the Group we now generate over £160m of online Gross Sales per year.

With most customers now beginning their research on potential furniture purchases online, our website provides both inspiration to visit our physical stores and the opportunity to make direct purchases through a convenient, interactive platform that is available 24 hours per day throughout the year.



2018 progress

- Sales completed online continued to grow strongly during FY18.
- Integrating online technology into our stores through the roll-out of "Swoosh" furniture visualisation technology across the DFS estate and in-bay "i-Tabs" in Sofology demonstrates our ability to offer our customers a true omnichannel proposition.



Targets

- We will continue to maintain a share of over 40% of upholstery segment web traffic.
- Our significant investment in key future online technologies, in particular mobile web, personalisation and strengthening the omnichannel customer experience will continue.

Key performance indicator

Online growth rate

15.1%

(FY17: 11.1%)



Broaden our product and brand appeal

Building on our leadership across all segments of the upholstered furniture market we aim to increase our appeal to older and more affluent 'aspirational customers' while retaining our core mass market appeal.

The DFS tradition of making all products to order, and our own UK manufacturing base, have provided a strong platform to achieve this by broadening the DFS product range, developing exclusive brand partnerships with leading brands such as French Connection, Joules Country Living and House Beautiful and acquiring complementary businesses.



2018 progress

- We set a target to reach a share in the 'aspirational' customer segment of 25% by the end of FY18, however we achieved this target a year ahead of schedule.
- Building on this success, we launched a partnership to design, manufacture and retail an exclusive range of Joules branded upholstery and completed the acquisition of Sofology as a further Group brand.
- We have now begun a new customer segmentation analysis to allow us to more accurately target valuable new segments with the right Group proposition.



Targets

- We will continue to grow sales of branded products ahead of DFS retail sales.
- We will not compromise our strong range and focus on our other core customer segments.
- We will invest in the growth of our non-DFS Group brands.

Key performance indicator

Growth in partnership brand sales

7%

(FY17: 20%)

3



Exploit UK and ROI roll-out opportunities

We see continued potential to build on our nationwide store coverage by both opening three to five profitable new stores each year in the traditional 10-15,000 sq ft DFS store format and by developing smaller stores of as little as 2,500 sq ft in high footfall urban locations.

We also see the opportunity to add new standalone Sofology and Sofa Workshop stores nationally to complete their network.

Our proven, bespoke customer catchment area model enables us to predict accurately where future store opening opportunities exist.



2018 progress

- Three new larger format stores were successfully opened in FY18 at Haverfordwest, Rugby and Wednesbury, and we also opened two smaller stores in Chelmsford and Guildford.
- We have identified and secured further locations for additional 10-15,000 sq ft stores that are each predicted to generate over £500,000 of incremental EBITDA net of existing store cannibalisation.



Targets

- We will open between three and five UK and ROI stores each financial year using our large and medium 10,000-15,000 sq ft formats.
- Each of these traditional formats is targeted to achieve cash payback within two years on the initial c. £1m operating and capital expenditure (including incremental logistics assets).
- We will continue to test and learn from our trial small-format (2,000-5,000 sq ft) stores.

Key performance indicator

Number of DFS stores (UK & ROI)

116

(FY17: 113)

4



Retail space and distribution cost efficiency

Releasing former warehouse space in our store estate enables us to generate incremental retail sales while consolidating warehousing and delivery in lower cost and more logistically efficient offsite locations.

We are also looking across our estate for opportunities to make our existing retail space operate more cost efficiently, through downsizing.



2018 progress

- In FY18 we have completed our planned nineteen-strong UK Customer Distribution Centre ("CDC") warehouse network, with the final two CDCs opening in early FY18.
- £1 cost per order benefit in FY18 relative to FY13 and FY17 despite material inflation being absorbed over the long-term period.
- We continue to convert the retail space released by the warehouse programme and expect to complete this repurposing in FY20.



Targets

- Retail space released by our CDC openings will either be converted into new Dwell or Sofa Workshop stores, allow us to downsize our retail footprint, or be used to sell an extended range of furniture.
- Once fully rolled out in FY20, our programme is targeted to deliver incremental annual EBITDA of an average of £650,000-£700,000 per CDC.

Key performance indicator

Stores with converted warehouse space

44

(FY17: 36)

5



Establish presence in international markets

Our ability to extend the DFS brand to new markets was first demonstrated by our successful expansion into the Republic of Ireland, where we opened our first store in 2012, and is continuing with our more recent developments in the Netherlands and Spain.



2018 progress

- To continue our development we conducted a national marketing test campaign in the Netherlands in early 2018, to understand the potential opportunity from further roll-out.
- This test was impacted adversely by the hot weather, so we will continue this test phase into FY19.



Targets

- Building on our success in the ROI, we aim to develop a profitable national network of 10-20 stores in the Netherlands, which leverages our UK infrastructure and proven operating model.
- We will continue development of our Spanish store presence to profitably serve significant ex-pat communities in southern Spain, giving us a foothold in the overall Spanish market.

Key performance indicator

Number of Netherlands & Spain stores

8

(FY17: 7)

Risks and uncertainties

How we manage risk

The Group faces a number of risks and uncertainties in both the development and day-to-day operations of its business.

Identify

The Group has an established risk register which is coordinated and analysed by the Group's Risk and Internal Audit function to facilitate regular review of key risks by the Directors.

Each identified risk is allocated to a member of the Executive Board. The Directors maintain overall responsibility for risk management throughout the Group and oversee the implementation by the Executive Board and operational management of processes to manage these risks. The Audit Committee reviews the Group's internal risk register on a regular basis.




Evaluate

The Directors confirm that they have made a robust assessment of the principal risks and uncertainties facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.



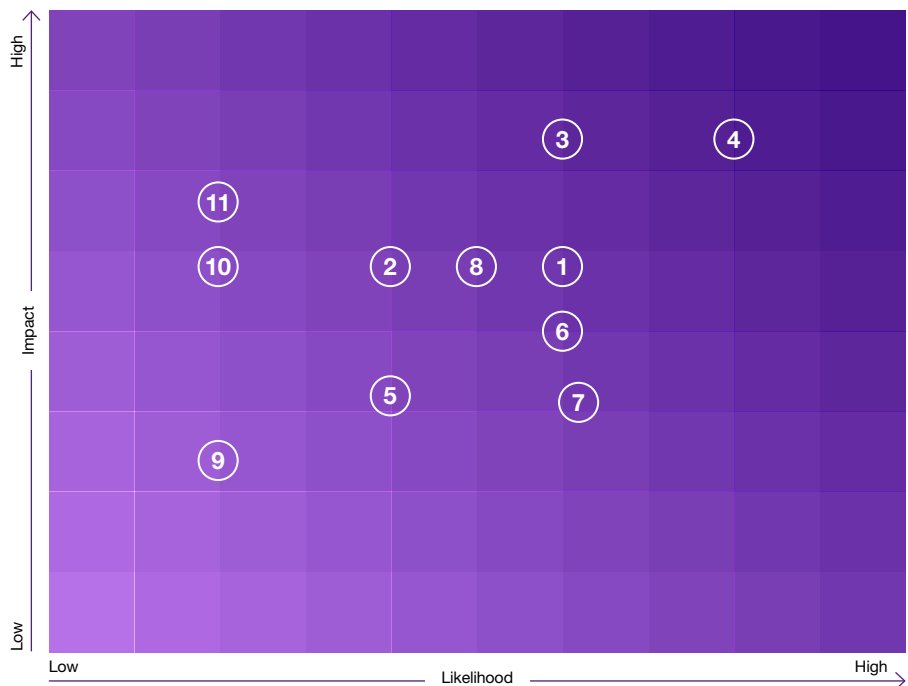
Mitigate

These risks are discussed opposite, together with the Group's related mitigating activities. Other risks which are currently either not known to the Group or are not considered material could also impact the Group's reported performance or assets.

 See pages 53 to 55 for more on how risk is managed

Risk heat map

In analysing the key risks for our business, we consider regulatory and other external publications and peer group comparisons to ensure that the Group's risk register is comprehensive and places appropriate emphasis on those risks that may pose a more significant threat. The heat map below illustrates the distribution of identified risks according to their relative likelihood of occurrence and potential severity of their impact after taking into account mitigating activities:



Strategic risks

Impacting our business plans and development

- 1 Economy & market
- 2 Customer proposition
- 3 Regulatory environment
- 4 Brexit
- 5 Acquisitions

Operational risks

Impacting our ability to execute & deliver our plans

- 6 People
- 7 Website & IT
- 8 Supply Chain
- 9 Property & store network

Financial risks

Impacting our capacity to fund our activities

- 10 Financial risk & liquidity
- 11 Consumer finance

Link to strategic priority

- | | |
|---|--|
| 1 Broadening our product and brand appeal | 4 Full utilisation of store retail space |
| 2 Exploit UK and ROI roll-out opportunities | 5 Maintain online leadership |
| 3 Establish presence in international markets | |

Movement

- ▲ Increase
- = Unchanged
- ▼ Decrease




Strategic risks

Risk	Strategic link	Mitigation	Movement
Economy and consumer market conditions The retail market for upholstered furniture in the UK is highly competitive. The Group's success is therefore dependent on its ability to compete effectively, particularly during peak trading periods. The Group's products represent a significant discretionary spend for customers and demand is heavily influenced by factors affecting the economies in which the Group operates including (but not limited to) consumer confidence, income levels, interest rates, the availability of credit and the level of housing market activity.	1 2 3 4 5	<p>The Group continues to make substantial investments in marketing to maintain its leading brand status. Marketing strategy is supported through econometric and customer insight analysis. The Chief Commercial & Marketing Officer is a member of the Executive Board.</p> <p>Detailed sales information by product and store is reviewed daily, enabling changes to product selection, incentive structures and advertising strategy to be made on a dynamic basis to optimise sales. Critical KPIs are monitored on a weekly basis and appropriate actions taken.</p> <p>The Group's interest-free credit offer allows customers to spread the cost into affordable monthly payments.</p> <p>Many of the Group's operating costs are variable or discretionary, allowing the cost base to be effectively managed in periods of lower income.</p>	=
Customer proposition Maintaining the reputation of, and value associated with, the Group's brands and product offering is central to the success of the business. Increased customer concerns or poor customer service could have a negative effect on the reputation of our brands, leading to loss of revenue. A failure to predict changes in customer tastes or the impact of changes in the competitor environment could reduce the Group's revenues and market share.	1	<p>Products and services are continually reviewed to ensure they suit customers' needs, are competitively priced, offer good value and are supported by excellent customer service, in order to enhance the Group's market-leading position.</p> <p>Our in-house design teams enable reaction to emerging trends and new entrants to the market. External design partners are also incentivised to generate new product concepts on a regular basis.</p> <p>The Group's focus on offering outstanding customer care and service is underpinned by our established use of Net Promoter Score ("NPS") at all touch points of the consumer journey. Colleagues across the business are directly incentivised on NPS scores to reinforce customer-focused behaviours.</p> <p>In-house customer service managers are available to expediently remedy customer product or service issues.</p> <p>Quality Level Agreements are in place with upholstery suppliers, reinforced with internal quality control procedures to rapidly identify and rectify product liability and recall issues. Compliance with fire regulations and other quality standards is supported by independent external testing. DFS is the first and to date only sofa company whose products have been awarded the British Standards Kitemark™.</p>	=

Risks and uncertainties

continued

Strategic risks continued

Risk	Strategic link	Mitigation	Movement
Regulatory environment The Group is subject to increasing levels of compliance requirements in many of its activities from regulatory and other authorities and is subject to regulatory risk with potential for significant financial impact or reputational damage. Changes to the regulatory environment surrounding DFS product warranty insurance could impact the sales of these products. Changes in other legislation which may have significant retrospective or future economic effects could also impact operating results.	1 2 3 4 5	<p>Comprehensive training and monitoring programmes (including external audits and mystery shoppers) are in place to ensure that employees are appropriately skilled to deliver high levels of customer service and maintain regulatory compliance.</p> <p>An executive Conduct and Compliance Committee is in place to monitor management information and review processes and procedures to ensure our customers are treated fairly. This includes rigorous oversight and escalation processes to maintain the status of limited permission to offer consumer finance granted by the FCA.</p> <p>A comprehensive project, supported by external advisors, was undertaken to determine and implement the requirements of the General Data Protection Regulations and ensure the Group's continuing compliance with data protection requirements. This is supported by ongoing review and monitoring.</p>	
Brexit The Group sources a substantial proportion of its raw materials and finished goods from outside of the UK, has retail operations in the Republic of Ireland, the Netherlands and Spain and employs many EU nationals across its operations, both in the UK (primarily within its manufacturing operations) and overseas. In common with other UK-based businesses, the Group is therefore exposed to a number of potential risks as a consequence of the UK leaving the European Union. These may include a negative effect on consumer demand, delays or additional costs in transporting goods into or out of the UK, an increase in the cost of goods and materials due to additional duties or tariffs, shortage of skilled employees and additional administrative costs.	1 2 3	<p>The Group has established a working group to focus on the analysis of expected legislative and practical changes to the Group's operating environment as a consequence of Brexit, and has engaged external advisors for additional guidance.</p> <p>The working group has identified a number of specific relevant areas of focus for the Group, as discussed in the Chief Executive's report on page 22.</p> <p>As further details become available of the UK's changing relationship with the EU, this working group will continue to assess the specific impacts for the Group and develop the relevant mitigating actions.</p>	
Integration of acquired businesses The Group has made a number of acquisitions in recent years, most significantly Sofology. The investment in these businesses was based on an expectation around the synergistic and other benefits that would be generated. Failure to effectively integrate these acquisitions or to realise expected synergies could negatively impact the results of the Group.	1 2 4 5	<p>The Group undertakes a thorough programme of due diligence before committing to an acquisition. This includes a rigorous analysis of the existing operations and capabilities of the acquired business as well as financial modelling of its potential future performance.</p> <p>Experienced senior management, supported by appropriate external specialists, are engaged in the design and delivery of the integration plans and regular updates are given to the Board.</p>	

Operational risks

Risk	Strategic link	Mitigation	Movement
People <p>The success of the Group depends significantly on its ability to attract and retain a workforce that includes experienced sales, product design and production personnel and to retain members of its senior management team, many of whom have significant experience in the Group's business and industry.</p> <p>The physical nature of our products and handcrafted production processes involves a number of manual activities, increasing the complexity of health and safety compliance.</p>	<div>1</div> <div>2</div> <div>3</div> <div>4</div> <div>5</div>	<p>Employee remuneration is structured to be at attractive levels and to incentivise employees towards results that are aligned with the objectives of the Group. In addition, senior management across the business may participate in equity in the Group or in longer term incentive plans operating over a three year cycle.</p> <p>The Group seeks to promote a positive and inclusive culture. Working practices and policies are developed with the aim of improving the diversity of the Group's people and making the Group an attractive employer for all.</p> <p>A wide range of development and training opportunities are available for Group employees, supporting individual progression and retention of a skilled workforce.</p> <p>Succession planning is operated throughout the business to identify short and long term successors to key roles. A high performance training programme is in place for individuals identified for key roles.</p> <p>The Group continues to make significant investment in training employees in health and safety requirements. Dedicated internal teams are supported where needed by external advisers in specialist areas.</p>	<div>=</div>
Website and IT systems <p>The Group's websites are a key component of its omnichannel proposition and a failure to review and innovate in this competitive area could impact achievement of the Group's strategic growth plans.</p> <p>Effective operational systems supporting supply chain, customer delivery, call-handling and the processing of financial transactions are essential to the delivery of a good customer experience. Delays or errors could result in increased costs or lost revenue.</p> <p>Websites and other parts of the Group's operations depend upon the continued availability and integrity of its IT systems, including the security of customer and other data held by the Group.</p>	<div>5</div>	<p>The Group continues to make substantial investment in both website development and digital marketing to maintain its market-leading position. An established team of experienced staff in this field are supported with ongoing relationships with external partners.</p> <p>The Group engages with independent third parties to actively monitor both customer satisfaction with its digital services and the emergence of new online competitors.</p> <p>Operational IT systems are regularly reviewed and upgraded to ensure they continue to support the needs of the Group.</p> <p>Full back up and business continuity procedures, comprising both internal and third party resources, are in place and are regularly reviewed, tested and updated. Technical security measures against data loss through a systems breach are in place and regularly reviewed and updated.</p> <p>Third party penetration testing is carried out routinely to check the resilience of the Group's systems to cyber-attack. A colleague cyber awareness programme is also in place.</p>	<div>=</div>
Supply chain <p>A large portion of the Group's products are supplied by a core of manufacturers, with many produced in continental Europe and Asia. The Group's internal manufacturing operations also supply a significant proportion of goods sold and may not wholly be able to compensate for the failure of any of the Group's key external suppliers to satisfy their delivery obligations.</p> <p>Increases in finished goods and underlying commodity prices may negatively impact the Group's trading margins.</p>	<div>1</div>	<p>The Group maintains flexible supply arrangements to facilitate switching between suppliers where necessary and uses a variety of freight forwarders to avoid reliance on any one transport link.</p> <p>Supplier performance is monitored against operational and quality targets and reviewed by senior management. All external upholstered furniture suppliers are frequently inspected by the Group to ensure working conditions and quality standards are maintained.</p> <p>Fixed prices are negotiated for finished goods for each promotional cycle and the scale of the Group enables it to achieve significant cost savings with supplier partners. The Group's in-house manufacturing capacity provides insight into production costs and the ability to create cost efficient designs.</p> <p>The Group has established detailed plans to actively manage its cost base and supply chain to mitigate foreign currency exchange risks as far as possible. Foreign currency hedging is in place up to 18 months ahead to provide stability of prices of overseas sourced raw materials and finished goods.</p>	<div>=</div>


Risks and uncertainties

continued

Operational risks continued

Risk	Strategic link	Mitigation	Movement
Property and retail store network The growth of the Group depends in part on its ability to open and operate new stores on a timely and cost-effective basis while continuing to increase sales at existing stores. Successful execution of any new store roll-out also depends upon a number of other factors, including the hiring, training and retention of qualified personnel and the capability of the Group's existing information technology and distribution systems to accommodate new stores. Property leases represent a significant commitment of the Group's resources. Unsuitable or underperforming sites may therefore negatively impact the Group's results for a number of years.	2 3 4	The Group continuously reviews the location and format of its stores and their contribution to overall results. A detailed appraisal model is applied to assess the payback period and expected profitability of each potential new store, including its impact on existing stores in the area. Appraisals are subject to thorough review and approval by the Board before any investment is made. The Group has an established supporting infrastructure in place to recruit and train new employees and fit out and open stores to schedule. The Group's property portfolio is reviewed regularly to ensure it remains appropriate and cost-effective for the needs of the business.	

Financial risks

Risk	Strategic link	Mitigation	Movement
Financial risk and liquidity A downturn in the macroeconomic environment may impact the Group's ability to obtain financing. An increase in interest rates could increase the Group's financing costs. The Group is also exposed to foreign currency exchange risk on certain purchases sourced from overseas.	2 3 5	The Group regularly reviews its financing arrangements to ensure it has adequate funds in place and financing costs are kept to a minimum. In August 2017 the Group's existing £200 million term loan was replaced with a new five year £230 million revolving credit facility. The new facility enables more dynamic management of short term borrowing needs, reducing interest costs. Foreign exchange and interest rate risks are managed through the use of appropriate hedging arrangements in accordance with its Board-approved treasury policy, with details reviewed by the Board on a regular basis. No financial instruments are entered into for speculative purposes.	
Consumer finance More than half of the Group's sales are to customers who utilise its interest-free finance offerings, which are provided by external finance houses that, in return for a fee, manage customer repayments and bear the risk of customer default. Credit availability with respect to customer finance offerings typically tighten during periods of economic downturn, which may limit the Group's ability to offer customer finance on commercially acceptable terms and/or may increase the amount of the fee payable to the external providers of customer finance. An increase in LIBOR may also result in an increase in the fees payable by the Group.	1	The Group has longstanding relationships with a number of finance houses, with long term contracts in place with four providers which more than cover the total requirement for customer finance. These arrangements provide surety of supply, acceptance rates and fee levels whilst also enabling a redistribution of business in the event of withdrawal by one or more providers. These key metrics are continuously reviewed to ensure that each provider remains competitive. The Group's Section 75 liability and complaints levels are extremely low due to its financial strength and focus on customer service, which is desirable to our finance partners. An increase in LIBOR that affects the cost of providing credit may be mitigated by revising the customer offer in line with maintaining market leader status. Further information can be found in note 23 to the financial statements.	

Viability reporting

In accordance with the revised UK Corporate Governance Code, the Directors have assessed the prospects of the Group over a period significantly longer than 12 months from the date of approval of the financial statements.

This assessment was based on the current position of the Group and the key risks and uncertainties as discussed on pages 12 to 16 of this Annual Report and considered a period of four years from 28 July 2018. A period of four years was selected by the Directors since it reflects the period over which the Group's various growth initiatives are anticipated to have a key impact on the business profile and corresponds to the Group's normal planning cycle.

Those risks which could significantly affect the future viability of the Group were identified, including the risk of a fall in consumer confidence or other market decline and the challenges that may arise from the UK's exit from the EU. The potential impacts of these risks on the financial performance and viability of the Group were assessed under a number of severe but plausible scenarios.

This assessment included sensitivity and stress-testing analysis of the impact of reduced revenues and a decrease in gross margin both separately and collectively. The analysis takes into account the high level of variable and discretionary spend in the Group's business model and the existence and effectiveness of other mitigating actions the Group could take, including the restriction of dividend payments.

In developing the viability assessment it has been assumed that the Group's £230.0 million revolving credit facility will continue to be available at least until its maturity in August 2022.

Based upon this assessment, the Directors have confirmed that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the four year assessment period.

Chief Executive's report

Continued development despite a challenging market in the fourth quarter



Ian Filby
Chief Executive Officer



In brief:

- Solid trading performance until exceptionally hot weather in fourth quarter
- Strategic levers continue to be pursued
- Well positioned to become stronger in this current environment

Overview

Our financial results for the year reflect a solid trading performance over the first three quarters, and the impact of the sustained market slowdown we saw in the fourth quarter. This sudden change in market environment was caused by the combination of very hot weather and the distraction caused by major public events. This was compounded by the impact of container shipping delays at Felixstowe, one of our major ports, which delayed some previously anticipated customer deliveries beyond the financial year end and still continues to cause disruption. Notwithstanding this, over the first three quarters we were satisfied with our financial performance in a challenging market and were pleased to see positive like-for-like order intake in the third quarter of the financial year. Throughout the year we have also sought to continue our strategic development and achieved some significant milestones.

Strategic update

Our Group has been transformed over the last twelve months through the acquisition of Sofology. We have commenced significant work to release the cost and revenue benefits of this new member of our Group.

DFS's performance has long been underpinned by an efficient operating platform, which we are working to develop further. Our scale enables us to realise cost advantages across a range of activities, from buying and advertising through to warehousing and two-man customer delivery. Following investment in technology and infrastructure, DFS's operating platform is now being leveraged in some areas by our subsidiaries Dwell and Sofa Workshop, and we have commenced work to broaden DFS's integration with Sofology. Critically the operating management of each brand will retain direct control over all aspects of the customer experience, thereby ensuring a distinctive brand proposition is maintained.

Our key strategic levers for the delivery of future growth continue to be those we set out at IPO. Progress in the year is described below:

Omnichannel

With the vast majority of sofa buyers carrying out significant research online, but also demanding a 'sit and feel test' in showrooms, we continue to believe a strong, integrated stores and web offer is critical to succeed in this segment. We have retained our strong online market leadership, with dfs.co.uk continuing to attract over 40% of all online specialist-sector traffic, and unique website visitor numbers continuing to grow across the Group. Online revenues once again grew strongly by 15.1%, a pleasing result given the challenging market backdrop.

We continue to invest in and optimise our omnichannel experience, particularly the mobile site where most of our web traffic originates. Our Sofology business has made significant progress with its omnichannel technology with the successful launch of its 'my sofology' app, which allows customers to receive additional information and build baskets on their phone in store, either independently or with sales colleague assistance, before then allowing them to check-out immediately or at home. On dfs.co.uk, we are delighted to be the first UK furniture brand to launch augmented reality furniture display on iOS 12 through the mobile website.

Broadening our appeal to customers

While we are market leader with all customer segments that we identify we still see significant growth opportunity from broadening the Group's appeal, with 32% of all potential customers that are aware of DFS still choosing not to consider the brand.

Our DFS advertising approach has continued to score strongly with customers, driving record 'brand love', 'brand acceptability' and 'brand consideration' scores. In making this progress we have also maintained 80% of all DFS advertising as having a pricing/promotional message, which has driven a strengthening of our perceived value and call to action. We have continued to develop new ranges for DFS under the French Connection,



Country Living and House Beautiful brands and successfully launched our new Joules ranges. We have also benefited from the sale of selected ranges from our own Sofa Workshop brand within the DFS store estate.

The acquisition of Sofology has also added a strong, distinctive brand with c.£180m of annual revenues to the Group's portfolio. We see significant roll-out potential for Sofology with a large number of areas where DFS currently trades successfully remaining unserved by the Sofology store network. Leveraging the strength of the DFS Group operating platform will also create the potential for some £4 million of near-term synergy benefits in the purchasing of advertising, interest-free credit, upholstery and other services. In the medium to longer term there is scope for further cost and revenue synergies, and for better utilisation of both companies' warehousing facilities and delivery fleets, together with potential for further Group benefits through shared innovation in the future.

Having now owned Sofology for approximately ten months, we are encouraged by the operational performance to date. Through the Group's scale we remain on track to drive anticipated synergies, and our financial strength has allowed us to secure beneficial working capital terms. Assisted by our support, Sofology has been able to deploy significantly higher amounts of marketing, including the use of national TV advertising, which has driven material like-for-like growth year-on-year. While this trading momentum has been encouraging, from October 2018 we will begin to annualise the reintroduction of TV advertising.

With the end of the earn-out period now being reached, Jason Tyldesley, Sofology's CEO and former majority shareholder, has decided to leave the business. I am however delighted to welcome Sally Hopson, who has joined the Group to take on the Sofology CEO role. Sally brings tremendous experience to Sofology and the Group, with a proven record of success in the furniture business and wider retail, having previously held senior roles at Habitat, Asda and most recently Pets at Home.

Chief Executive's report

continued



Delivering the highest standards of service to all our customers is explicit in our Group's values.

Store network development

Our well-established programme of opening new 10-15,000 sq ft DFS stores in the UK and Republic of Ireland at the rate of three to five per annum has remained on track, with three new stores in Haverfordwest, Rugby and Wednesbury all opening in the first half of the year. We continue to develop our small format store operating model, with openings in Chelmsford and in Guildford during the year resulting in five in total.

We have three new DFS stores due to open in the 2019 financial year, maintaining our established rate of expansion. We intend to be more selective in future given the national roll-out opportunity in non-cannibalistic locations offered by Sofology.

We are also currently finalising submissions for planning consent at an initial three trial retail park locations within the UK to optimise the existing leased Group retail footprint. In these proven locations, through the use of mezzanine space, we intend to open new Sofology and Dwell stores, while maintaining a full-size DFS 'ground floor only' presence, without any material increase to passing rents. We are also discussing commercial terms with a key partner landlord to deliver three further new build standalone Sofology stores within existing DFS leasehold curtilage, at a limited incremental rental cost for the Group.

Retail space and distribution cost efficiency

I'm pleased to confirm that our accelerated programme of establishing Customer Distribution Centres ("CDCs") for final mile delivery to customers has now completed with the opening of our two final UK CDCs this year. At the year end 45 stores had benefited from the conversion of their former warehouse space to retail use, while the weighted average of converted stores operational through the year was 44. During the current financial year we are converting ex-warehouse space in 16 stores to sell an extended range of DFS beds and dining furniture, and we will open one additional Dwell store in Farnborough.

We opened six new co-located Dwell stores, thus reaching a total of 36 Dwell stores across the UK. We also opened five new co-located Sofa Workshop stores. Sofa Workshop further grew through the acquisition of six standalone stores that formerly traded as Multiyork. At the end of the financial year there were therefore 31 Sofa Workshop stores operating, offering a true national footprint. We have been pleased at how quickly all these new stores have established themselves and we expect that Sofa Workshop and Dwell will generate attractive financial returns in the 2019 financial year as they leverage the Group operating platform and benefit from their increased store network scale.

We have continued to make progress in negotiations with landlords regarding our leased property estate, seeing significant rent reductions in five recently extended leases. We also took the difficult decision to close, following conversations with landlords, two legacy DFS stores in Darlington and Wetherby and one Dwell store at Westfield White City. Although all established DFS stores contribute towards profits, we are highly disciplined in ensuring we generate incremental profits and good returns on the lease adjusted capital employed. We intend to maintain this approach in future and where we believe stores do not generate an appropriate return we will either mothball or close those locations. The annualised combined benefit of the actions recently implemented will be to reduce our rental cost by over £2.0 million per annum, of which c. £1.2 million relates to leases renegotiated and extended.

Looking forward, with 42 leases now due to expire by the end of 2023, we continue to believe there will be a significant annualised property cost (rent and rates) benefit of £6-8 million to be realised through the renewal of leases.





International development

Our measured strategy of testing and learning in the Netherlands continues to progress. As we previously announced, we trialled TV marketing this Spring to assess the potential uplift from replicating the UK operations' broadcast marketing model. This proved initially encouraging, however as the Netherlands experienced the same hot weather seen across the UK in the fourth quarter we shall continue our trial for a further six months in order that we may fully assess this opportunity. This will fall within the scope of our budgeted operating loss in the Netherlands, which we expect to be in the range of £2-3 million for the coming year.

In Spain, our second store in Malaga is now fully established and together with our first store in San Javier, we continue to be pleased by progress. Notwithstanding the uncertainties surrounding Brexit, the business has performed well and contributed to operating profit during the year.

Customer service

Delivering the highest standards of service to all our customers is explicit in our Group's values. Our approach relies both on proactive training and on careful monitoring of our Net Promoter Score ("NPS") which is linked to staff incentivisation, combined with a feedback system that allows us to accurately measure and track the satisfaction of customers throughout their purchase down to product, store, factory and employee level.

I am pleased to report another strong performance in our DFS overall post-purchase NPS of 84.9% during the year, broadly in line with 85.2% in the prior year, and an improvement in established customer satisfaction (surveyed six months after orders are placed) to 35.8%, compared with 34.2% in FY17.

The quality of our products has always been of great importance to use and we are very proud that DFS has become the first (and to date only) retailer in the sector to have its upholstery products carry the prestigious British Standards Kitemark™.

Corporate responsibility

Our Group believes in responsible business conduct, and we work to raise our operational standards each year. We aim to interact with our customers, colleagues, shareholders, suppliers and the people in the communities in which we operate in a way that has a positive impact on society and the environment while supporting the Group's longer term commercial and strategic objectives.

Our sofa recycling partnership with The British Heart Foundation generated close to £4 million this year and we are on target to raise £1.5 million for BBC Children in Need by 2019 through our "Give me Five" customer initiative. In addition we continue to support The Duke of Edinburgh's Award and numerous local charities through direct donations.

We are committed to promoting a positive health and safety culture throughout DFS and improving the environmental performance of our operations year-on-year. We have continued to invest in improving our processes and practices to ensure that we operate safe, secure and responsible workplaces no matter where they are.

We will introduce a timber sourcing policy in the current financial year, under which we will measure and report on the certification of timber sources to inform future improvements. We are also undertaking a review of our finished goods packaging to seek to minimise our impact on the environment.

Chief Executive's report

continued

We recognise investing in our team of more than 5,000 people is critical to our success. We have continued our programme of training and development of all our people, with a particular emphasis on leadership development across our retail organisations. We are also proud of our award-winning apprenticeship programme, which is providing us with a new generation of highly-skilled colleagues. We are pleased to receive external recognition for excellence in employee conditions by the continuation for the fifth year of our Top Employer certification from the Top Employers Institute, and also our recognition within the Sunday Times' Top 25 'Best Big Companies to Work For'.

CEO succession

DFS announced in May 2018 that I was planning to retire as CEO at the end of October 2018. I was delighted to see that the Board of Directors and Nomination Committee chose Tim Stacey, previously our Chief Operating Officer, to be my successor. Having worked with Tim for many years, I believe he is a strong choice with a good balance of omnichannel retail, people leadership, strategic development and financial analysis skills. This appointment reflects both the quality of the Group's senior leadership and the success of our philosophy of developing internal talent. I look forward to supporting him in this role as I take on the role of Non-Executive Chair of Sofology over the 12 months to October 2019.

Outlook

We have continued working to develop our Group's strategic and market position; however financial results for the year reflected the exceptional downturn in market demand we saw in the fourth quarter. Our online channels, together with our Sofology, Dwell and Sofa Workshop businesses, continue to grow and we will continue to progress our operational and strategic development. The financial returns of strategic investments in online, new stores and our distribution network are feeding through into our results and we expect these along with operating cost efficiencies to benefit the new financial year.

We are pleased to note that the market has recovered since the start of the new financial year, with the Group seeing like-for-like order growth across all brands over the first nine weeks. We believe, however, we are benefiting from deferred purchases in the prior financial year and overall we expect the market to remain subdued into 2019, constrained by political risk and weak consumer sentiment. Notwithstanding this we believe we are well positioned to become stronger in this current environment, boosted by investment and acquisition benefits, and we have excellent prospects for profitable growth and attractive cash flow generation over the longer term.

Ian Filby

Chief Executive Officer
3 October 2018



Impact of the UK's exit process from the EU

We continue our work to assess and mitigate the likely impact from the current UK process to exit the EU. Given the range of possible scenarios it is impossible for us to be specific, however, we have been reviewing and continue to assess five potential aspects in particular, which may have an impact on our Group:

1. Consumer demand – we recognise the retail market for furniture may be volatile, so we intend to remain vigilant to signs that consumer demand is being affected, so that we may seek to respond appropriately and expediently
2. Border delays – while we have significant internal manufacturing activities and strong relationships with British manufacturers, just over half of finished good products that we sell are imported into the UK from mainland Europe or China. Although furniture goods will not 'spoil' as a result of any border delays, we would still see a deferral in revenue recognition in our made-to-order model and there would be an adverse impact to the customer proposition. We are trialling ways to accelerate the movement of goods internationally to mitigate some of these impacts. We also import raw materials (principally timber and fabric) to manufacture finished goods. We would expect our partner suppliers to increase the near-shore supply of these.
3. Increased regulatory burden and other friction – we operate our mainland EU activities using UK entities, and complying with European standards, including on passporting arrangements in financial services. We are reviewing any impacts on our ability to trade using this approach.
4. We do not currently expect to see a material tariff impact, as our finished goods currently largely attract a 0% tariff under WTO terms and our business has experience of operating within the tariff regime for Far East imports. Notwithstanding this there may be additional administrative and other cost burdens associated with the chain of custody requirements to avoid tariffs being imposed on raw materials imports.
5. Exchange rates – the exit process may prompt movements in the USD/GBP exchange rate, which would impact the cost of our Far East imports. We have increased Group hedging to cover our expected US Dollar requirements for the next eighteen months to give us increased time to respond to any such adverse trends.

We will continue our preparations for all likely process outcomes as part of our regular risk mitigation process, until the UK and EU's path forward is clear.

Chief Executive Officer Designate's remarks

Introductory thoughts from Tim Stacey



Tim Stacey

Chief Executive Officer Designate



In brief:

- I'm excited and honoured to take on this role and see many opportunities ahead
- I have some strategic priorities where I intend to increase the Group's pace and focus
- I intend to present a full update on our strategy in early 2019

I am excited and feel hugely honoured to be very shortly taking on the position of CEO at DFS. I have enjoyed working with Ian and every single member of the DFS family over the last seven years to grow our market-leading position and I see many exciting opportunities ahead. I'd like to take this opportunity to thank Ian for his continuing support and guidance, particularly over the last four months in helping me transition into my new role.

During this period I have taken some significant time to pause and reflect on our strategic priorities. While I intend to present a more detailed update in our interim results in early 2019, I'd also like to share some early reflections at this stage.

The five growth levers that we have followed to date have each had a clear business rationale and generated near-term returns. However, in today's market, I intend to increase the pace and focus in a few specific areas:

- We need to grow the core DFS business, driving like-for-like sales through strengthening of our end-to-end customer proposition and by accelerating our omnichannel strategy;
- With the acquisition of Sofology, and the continued growth at Dwell and Sofa Workshop it is now time to develop a true platform of services shared across the Group to reduce costs and increase capital efficiency; and
- We will exploit the revenue and earnings growth opportunities now presented by Sofology, Dwell and Sofa Workshop.

I'm also keen to ensure that our plans are underpinned by a deeper evidence-based understanding of our customers across the Group portfolio. We will continue our work in building these foundations.

To deliver the plan I need great people around me and I'm delighted to have such a strong Executive Team in place, consisting of talent from within the Group, following the restructuring of our key leadership positions to align with my appointment as CEO designate in August. I've also taken the opportunity to reinforce the executive team through the addition of Sally Hopson as CEO of Sofology. Sally brings a wealth of retail experience to the Group and will work with Ian Filby, in his new role as Chair of Sofology, to build this growing business.

In summary I'm looking forward to taking up the mantle of CEO and seizing the opportunities available to us to ensure the Group continues to flourish.

There is a real 'can do' attitude that pervades throughout the organisation and this provides me with great confidence that we will build on our position as the market leader by delighting our customers, providing a great working environment for our colleagues and as a result produce strong returns for our shareholders.

Key performance indicators



Financial



Gross sales (£m)

£1,125.6m

FY18	+13.6%	1,125.6
FY17		990.8
FY16		980.4
FY15		913.1

Description

Gross sales represents the total amounts payable by external customers for goods supplied by the Group, including aftercare products (for which the Group acts as an agent), delivery charges and value added and other sales taxes.

Performance

Sales growth from new stores and Sofology acquisition, but decrease in like-for-like store sales.

Underlying EBITDA (£m)

£76.1m

FY18	-7.6%	76.1
FY17		82.4
FY16		94.4
FY15		89.2

Description

Underlying EBITDA means underlying earnings before interest, taxation, depreciation and amortisation.

Performance

EBITDA decrease from reduced Group sales volumes and the lower relative profitability of acquired business.

Free cash flow (£m)

£60.4m

FY18	+6.0%	60.4
FY17		57.0
FY16		75.6
FY15		70.7

Description

Free cash flow is Underlying EBITDA, less cash capital expenditure and changes in working capital.

Performance

FY18 growth in free cash flow reflects normalisation of capital expenditure levels as activity on retail space release programme completes.

Cash conversion (%)

79.4%

FY18	+10.2%pt	79.4
FY17		69.2
FY16		80.1
FY15		79.2

Description

Cash conversion is free cash flow expressed as a percentage of Underlying EBITDA.

Performance

Significant increase in cash conversion due to increase in free cash flow despite decrease in underlying EBITDA.

ROCE (%)

15.6%

FY18	-3.1%pt	15.6
FY17		18.7
FY16		21.2
FY15		21.2

Description

Return on Capital Employed ("ROCE") is post-tax operating profit before non-underlying items plus operating lease charges expressed as a percentage of the sum of: property, plant & equipment, computer software, working capital and 8x operating lease charges.

Performance

Decrease in ROCE reflects the lower profitability of the pre-acquisition Group together with dilutive impact of acquired business.

Non-financial



Number of DFS stores

116

FY18		116
FY17		113
FY16		109
FY15		105

Description

Number of UK and Republic of Ireland stores trading at the end of the financial period.

Performance

Net increase of 3 stores comprises 5 opened and 2 closed.

NPS (%) – post purchase customer satisfaction

84.9%

FY18		84.9
FY17		85.2
FY16		83.9
FY15		78.8

Description

Average across all DFS stores based on post purchase customer satisfaction surveys.

Performance

Small year on year decrease in very strong overall level.

NPS (%) – established customer satisfaction

35.8%

FY18		35.8
FY17		34.2
FY16		31.2
FY15		21.9

Description

Average across all DFS stores based on established customer satisfaction surveys (six months after order).

Performance

Further progress achieved in FY18.

Online growth rate (%)

+15.1%

FY18		15.1
FY17		11.1
FY16		15.6
FY15		17.5

Description

Year-on-year change in Group sales generated by internet, telephone and live chat channels.

Performance

Continued growth in omnichannel sales.

Growth in partnership brand sales (%)

+7.0%

FY18		7
FY17		20
FY16		33
FY15		94

Description

Year-on-year change in value of DFS sales orders of external partnership brand product ranges.

Performance

Year-on-year growth normalising as new partnerships annualise. FY18 growth includes introduction of Joules partnership.

Stores with converted warehouse space

44

FY18		44
FY17		36
FY16		19
FY15		8

Description

Weighted average number of DFS stores during the financial period where former warehouse space has been converted into retail space.

Performance

CDC programme completed in FY18, remaining retail space conversion ongoing to FY20.

Financial review

Focus on maintaining gross margin and controlling costs



Nicola Bancroft
Chief Financial Officer



In brief:

- Reduced revenues in pre-acquisition Group impacted profitability
- Sofology performance encouraging
- Continued focus on maintaining gross margin and controlling costs
- Targeted investment and cash management key to delivering shareholder returns

The Group successfully completed the acquisition of Sofology on 30 November 2017. Accordingly, the consolidated results presented in this annual report include eight months' activity of the acquired business. In order to facilitate an understanding of underlying trading performance, the following table (which excludes non-underlying items) separates the results of Sofology from the pre-acquisition Group:

	DFS £m	Other brands £m	Existing Group £m	Sofology £m	Total £m
Gross sales	898.5	71.9	970.4	155.2	1,125.6
Revenue	689.2	58.5	747.7	122.8	870.5
Cost of sales	(276.7)	(25.9)	(302.6)	(61.0)	(363.6)
Gross profit	412.5	32.6	445.1	61.8	506.9
Selling and distribution costs (excluding property costs)	(223.9)	(22.3)	(246.2)	(35.3)	(281.5)
Brand contribution	188.6	10.3	198.9	26.5	225.4
Property costs			(84.8)	(14.3)	(99.1)
Underlying administrative expenses			(41.5)	(8.7)	(50.2)
Underlying EBITDA			72.6	3.5	76.1

We began the year well prepared for the continued challenging conditions in the UK living room furniture market, and the actions initiated in FY17 to improve our gross margin percentage have yielded positive results. The underlying weakness in the market was compounded in the last quarter of the year by a sustained period of hot weather which impacted key trading periods.

The acquisition of Sofology represents a significant opportunity for the Group and the performance of the acquired business has been encouraging so far.

As noted in the financial statements, with the expansion of the Group through a significant acquisition, we have taken the opportunity to enhance the presentation of our financial information by separating direct cost of sales from other selling and distribution costs on the face of the income statement. The table opposite further shows property costs separately in order to highlight brand contribution, our preferred measure of segment profitability.

Pre-acquisition Group

Gross sales and revenue

At the half year we reported a 3.5% decrease in Group gross sales and revenue, reflecting the tougher market conditions that had begun in the latter part of FY17. The impact of this new environment began to annualise in the second half of this year, giving a lower percentage decrease for the full year of 2.0%.

We had planned for challenging trading conditions through the year; however, as set out above, the final quarter was significantly more challenging than expected which gave rise to a disappointing end to the year as we described in our July trading statement.

As a consequence, gross sales for the year excluding acquisitions were £970.4 million (FY17: £990.8 million) and revenue was £747.7 million (FY17: £762.7 million).

Gross profit

While we experienced a reduction in revenue, we continued to benefit from our ongoing actions to improve our sourcing and range mix and consequently the gross profit for the pre-acquisition Group of £445.1 million (FY17: £448.5 million) was only 0.8% below last year. This represents an increase of 70 basis points in gross margin percentage to 59.5% (FY17: 58.8%) across the full financial year, in line with the expectation we shared at the half year.

This improvement was despite the impact of less favourable US Dollar exchange rates, particularly in the first half of the year. We continue to fully hedge our US Dollar purchases, with cover currently in place for the Group up to 18 months ahead.

Operating Costs

The deflation in TV advertising costs that we noted at the half year continued for the majority of the second half, allowing us to make savings in promotional spend while maintaining our strong presence and share of voice. This deflationary trend annualised towards the end of the financial year and we anticipate some inflationary impacts as we move forward into FY19.

Other operating costs were broadly consistent as a proportion of revenue, reflecting the high degree of variability in our cost base. However, new store openings in the year (and annualisation of those opened last year) did contribute to a small increase in non-variable elements of employee and site costs. Total selling and distribution costs excluding property costs decreased by 0.5% to £246.2 million (FY17: £247.5 million).

Property costs and administrative expenses

New store and CDC openings resulted in an increase in property costs of £4.3 million to £84.8 million, which in an environment of negative like-for-like revenues generated an increase in these costs relative to revenue.

Underlying administrative expenses increased by 8.9% to £41.5 million (FY17: £38.1 million) reflecting increased share based payment charges and auto-enrolment pension costs as well as some annualisation of vacancies filled in the last year.

Underlying EBITDA

As a net consequence of the decrease in revenue and other factors described above, underlying EBITDA for the pre-acquisition Group decreased by 11.9% to £72.6 million (FY17: £82.4 million).

Acquisitions

Sofology

The Group's acquisition of Sofology Limited was formally completed on 30 November 2017, with initial cash consideration payable of £26.0 million, reflecting a debt-free cash-free valuation of £25 million. After the recognition of an intangible asset of £13.8 million in respect of the Sofology brand name, goodwill arising on the transaction was £28.4 million. This figure represents an update on the provisional values available at the time of our interim results in March 2018.

The earnings period determining the value of any deferred consideration payable on the acquisition ended on 30 September 2018. Final results were still being prepared at the time of the publication of this annual report and there remains a high degree of uncertainty; however based on information available to date it is possible that some additional consideration may be payable and accordingly an accrual of £5.0 million has been recognised as a non-underlying expense.

The performance of the acquired business has been encouraging and we are beginning to see some early benefits of the synergies we aim to realise. Sofology contributed £122.8 million to Group revenue in the year and generated brand contribution of £26.5 million and a loss before tax of £1.4 million. If Sofology had been part of the Group for the full financial year, it would have contributed a total of £180.0 million to reported Group revenue, brand contribution of £36.6 million and a loss before tax of £4.1 million.

Multiyork

As announced on 22 December 2017, the Group agreed to acquire eight store leases and certain assets and intellectual property from Multiyork Furniture Limited on 27 December 2017, following that business entering administration, for cash consideration of £1.2 million.

Financial review

continued

Combined Group

Revenue and profit

Total Group revenue for the year, including acquisitions, was £870.5 million, an increase of 14.1% on the previous year (FY17: £762.7 million). The relative increase in gross profit of 13.0% to £506.9 million (FY17: £448.5 million) was slightly lower due to the dilutive effect of the Sofology gross margin percentage which for FY18 was 50.3% – substantially lower than the 59.9% equivalent margin reported for the DFS brand. While this dilution will not be eliminated immediately, the development of buying synergies and improved exchange rates on US Dollar purchases, offset by some inflationary pressures, should overall result in an improved Group gross margin percentage for FY19. The projected US Dollar requirements of the Group for the next 18 months are now fully hedged.

Underlying Group EBITDA of £76.1 million was 7.6% lower than the previous year (FY17: £82.4 million).

Group depreciation and amortisation charges increased to £28.3 million (FY17: £21.9 million). This was due to the combined effect of growth in the pre-acquisition Group, reflecting the capital investment in the CDC and retail space optimisation programme over the last three years, and additional charges for Sofology fixed assets. Amortisation charges include £1.1 million in respect of acquired brand names.

The increase in depreciation and amortisation charges in addition to the reduced operating margin of the Group resulted in a 21.0% decrease in underlying operating profit to £47.8 million (FY17: £60.5 million).

Non-underlying costs

A total of £9.9 million of non-underlying costs are included in administrative expenses comprising £2.6 million of professional fees relating to the Sofology and Multiyork acquisitions, £5.0 million estimated additional consideration for Sofology, £2.0m of integration costs incurred to date to drive the release of synergies and £0.3 million of restructuring costs relating primarily to the closure of our national distribution centre.

As we have previously guided, there will be further non-underlying expenses of c.£3 million incurred in FY19 in connection with the integration of Sofology to unlock the near-term synergy benefits that we see for the Group. We anticipate that we will be in a position to achieve the estimated £4 million annual benefit from these synergies from the beginning of FY20.

Operating profit after non-underlying costs was £37.9 million, a decrease of 37.4% on the previous year (FY17: £60.5 million).

Finance costs

At the start of the financial year the Group successfully refinanced its existing senior loan and revolving credit facilities with a new £230 million revolving credit facility. This has enabled us to flex the level of borrowings to more closely meet short term requirements, and minimise finance costs by using surplus cash to reduce borrowings instead of being held separately. The Group continues to manage interest rate risks associated with its borrowings through the use of appropriate hedging instruments.

As a consequence, notwithstanding the £21.3 million increase in net debt arising from the Sofology and Multiyork acquisitions, total net underlying finance costs of £10.7 million (FY17: £10.6 million) were in line with last year. In addition, £1.5 million of non-underlying finance costs were incurred in connection with the refinancing.

Tax

As in previous years, the underlying effective tax rate for the year of 20.7% (FY17: 21.1%) was higher than the applicable UK Corporation Tax rate of 19.0% (FY17: 19.67%), primarily due to disallowable depreciation on non-qualifying fixed assets. The higher total tax rate of 27.1% (FY17: 21.1%) reflects the non-deductible acquisition consideration and expenses incurred in the year.

Earnings per share

Underlying basic earnings per share for the Group were 14.0 pence per share (FY17: 18.7 pence), a decrease of 25.1% on last year. Including the effect of non-underlying operating and finance costs totalling £10.7 million, reported basic earnings per share decreased by 52.4% to 8.9 pence per share (FY17: 18.7 pence).

Capital expenditure

Although conversion of released retail space will continue through to FY20, the CDC warehouse opening programme was completed in the first half of FY18, and consequently cash capital expenditure reduced to £22.0 million (FY17: £28.3 million). This was slightly lower than our previous guidance of £24-26 million as during the year we began to source replacement commercial vehicles under finance lease arrangements. In FY19 we anticipate cash capital expenditure for the Group, including Sofology, to be £24-26 million.

The Board continues to place importance on enhancing the Group's return on capital employed. While we will continue to make an appropriate level of maintenance spend on our store estate and infrastructure and maintain a considered approach to our trial and innovation pipeline, we will focus the allocation of capital where there is a proven and positive return.

Cash flow and balance sheet

Although the decrease in profit had an inevitable impact, the Group continues to be highly cash generative, with net cash inflow from operating activities of £67.5 million (FY17: £74.8 million). Free cash flow (measured as underlying EBITDA, less capital expenditure and working capital movements) increased 6.0% on FY17 to £60.4 million (FY17: 57.0 million), primarily as a consequence of lower capital expenditure.

After £23.7 million of dividends paid to shareholders, and the costs of acquisitions, closing net debt was £159.0 million (FY17: £144.5 million). This resulted in a gearing ratio of 2.1 times underlying EBITDA (FY17: 1.75 times). The Board continues to target a return to a gearing ratio of 1.5 times over the medium term.

The Group will adopt IFRS 16 in FY20 and this will have a significant impact on the reported gearing ratio of the Group as leasing obligations are recognised in full on the balance sheet. Our work in this area is continuing and we will provide further updates in the year ahead. This change in reported gearing will not affect covenants on our bank facilities which will continue to be calculated in accordance with the pre IFRS 16 methodology.

Dividend

The Board remains focused on delivering appropriate returns to shareholders whilst maintaining a robust balance sheet. Over the medium term the Board expects to target a dividend pay-out ratio of 45-50% of profit after tax and will continue to work towards its commitment to maintaining a capital structure of 1.5x net debt/EBITDA.

The Board has decided to recommend to shareholders a final dividend of 7.5 pence per share (FY17: 7.5 pence), resulting in a total dividend for the year of 11.2 pence, in line with FY17. This reflects the Board's confidence in the underlying performance of and outlook for the business.

The Board continues to monitor the overall level of net debt in light of recent acquisitions and future investment opportunities. To the extent that the Group has sustainable levels of capital in excess of anticipated requirements, the Board expects to return it to shareholders.

Looking forward

As we move into a new financial year in what we anticipate to be continued challenging market conditions, we will retain our focus on maintaining our gross margin and controlling our costs while making appropriate investment in the growth of our business. The management of our cash will also be of importance in order to maintain the strength of our returns to shareholders and make the most efficient use of our borrowing facilities.

Nicola Bancroft

Chief Financial Officer
3 October 2018

Financial review

continued



Change of financial reporting period

As part of our work on transitioning Group reporting following the acquisition of Sofology we have completed a careful review of our Group's operational cycle and fit with financial reporting periods. This review has concluded that moving the Group's financial year to a 52 week period ending late June, would offer a number of benefits:

1) Manufacturing operations benefits – In order to maximise deliveries in each respective financial period the business has historically sought to delay manufacturing summer maintenance shutdowns for both our internal operations and also supplier partners through to early August. This has not been consistently possible with external suppliers, and is seen as less desirable by our manufacturing employees. A June financial period end would consistently be before any shutdown periods, improving year-on-year comparability of our financial results as well as allowing manufacturers to choose their optimal timing for annual shutdowns.

2) Improved comparability of period ends – We see consistent strong customer demand to receive orders ahead of Christmas as part of our Guaranteed Christmas Delivery campaign, which contrasts with customers' more variable willingness year-to-year to take delivery of orders at the end of January. We believe this consistent low point in the order bank allows more consistent measurement of trading performance in the half-year. Likewise we believe a similar comparability benefit will be seen in the change from July to June period ends, with the holiday period having differing degrees of impact on delivery of the order bank.

3) Timing of new store opening costs – Our experience indicates that the most immediate financial paybacks are generated by store openings made in time for the August bank holiday. In order to open a store in late August however, the store fit-out and training of staff must commence during July, resulting in a loss in that month as no revenues are being generated by the store. Although we have previously chosen to open a number of stores to be ready for the August bank holiday (most recently Barnstaple), it does create a distorting impact on the prior financial year. A move to a June financial year end allows these pre-opening costs to be recognised in the same financial period that the store opens.

4) Alignment of acquired business – Following its acquisition by the Group, there is a need for Sofology to align its financial year end (historically December) with that of the Group. This can be achieved more straightforwardly through an 18 month long period of account to June 2019 than inserting an additional short accounting period in order to align to a July year end.

We will therefore adopt an accounting reference date for the Group of 30 June with immediate effect, meaning FY19 will be a 48 week financial period ending 30 June 2019.

We do not anticipate there will be a material difference in our financial performance over the 52 weeks to June 2019 relative to the 52 weeks to July 2019. To aid comparison however we publish below a summary of financial performance for the 52 weeks and 48 weeks ending 30 June 2018.

52 weeks ending 30 June 2018 (unaudited)

	DFS £m	Other brands £m	Existing Group £m	Sofology* £m	Total £m
Gross sales	902.0	71.4	973.4	132.1	1,105.5
Revenue	691.3	58.1	749.4	104.6	854.0
Cost of sales	(277.0)	(25.7)	(302.7)	(52.6)	(355.3)
Gross profit	414.3	32.4	446.7	52.0	498.7
Selling and distribution costs (excl. property costs)	(222.5)	(22.0)	(244.5)	(31.0)	(275.5)
Brand contribution	191.8	10.4	202.2	21.0	223.2
Property costs			(84.7)	(13.0)	(97.7)
Underlying administrative expenses			(41.6)	(7.2)	(48.8)
Underlying EBITDA			75.9	0.8	76.7

* Sofology shown for the seven months ending June 2018, since acquisition

48 weeks ending 30 June 2018 (unaudited)

	DFS £m	Other brands £m	Existing Group £m	Sofology* £m	Total £m
Gross sales	806.7	64.7	871.4	132.1	1,003.5
Revenue	618.0	52.6	670.6	104.6	775.2
Cost of sales	(249.6)	(23.3)	(272.9)	(52.6)	(325.5)
Gross profit	368.4	29.3	397.7	52.0	449.7
Selling and distribution costs (excl. property costs)	(207.6)	(20.6)	(228.2)	(31.0)	(259.2)
Brand contribution	160.8	8.7	169.5	21.0	190.5
Property costs			(78.1)	(13.0)	(91.1)
Underlying administrative expenses			(39.4)	(7.2)	(46.6)
Underlying EBITDA			52.0	0.8	52.8

* Sofology shown for the seven months ending June 2018, since acquisition

The strongly profitable financial results that can be implied for July 2018 and July 2017 partly reflects significant volumes of deliveries being made in the month, following the important Easter and May bank holiday periods. Lead times are also typically shorter in this period in order to minimise the customer impact of August manufacturing shutdowns and to ensure booked orders are recognised before year end. In addition, operating costs are generally lower during the July period as with limited consumer demand events, minimal promotional marketing spend is incurred. Measuring July and August together shows a financial result that is not materially different to a typical two month period in the year.

Corporate responsibility at a glance

At DFS, we believe in responsible business

Our approach

At DFS, we believe responsible business should run through everything we do, so we can make a positive impact on our customers, employees, shareholders, suppliers, the communities in which we operate and our planet. Each member of our Executive Board takes responsibility for relevant matters within their area to align the achievement of the Group's longer term commercial and strategic objectives with this ambition.

2018 highlights

This year we have continued to develop our people and products to give our customers the best possible experience.

Completed apprenticeships

34

See page 34



The Board

Oversight of CSR matters and performance



Executive Board

Responsibility for focus areas



Areas of focus

People | Customers | Working Sustainably



Who benefits

Employees | Communities | Suppliers
Customers | Shareholders

People & community

- Placed 23rd in Sunday Times Best Big Companies to Work For 2018
- Approved training provider under the Apprenticeship Levy, supporting our award-winning modern apprenticeship scheme
- Almost £4 million raised for British Heart Foundation this year

Primary responsibility:

Chief People Officer





Customers

- DFS upholstered products the first to be awarded the British Standards Kitemark™
- Continuous customer feedback aligned to employee reward

Primary responsibility:

Chief Commercial and Marketing Officer



Working sustainably

- Sustained control on CO₂e emissions as we grow
- Further progress on timber sustainability and documentation of sourcing

Primary responsibility:

Chief People Officer | Chief Commercial and Marketing Officer



Company
car CO₂

100g/km

See page 37

Corporate responsibility

People & community

The people in our business are absolutely fundamental to its success and the Group continues to invest in training and development to equip our teams with the knowledge and skills they need to provide the best possible service to our customers and to progress their own personal development.

We employ over 5,500 people across the UK, Republic of Ireland, the Netherlands and Spain. We believe that our ability to deliver fantastic products and service to our customers comes from the passion and commitment shown by all our people across all parts of our Group. We are proud of the work we do to develop and strengthen our teams.

Apprenticeships

We began our modern apprenticeship programme back in 2014 with a focus on recruiting and developing young people. We are very proud of our award-winning programme which supports participants to achieve formal qualifications in their chosen field, complete the Duke of Edinburgh Gold award and gain valuable work experience. To date, 34 young people have successfully completed the programme and now hold permanent positions in the Group in a variety of areas including service upholstery, manufacturing, retail and administration.

DFS participates actively in the national development of apprenticeship standards in manufacturing and retail for our industry. In February 2018 we were pleased to be accepted on to the register of approved training providers which means we are able to deliver Level 2 apprenticeship programmes ourselves utilising the Apprenticeship Levy fund. In addition, we actively promote the benefits of further learning and development for all our employees, at whatever stage of their career. As a result a number of existing employees are now pursuing advanced training at Level 3 and above and we aim to further expand this in the year ahead.

New colleagues welcomed to the Group after Sofology acquisition

+1,000



Workplace

We first launched Workplace by Facebook as an internal communication and engagement tool in 2017, and currently more than 2,300 of our colleagues use it on a daily basis to connect teams and support business efficiencies. Our supply chain teams used Workplace to host their #Drivewise campaign to promote safe and efficient driving, posting regular updates and helpful advice. Our service manager teams have also embraced the tool, using it to host groups for different regions/areas and sharing best practice, while retail colleagues use it to facilitate

queries and share successes. In addition to specific business area groups, company-wide groups generate positive engagement more broadly with activities such as the #HealthySelfie campaign in the 'Living Well' Workplace group which focused on colleague health and wellbeing.

We were delighted to receive recognition for the energy and enthusiasm our colleagues have shown in developing their use of the tool when we won 'Most impressive business results' at the Workplace awards.

Staff using Workplace daily

2,300



Diversity

DFS firmly believes in the benefits of a diverse workforce. The gender analysis of employee numbers is reported to the operating board on a monthly basis and monitored against targets for sales and management teams. DFS has established a Diversity Steering Group to develop and implement new and ongoing initiatives to further improve our gender balance, including specific diversity objectives for all senior managers. The gender balance of employees at July 2018 is shown opposite:

Directors

2018	3 (50%)	3 (50%)
2017	3 (50%)	3 (50%)

Senior managers

2018	10 (83%)	2 (17%)
2017	6 (75%)	2 (25%)

All employees

2018	3,628 (65%)	1,919 (35%)
2017	2,867 (66%)	1,473 (34%)

■ Male
■ Female

Although the proportion of female employees increased in each of the existing brands compared to 2017, the Group figures above also reflect the influence of the acquisition of Sofology. This has a particular impact on the senior manager category given the smaller number of individuals.

Employee rewards

DFS aims to reward our employees fairly. In addition to competitive salaries all employees are able to influence their earnings through reward schemes linked to performance. We also offer a Sharesave scheme to all UK and Republic of Ireland employees to give them the opportunity to share in the longer term success of the Group. During the year the Group published details of its Gender Pay Gap Reporting, further details of which can be found in the Remuneration Report on page 80.

Employee engagement

In addition to open communication via Workplace, employee views are sought an active programme of engagement surveys, the results of which are communicated back to staff. Having achieved 26th place in the Sunday Times Top Big Companies List last year, we were very pleased to have made further improvement this year, reaching 23rd place. We also continue to receive external recognition for excellence in employee conditions by the retention of our Top Employer certification from the Top Employers Institute.

Health & safety

The health and well-being of our employees, customers and partners is extremely important to DFS. We are committed to promoting a positive health and safety culture throughout the Group, and have continued to invest in training and

in improving our processes and practices to ensure that we operate safe and secure workplaces no matter where they are.

All employees complete online training modules to ensure awareness of DFS 'house rules' for health and safety and these are reinforced with monthly safety messages to refresh and remind on particular subjects. More detailed, role-specific training is provided to store, production and supply chain managers. Other areas of the business receive focused training according to need.

Our dedicated health and safety team have made further enhancements to training and internal audit programmes to consolidate the significant progress made in this area over the last few years. Although we are pleased with the advances that we have made, we recognise that continuous monitoring and development is essential to sustain this. The Chief People Officer chairs monthly health and safety governance meetings with operational directors to review incidents and activities in detail and share experience and best practice. Full reports are provided to each Operating Board and Reputational Risk Committee meeting.

We were delighted to receive a Bronze Award from RoSPA during the year in recognition of our efforts and progress to date.

DFS aims to support the health and welfare of our employees and their families through a variety of initiatives including life and critical illness cover, and an employee assistance service. It is the policy of the Group to support the employment of disabled people, wherever possible, both in recruitment and by retention of employees who become disabled whilst in the employment of the Group as well as generally through training and career development.

During the year we have also increased our focus on the well-being of our people, with monthly 'Living Well' messages and activities to provide education and support on a wide range of topics including exercise, nutrition, stress management and mental health.

Corporate responsibility *continued*

Community

The Group has continued to support the three major national charities with which we have longstanding relationships:

Our partnership with British Heart Foundation offers our customers a convenient and responsible way to recycle their old sofas while raising money to support the work of the charity. The scheme, which has been running since 2012, goes from strength to strength and has generated in that time an incredible £18 million for the charity.

We have also continued our support for BBC Children in Need through a variety of fundraising activities including our "Give me Five" initiative which offers customers a chance to win their entire order for free by entering a monthly draw. We have pledged to raise £1.5 million by 2019 for the charity, which funds life changing projects for disadvantaged children across the UK.

DFS remains a Gold Partner of the Duke of Edinburgh's Award, supporting young people to develop new skills for work and life and contribute to their communities. This includes our apprentices, who complete the Gold award as part of their apprenticeship programme.

In addition to the major national charities above, DFS supports a number of charities and initiatives based locally to our operations across the UK and in Europe, particularly those promoting opportunities for young people. We also offer a matched funding plan for DFS team members raising money for a charity of their choice. Charitable donations made by the Group during the year amounted to £168,320 (2017: £181,050).



Amount pledged
to BBC Children in
Need for FY18/FY19

£1.5m

Customers

Our key strength as the market leader is to provide our customers with a fantastic range of products, backed up by friendly and knowledgeable customer service.

To ensure we deliver the highest levels of customer service we make significant investment in training and developing all of our people. Staff performance and customer satisfaction are monitored through regular inspections, surveys and mystery shoppers, which are carried out through an independent consumer research group.

Customer referral is the perfect indicator of excellent customer satisfaction and we use Net Promoter Score ("NPS") as a measure of recommendation, which provides us with an internationally recognised predictor with proven links to business success. We measure this not only after a customer has placed an order ("Post Purchase NPS"), but also after their furniture is delivered ("Post Delivery NPS") and six months after the order was placed ("Established Customer NPS"). Established Customer NPS forms a component of remuneration for employees throughout the business, including salespeople, management and head office teams and Executive Directors.

All upholstered furniture items are offered with a guarantee of at least

15 years



The only sofa company
awarded the British Standards
Kitemark™ for quality

Products & suppliers

DFS goes to great lengths to ensure the quality and safety of all the products it sells. With nearly 50 years of designing and manufacturing sofas in the UK, our unique knowledge of the manufacturing process enables us to understand and work with our key suppliers worldwide to ensure they can meet our quality standards.

Our own detailed quality checks and product testing are supported by the use of independent safety specialists, and all upholstered furniture items are offered with a guarantee of at least 15 years. Fire safety is also of paramount importance so all our products are tested by independent organisations such as the Furniture Industry Research Association ("FIRA") to ensure they meet our rigorous standards policy.

We are very proud that our upholstery products now carry the British Standards Kitemark™ for domestic furniture, making DFS the first and to date only furniture retailer to be awarded this prestigious external quality standard.

Working sustainably

Environment

The Group has continued its efforts to improve the environmental performance of its operations. Our focus continues to be on the key areas of energy efficiency, waste reduction and reducing the impacts of our vehicles and transport operations. We have an Energy Management Policy in place to support the reduction of the Group's energy use where practical and consistent with the operational needs of the business.

Electricity use is a key component of the Group's CO₂ emissions. Significant reductions in electricity usage have been achieved and we continue to roll out low energy lighting schemes. Additionally, we use automated meters to monitor and investigate usage of both gas and electricity.

Our customer distribution centres are all equipped with balers to facilitate the recycling of both cardboard and polythene used in packaging materials and we continue to look at ways to reduce our use of these materials.

The growth in the Group has increased the number of customer deliveries being made. In addition to investing in telemetry systems for our distribution fleet, we also launched a #Drivewise initiative during the year which promotes techniques for safer and more fuel-efficient driving. All our drivers receive regular feedback via the telemetry system and use Workplace to share tips and knowledge.

We have also achieved further improvements in the CO₂ performance of our company car fleet which at an average of 100g/km (FY17: 103g/km) is 18% below the UK national average for new registrations.



Greenhouse gas data

	Tonnes CO ₂ e		Tonnes CO ₂ e per employee	
	2018	2017	2018	2017
Scope 1	14,229	13,766	2.9	3.2
Scope 2	15,608	15,733	3.2	3.7
Total	29,837	29,499	6.1	6.9

Sustainability

DFS is committed to responsible sourcing, and our long-term aim is to ensure the timber and timber products in our furniture originate from well managed forests and recycled sources certified to credible certification standards, especially FSC® and PEFC certification. We are engaging actively with our suppliers to implement a robust verification programme for timber and timber products sourcing – to trace the timber and timber products used and bought to ensure legality and sustainability.

We have longstanding relationships with our upholstery suppliers and close contact with them is maintained through frequent visits by our operational and senior management. DFS has led the industry in establishing quality level agreements with all suppliers; these set targets for ways of working and service outcomes together with a dedicated forum for working in partnership with suppliers to monitor and improve performance, including compliance with our ethical trading requirements.

Modern slavery

The Group does not tolerate modern slavery in any part of our operations or supply chain. We have developed a series of steps to mitigate the risks of slavery or human trafficking within our business, including: formal communication with new and established suppliers, regular visits to suppliers both in the UK and overseas to audit our suppliers' practices in accordance with our supplier Code of Conduct. Our suppliers must be able to demonstrate that they operate to recognised standards, uphold human rights and prevent modern slavery. Our statement made in accordance with the Modern Slavery Act 2015, which contains further information, is available on our website at www.dfscorporate.co.uk.

As our business grows and our supply chain develops, we will continue to assess the effectiveness of our programme through our already established Conduct & Compliance Committee.

This Strategic Report was approved by the Board on 3 October 2018.

On behalf of the Board

Ian Filby
Chief Executive Officer

Nicola Bancroft
Chief Finance Officer

Board of Directors



Ian Durant (60)
Non-Executive Chair

Date of joining DFS
May 2017

Experience

Ian has a background in international finance and commercial management and previously held non-executive roles with Home Retail Group plc, Greene King plc, Westbury plc and, more latterly, as Chair of Capital and Counties Properties plc. Prior to this, he held several Finance Director/CFO roles at Liberty International plc, Sea Containers and Thistle Hotels plc as well as various associate companies of the Jardine Matheson group.

Qualifications

BA (Hons) in Development Studies, Economic and Social History from Kent University, Fellow of the Institute of Chartered Accountants in England and Wales and Fellow of the Association of Corporate Treasurers

External appointments

- Chair of Greggs plc¹
- Trustee and Chair of Finance and Investment Committee of Richmond Parish Lands Charity



Ian Filby (59)
Chief Executive Officer*

Date of joining DFS
September 2010

Experience

Ian has 37 years of retail experience, primarily at Alliance Boots, where his most recent roles were Retail Brand Development Director and Trading Director.

He was also previously Interim Chief Executive Officer of Nectar and Non-Executive Chair of Shoe Zone plc.

Qualifications

MA (Hons) in Chemistry from Cambridge University

External appointments

- Chair of Joules Group plc
- Member of the British Retail Consortium Board
- Chair of the British Retail Consortium Policy Board
- Trustee of The Pennies Foundation charity
- Director of IFF Life and Business Solutions Ltd



Nicola Bancroft (54)
Chief Financial Officer

Date of joining DFS
January 2013

Experience

Nicola has 30 years of experience in the retail sector and previously worked for Alliance Boots where she held a series of senior finance roles, including Commercial Finance Director and Retail & Transformation Finance Director. She initially joined DFS as Commercial Finance Director and established the commercial finance function. Currently, as CFO, her responsibilities include finance, internal audit, risk management, financial services and company secretariat.

Qualifications

BA (Hons) in Accounting and Finance and fellow of the Chartered Institute of Management Accountants

External appointments

None



Luke Mayhew (65)
Senior Independent
Non-Executive Director

Date of joining DFS
October 2014

Experience

Luke previously served for 13 years on the Board of John Lewis Partnership, including as Managing Director of the Department Store division. He also spent five years at British Airways plc and seven years at Thomas Cook Group plc in senior positions. He was also previously Chair of the British Retail Consortium, a Non-Executive Director of WH Smith plc and Brambles Ltd, and Chair of Pets at Home Group Limited.

Qualifications

BA (Hons) in Politics, Philosophy and Economics from Oxford University and a Masters in Economics from the University of London

External appointments

- Independent Non-Executive Director of InterContinental Hotels Group plc
- Trustee of BBC Children in Need
- Trustee of the National Youth Orchestra of Great Britain
- Governor of the Southbank Centre
- Director of Platinum Sports Management Ltd



Alison Hutchinson C.B.E. (51)
Independent
Non-Executive Director

Date of joining DFS
May 2018

Experience

Alison has a background in both IT and retail financial services and was previously Group CEO of Kensington Group.

She has also held senior management positions, including Marketing Director, at Barclaycard having started her career at IBM where she became Global Director of Online Financial Services.

Alison has worked with the retail industry over the last 10 years to establish the fastest growing fintech charity. Up to December 2017, she was an Independent Non-Executive Director of Aviva Life, GI & Health UK. In 2016, Alison received a CBE for her services to the Economy and Charity.

Qualifications

BSc (Hons) in Technology and Business Studies from Strathclyde University

External appointments

- Chief Executive of The Pennies Foundation charity
- Independent Non-Executive Director of Liverpool Victoria Friendly Society Ltd²
- Independent Non-Executive Director of Yorkshire Building Society



Julie Southern (58)
Independent
Non-Executive Director**

Date of joining DFS
February 2015

Experience

Julie was previously with Virgin Atlantic for 13 years, firstly as CFO for ten years before taking on the role of Chief Commercial Officer. Prior to joining Virgin Atlantic, she was Group Finance Director of Porsche Cars GB and Finance and Operations Director of WH Smith's subsidiary HJ Chapman & Co. She was previously an Independent Non-Executive Director of Gate Group Holdings AG and Stagecoach Group plc.

Qualifications

MA (Hons) in Economics from Cambridge University and member of the Institute of Chartered Accountants in England and Wales

External appointments

- Independent Non-Executive Director of NXP Semiconductors N.V.
- Independent Non-Executive Director of Cineworld Group plc³
- Independent Non-Executive Director of Rentokil Initial plc³
- Independent Non-Executive Director of Ocado Group plc
- Independent Non-Executive Director of easyJet plc



Tim Stacey (47)
Chief Executive Officer
Designate***

Date of joining DFS
July 2011

Experience

Tim currently serves as DFS's Chief Operating Officer being responsible for retail, supply chain, IT, property and business development activities.

Prior to this, he was Business Development Director and led the successful acquisitions, integration and development of Sofa Workshop and dwell.

Before joining DFS, he spent 12 years at Alliance Boots, where he became Multi-Channel Director responsible for Boots.com.

Qualifications

BA (Hons) in Accounting and Finance from Nottingham Trent University and member of the Institute of Chartered Accountants in England and Wales

External appointments

None

Committee membership key

- A** Audit Committee Member
- N** Nomination Committee Member
- R** Remuneration Committee Member
- ☐ Denotes Chair
- None

- 1 Chair of the Nomination Committee
- 2 Chair of the Remuneration Committee
- 3 Chair of the Audit Committee

* to step down from the Board on 31 October 2018

** to step down from the Board on 30 November 2018

*** to be appointed to the Board as Chief Executive Officer on 1 November 2018

Directors' report



Introduction

The Directors present their Annual Report and audited financial statements for the 52 weeks ended 28 July 2018, in accordance with section 415 of the Companies Act 2006. Certain disclosure requirements for inclusion in this report have been incorporated by way of cross reference to the Strategic report and the Directors' remuneration report, and should be read in conjunction with this report.

The following also form part of this report:

- greenhouse gas emissions, which can be found on page 37;
- employees, which can be found on pages 34 to 35;
- the Corporate Governance statement, set out on pages 42 to 49; and
- our strategy and objectives, set out on pages 10 to 11.

Information regarding the Company's charitable donations can be found in the corporate responsibility report on page 36. No political donations were made in FY18 (FY17: £nil).

The Company

DFS Furniture plc (the "Company") is a company incorporated and domiciled in the UK, with registration number 07236769.

The shares of the Company have been traded on the main market of the London Stock Exchange throughout the 52 weeks ended 28 July 2018. The Company has no overseas subsidiaries but operates branches in the Republic of Ireland, Spain and the Netherlands.

Results and dividends

The Group's results for the year are set out in the consolidated financial statements on pages 90 to 117. The Company only results of DFS Furniture plc are set out on pages 118 to 121. The Directors have declared an interim ordinary dividend of 3.7 pence per share which was paid on 20 June 2018, and also proposed a final dividend of 7.5 pence per share to be paid in respect of the 52 weeks ended 28 July 2018. It is intended that the final dividend will be paid on 27 December 2018 to all shareholders on the register on 7 December 2018. The Company's shares will trade ex-dividend from 6 December 2018.

Directors

The Directors of the Company who held office at the date of this Annual Report and their biographical details can be found on pages [38] to [39]. Following recommendations from the Nomination Committee, the Board considers that all Directors continue to be effective, committed to their roles and able to devote sufficient time to discharge their responsibilities.

All of the Directors were appointed to the Company on 2 February 2015 with the exception of Nicola Bancroft who was appointed on 1 August 2016, Ian Durant who was appointed on 2 May 2017 and Alison Hutchinson who was appointed on 1 May 2018. In accordance with the Company's Articles of Association, all of the Directors will retire from office and seek re-election at the Company's Annual General Meeting on 30 November 2018, with the exception of Julie Southern and Ian Filby, who will step down on that date, and Alison Hutchinson who will seek election.

Directors' interests

Information about the Directors' interests in the Ordinary Shares of the Company on 28 July 2018, or date of appointment if later, and any subsequent changes as at 1 October 2018 is set out in the Directors' remuneration report on pages 58 to 82.

Directors' indemnities and insurance

In accordance with the Companies Act 2006 and the Company's Articles, the Company has purchased and maintains directors' and officers' liability insurance cover which remains in place as at the date of this report. A review is carried out on an annual basis to ensure that the Board remains satisfied that an appropriate level of cover is in place.

Employees

As at the year end the Company employed 5,565 employees (as set out in the gender analysis table on page 35).

Articles of Association

The Articles of Association of the Company can only be amended by special resolution at a general meeting of the shareholders. No amendments are proposed at the 2018 AGM.

Annual General Meeting ('AGM')

The Company's next AGM will take place on 30 November 2018 at DFS Head Office, 1 Rockingham Way, Redhouse Interchange, Adwick-le-Street, Doncaster, DN6 7NA at 2.30pm, and the Chair of each of the Board's Committees will be present to answer questions put to them by shareholders. The Annual Report and Accounts and Notice of the AGM, including the resolutions to be proposed, will be sent to shareholders at least 21 clear days prior to the date of the meeting.

To encourage shareholders to participate in the AGM process, the Company proposes to offer electronic proxy voting through the CREST service and all resolutions will be proposed and voted on at the meeting on an individual basis by shareholders or their proxies. Voting results will be announced through the Regulatory News Service and made available on the Company's corporate website.

Share capital

Details of the Company's share capital are set out in note 21 to the consolidated financial statements. The Company has one class of Ordinary Shares and, as at 1 October 2018, the Company had an issued share capital of 213,030,601 Ordinary Shares of £1.50 each.

The rights and obligations attached to these shares are governed by UK law and the Company's Articles of Association. Holders of Ordinary Shares of the Company are entitled to receive notice and to attend and speak at general meetings. On a show of hands, every shareholder present in person or by proxy (or duly authorised corporate representatives) shall have one vote and, on a poll, every member who is present in person or by proxy shall have one vote for every share held.

Other than the general provisions of the Articles of Association and prevailing legislation, there are no specific restrictions on the size of a holding or on the transfer of the Ordinary Shares. The Directors are not aware of any agreements between holders of the Company's shares that may result in the restriction of the transfer of securities or on voting rights. No shareholder holds securities carrying any special rights or control over the Company's share capital.

Authority to purchase own shares

At the last AGM of the Company on 1 December 2017, the Company was authorised to purchase a maximum of 10% of the Company's issued share capital. This authority will expire at the close of the next AGM on 30 November 2018 unless revoked, varied or renewed prior to that meeting.

Since the date of the last Annual Report, no shares have been purchased by the Company and 161,120 treasury shares have

been utilised to satisfy share-based employee-awards and SAYE options. As at the date of this Annual Report, 1,338,022 Ordinary shares of £1.50 each are held by the Company as treasury shares with the expectation that they will be utilised to satisfy future share-based employee-award/SAYE option obligations.

A resolution will be proposed at the 2018 AGM to renew this authority.

Authority to allot shares

At the last AGM of the Company on 1 December 2017, the Company was granted a general authority by its shareholders to allot shares up to an aggregate nominal amount of £105,765,729 (or up to £211,531,459 in connection with an offer by way of a rights issue).

As at the date of this Annual Report, no shares have been issued under this authority. This authority will expire at the conclusion of the 2018 AGM unless revoked, varied or renewed prior to that meeting.

A resolution will be proposed at the 2018 AGM to renew this authority.

Major interests in shares

As at 1 October 2018, being the last practicable date prior to the publication of this report, the Company had been advised of, and subsequently disclosed, the following significant notifiable interests in the Company's voting rights:

	Number of voting rights	% voting rights	Date of last notification
Franklin Templeton Fund Management Ltd	21,157,000	10.0%	27 Aug 2018
Jupiter Asset Management	12,391,391	5.9%	23 Oct 2015
Pelham Long/Short Small Cap Master Fund Ltd	12,292,942	5.8%	11 Apr 2016
UBS Investment Bank	10,879,004	5.1%	21 May 2018
J O Hambro Capital Management Ltd	10,804,588	5.1%	24 Nov 2017
Standard Life Aberdeen plc	10,802,656	5.1%	9 Jul 2018
Aviva plc & subsidiaries	10,681,110	5.0%	23 May 2018
SK Family Investment LLC	10,611,623	5.0%	28 Sep 2017

These interests may have changed since the Company received notification. However, notification is not required until the next applicable threshold is crossed.

Financial risk management

The Company's objectives and policies on financial risk management, including information on credit, liquidity and market risks can be found in note 23 to the financial statements.

Going concern

The Group remains highly cash generative and currently has sufficient medium and long-term facilities in place, including a £230.0 million revolving credit facility in place until August 2022, of which £207.0 million is currently utilised at the date of this Annual Report. Further details of these facilities and the Group's financial management objectives are detailed in the financial statements.

On the basis of their assessment of the Group's financial position, forecasts and projections, the Company's Directors have a reasonable expectation that the Company and the Group will be able to continue in operational existence as detailed in the Viability Statement on page 17. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Auditor and disclosure of information to auditor

Each of the Directors at the date of this report confirms that:

- so far as he/she is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- he/she has taken all the reasonable steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of the information.

The confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

KPMG LLP has expressed its willingness to continue in office as auditor and a resolution to re-appoint it as the Company's auditor will be proposed at the forthcoming AGM.

Subsequent events

Between 28 July 2018 and the date of signing this report there have been no reportable subsequent events.

This report has been approved by the Board of Directors and has been signed on its behalf by:

Elizabeth McDonald

Group Company Secretary
3 October 2018

Corporate governance statement



Ian Durant
Chair of the Board
3 October 2018



The effectiveness of our governance relies on a culture of open communication, mutual trust and honest assessment of our strengths and areas for development.



Governance contents

Audit Committee report

- Financial reporting
- External audit
- General Data Protection Regulations

 See page 50-55

Nomination Committee report

- Chief Executive succession
- New non-executive appointment

 See page 56-57

Director's Remuneration report

- Updated remuneration policy
- FY18 bonus results
- Proposals for FY19

 See page 58-82

Dear Shareholder

I am pleased to introduce DFS Furniture plc's corporate governance report for the year, being my first full year as the Non-Executive Chair.

We have continued to apply the principles and provisions of the UK Corporate Governance Code ("Governance Code") and the following reports provide details of the Board's activities during the year, including how it has discharged its governance duties and applied the principles of good corporate governance.

The effectiveness of our governance relies on a culture of open communication, mutual trust and honest assessment of our strengths and areas for development.

This year has involved an increased focus on succession management. This was particularly in relation to the planned stepping-down of Ian Filby, our Chief Executive Officer, further details of which can be found in the Nomination Committee report on page [56], and changes to the executive team which resulted from the appointment of Tim Stacey as his successor. It also included the appointment of Alison Hutchinson, to succeed Gwyn Burr, as a non-executive director.

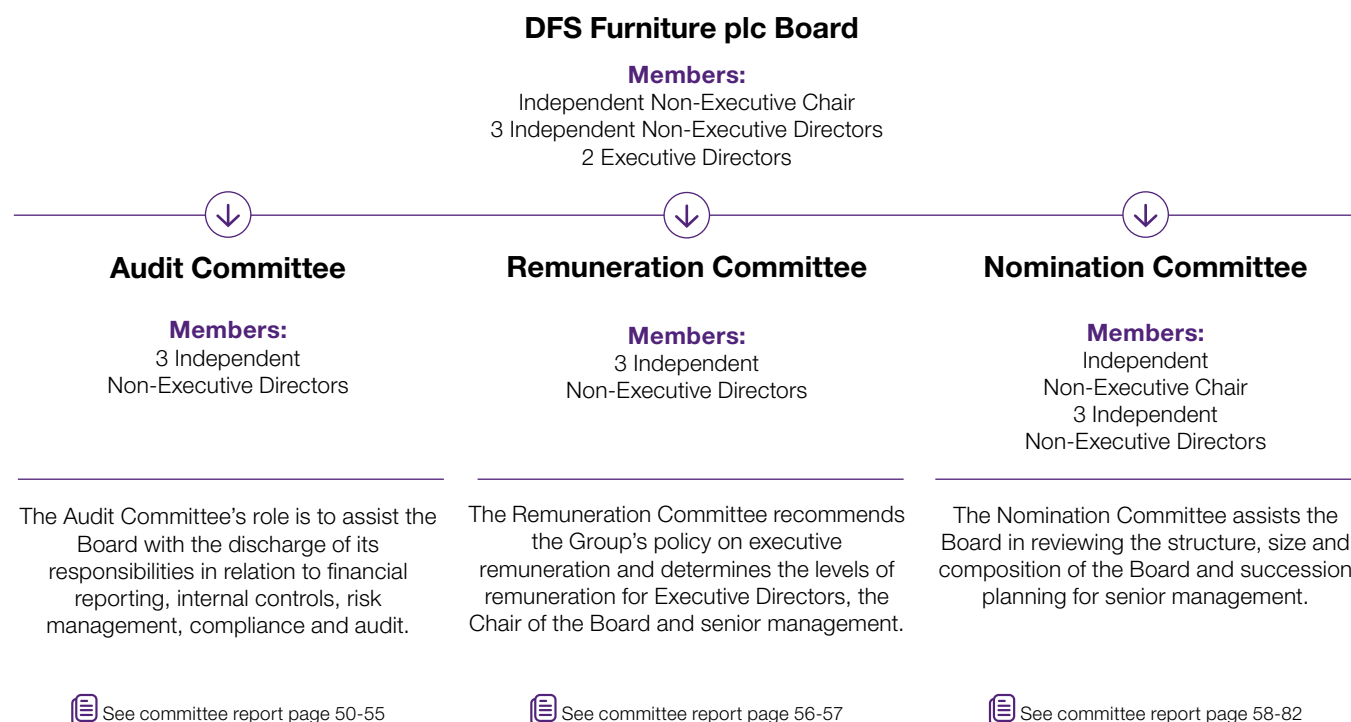
In addition, the Remuneration Committee, following the third anniversary of our first Remuneration Policy as a listed company, has reviewed the Directors' Remuneration policy, in preparation for seeking shareholder approval at the forthcoming Annual General Meeting ("AGM"), in accordance with the requirements of the Governance Code. Further details of this policy can be found in the Remuneration Committee report on page 58.

In the Corporate Governance Statement last year, I noted our intention to undertake an externally facilitated review of the Board this year. I am pleased to confirm that such a review of the Board was carried out and the results of the evaluation were positive and helpful. This is discussed later in the Corporate Governance Statement on page 48.

Looking forward, the Board is considering the new requirements of the recently published 2018 UK Governance Code, (which takes effect from 1 January 2019) and ways to provide continual development and improvement of our governance. A particular area to highlight is the need to develop deeper engagement by the Non-Executive Directors with the workforce to better understand the views of our colleagues.

I look forward to welcoming shareholders to the AGM, to be held in Doncaster on 30 November 2018, and to receiving and answering your questions.

Governance framework



Executive Board



Key governance activities

The main governance issues addressed by the Board, and its Committees, during the year include:

- assessing the operating and financial performance and strategy of the Group, including the significant acquisition of Sofology, in the context of the trading environment and market expectations
- planning and managing the selection process for the new Chief Executive Officer, to succeed Ian Filby on 1 November 2018, and a replacement Non-Executive Director
- overseeing the continued development of the internal control and compliance environment in-line with the Group's expanding brand portfolio, including the implementation of processes to comply with the new General Data Protection Regulation
- reviewing and updating the Directors' Remuneration Policy to ensure that rewards and performance are aligned whilst aiding the recruitment and motivation of high quality leaders

Corporate governance statement

continued

Compliance with the UK Corporate Governance Code 2016: Introduction

The Board is wholly committed to upholding high standards of corporate governance and following a rigorous structure for the supervision, control and management of the Group.

The UK Corporate Governance Code ("Governance Code"), the latest version of which, that applies to this Annual Report, was published by the Financial Reporting Council in April 2016. A copy of the Governance Code can be found at www.frc.co.uk.

The Corporate Governance report that follows, which incorporates reports from the Audit and Nomination Committees on pages 50 to 59 together with the Strategic Report on pages 1 to 37, the Directors' Remuneration Report on pages 58 to 82 and the Directors' Report on pages 40 and 41, describes and explains how the Company has applied the relevant provisions and principles of the Governance Code, and the Financial Conduct Authority's Listing Rules and Disclosure and Transparency Rules throughout the year.

Compliance statement

The Company has adopted the "Governance Code" since admission of the Company's shares to the main market of the London Stock Exchange on 11 March 2015. Throughout the year, the Company has applied all of the main principles of the Code and has been fully compliant with it.

The role of the Board

The Board currently consists of three Independent Non-Executive Directors, an Independent Non-Executive Chair and two Executive Directors. Biographies of all members of the Board appear on pages 38 to 39.

The Board is collectively responsible for the long-term success of the Company and for leading and controlling the Group and has overall authority for the management and conduct of the Group's business, strategy and development. The Board is also responsible for ensuring the maintenance of a sound system of internal control and risk management (including financial, operational and compliance controls and for reviewing the overall effectiveness of systems in place) and for the approval of any changes to the capital, corporate and/or management structure of the Group.

The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are members of the Board and two levels of management sit below the Board: the Executive Board and the Operating Board, each of which are led by the CEO. The CEO and CFO therefore act as a bridge between Management and the Board. The Board delegates to the executive team the day-to-day running of the business within defined parameters and Board meetings are scheduled to coincide with key events in the corporate and trading calendar.

The Board has adopted a formal schedule of matters reserved for its approval and has delegated other specific responsibilities to its Committees. This schedule sets out key aspects of the affairs of the Company which the Board does not delegate, including:

- approval of the annual Group budget and strategic four year business plan and review of performance against them, including approval of growth activities into new markets or countries;
- approval of the interim/annual report and accounts and any preliminary announcement, including approval of dividend policy/payments;
- approval of treasury policies, material guarantees, granting of security and entry into/material amendment of loan facilities;
- approval and review of the management of balance sheet foreign exchange exposure;
- approval of material finance and operating leases and approval of major investments including corporate/capital acquisitions/disposals;
- approval of changes to the Group's capital structure including reductions of capital and share issues/buybacks;
- approval of recommendations from the Audit, Remuneration or Nomination Committees;
- ensuring satisfactory dialogue with shareholders based on a mutual understanding of objectives;
- approval of changes to the structure, size and composition of the Board and any other control structure;
- maintenance of a sound system of internal controls and risk management, including approval of the Group's risk register; and
- any decision likely to have a material impact on the Group from any financial, operational, strategic or reputational perspective.

All Directors have access to the advice and services of the Company Secretary, who has responsibility for ensuring compliance with the Board's procedures. All the Directors have the right to have their opposition to, or concerns over, any Board decision noted in the minutes. During the year, no such opposition or concerns were noted. The Board has adopted guidelines by which Directors may take independent professional advice at the Company's expense in the performance of their duties.

The Chair and the Non-Executive Directors met several times throughout the year without the Executives present.

Board committees

Subject to those matters reserved for its decision, the Board has delegated to its Audit, Nomination and Remuneration Committees certain authorities. There are written terms of reference for each of these Committees which are available on the Group's corporate website, www.dfscorporate.co.uk. Separate reports for each Committee are included in this Annual Report from pages 50 to 82.



Role of the Chair and Chief Executive Officer

The Board is chaired by Ian Durant. The Chair of the Company is responsible for leading the Board and ensuring its effectiveness in all aspects of its role. Ian Filby is the current Chief Executive Officer, to be succeeded by Tim Stacey from 1 November 2018, and is responsible for managing the profitable operation of the Company to create shareholder value by promoting the long-term success of the Company. The role is distinct and separate to that of the Chair and clear divisions of accountability and responsibility have been agreed by the Board and are set out in writing, as summarised below:



Role of the Chair

- managing the business of the Board including organising and chairing regular meetings;
- ensuring the submission to the Board by the Chief Executive of objectives, policies and strategies for the Group, including the Group business plan and annual budget;
- keeping under review with the Board the general progress and long term development of the Group and ensuring that effective strategic planning for the Group is undertaken;
- facilitating the contributions of Non-Executive Directors to the leadership of the Group;
- holding meetings with the Non-Executive Directors without the Executive Directors present, as appropriate;
- ensuring effective communication between the Board and the Company's shareholders;
- acting on the results of the Board's annual review of its and its Committees' and individual Directors' performances; and
- appraising the performance of the Chief Executive Officer and making appropriate recommendations as to his or her remuneration to the Remuneration Committee.



Role of the Chief Executive Officer

- managing the Group's physical, financial and human resources;
- planning the Group's strategies effectively;
- ensuring that the Group complies with all relevant legislation and regulatory requirements;
- allocating duties and responsibilities to Directors;
- reviewing the performance of the other Executive Directors and making appropriate recommendations as to their remuneration to the Remuneration Committee;
- managing the Group's relations with shareholders, customers, suppliers, regulators, other public organisations, other companies and the media; and
- keeping the Chair and other Non-Executive Directors informed in respect of all relevant matters.



Role of the Senior Independent Director (SID)

The Governance Code recommends that the Board of Directors of a company with a premium listing on the official list of the London Stock Exchange ("Official List") should appoint one of the Independent Non-Executive Directors to be the Senior Independent Director to provide a sounding board for the Chair and to serve as an intermediary for the other Directors when necessary. The Senior Independent Director should be available to shareholders if they have concerns which the normal channels through the Chair, Chief Executive Officer or other Executive Directors have failed to resolve, or for which such channels would be inappropriate. Luke Mayhew was appointed as the Senior Independent Director and has served in this capacity throughout the year.

Corporate governance statement

continued



Board balance and independence

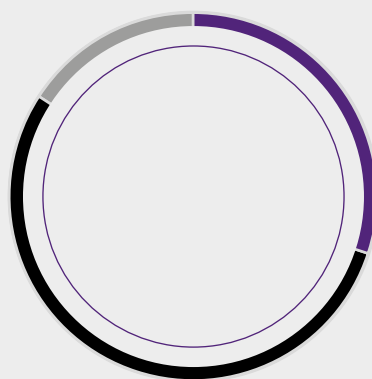
As mentioned in the Chair's introduction, DFS has been fully compliant with the recommendations of the Governance Code in this area throughout the year.

Principal skills and experience	Retail	Customer service/ marketing	People	Operations	International	Regulatory	Finance
Ian Durant Chair	✓			✓	✓	✓	✓
Ian Filby Chief Executive Officer	✓	✓	✓	✓	✓		
Nicola Bancroft Chief Financial Officer	✓			✓	✓	✓	✓
Luke Mayhew Senior Independent Non-Executive Director	✓	✓	✓	✓	✓		
Julie Southern Independent Non-Executive Director	✓	✓			✓	✓	✓
Alison Hutchinson Independent Non-Executive Director	✓	✓	✓		✓	✓	

Length of appointments

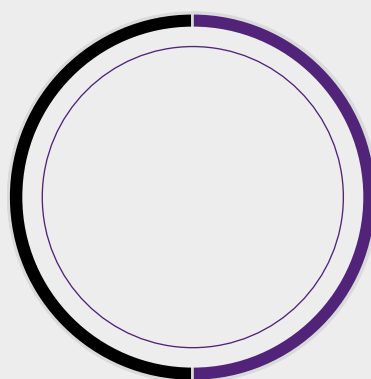
Non-Executive appointments to the Board are for an initial period of three years, are subject to annual re-election by shareholders at the Company's Annual General Meeting and to any requirements of the Listing Rules, and are contingent on continued satisfactory performance.

Board length of service



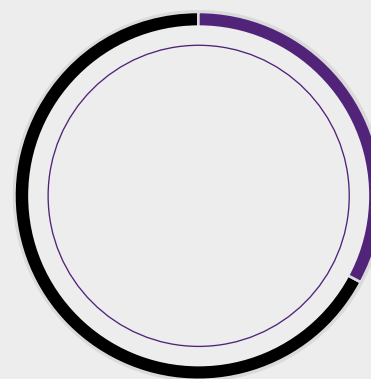
0-3 years 33%
3-6 years 50%
6+ years 17%

Gender analysis



Male 50%
Female 50%

Executive/Non-Executive analysis



Executive 33%
Non-Executive 67%

Information, meetings and attendance

During the year, the Board met on eight occasions to review operational, trading and strategic performance, including the approval of the updated strategic four-year plan and budget for the next financial year. In addition, one scheduled telephone meeting was held to review the important Christmas trading period, and a further ad-hoc telephone meeting was held to review a market announcement regarding trading performance.

This year, a board meeting was held at the Customer Distribution Centres in Milton Keynes and it is intended to continue this initiative moving forward. The use of operating locations away from the Head Office or central London will help promote colleague engagement and provide the Board with greater insight and invaluable direct feedback.

A summary of meeting attendance for the year is as follows:

Meetings and attendance

	Date of appointment	Board	Audit Committee	Remuneration Committee	Nomination Committee
Total meetings in financial year		10	3	5	6
Ian Durant	2 May 2017	10/10	–	–	6/6
Ian Filby	3 Feb 2015	10/10	–	–	–
Nicola Bancroft	1 Aug 2016	10/10	–	–	–
Luke Mayhew	3 Feb 2015	10/10	3/3	5/5	6/6
Julie Southern	3 Feb 2015	10/10	3/3	5/5	6/6
Gwyn Burr ¹	3 Feb 2015	5/6	2/2	3/3	5/5
Alison Hutchinson ³	1 May 2018	4/4	1/1	2/2	1/1

Notes:

1. Gwyn Burr stepped down from the Board on 30 April 2018 and therefore was only eligible to attend six Board meetings, two Audit Committee meetings, three Remuneration Committee meetings and five Nomination Committee meetings in the year.
2. Gwyn Burr was unable to attend one telephone Board meeting (due to prior commitments) but received the papers, provided advance input and received a full detailed briefing shortly after.
3. Alison Hutchinson was appointed to the Board and its Committees on 1 May 2018 and therefore was only eligible to attend four Board meetings, one Audit Committee meeting, two Remuneration Committee meetings and one Nomination Committee meetings in the year.

All Directors are invited to attend the Audit Committee, the Chair of the Board is invited to attend the Remuneration Committee, and the Chief Executive Officer is invited to attend both the Remuneration and Nomination Committees (where appropriate). Members of the Executive Board are also invited to attend committee meetings as appropriate.

At each Board meeting, the Board receives and discusses reports from each of the Executive Directors. In addition, and as part of the process of maintaining an awareness of the Company's activities and assessing the ability of the management team, members of the senior management team are invited to attend Board meetings to present papers to the Board. This process also affords senior managers the opportunity to bring matters to the attention of the Board.

The Board has a full programme of Board meetings planned for the year ahead and intends to meet eight times, with additional telephone meetings to review important trading periods, as appropriate.

At these meetings, the Board will monitor the Company's performance against the agreed strategy and business plan and review specific business areas, including Health and Safety and regulatory matters, in order to maintain and enhance a broad and thorough understanding of the business model.

The Chair, in conjunction with the Group Company Secretary, is responsible for ensuring that the Directors receive accurate, timely and clear information. Prior to each scheduled Board meeting, a pack is circulated in respect of the most recent financial period which includes an update on key performance targets, trading performance against budget and includes detailed financial and non-financial data and analysis. Board packs are distributed in the week prior to each meeting to provide sufficient time for Directors to review their papers in advance. If Directors are unable to attend a Board meeting for any reason, they nonetheless receive the relevant papers and are consulted prior to the meeting and their views are made known to the other Directors.

During the year, the Non-Executive Directors visited a number of UK retail, warehousing and manufacturing sites so that they are well-versed in the operations of the business and have a chance to meet with the front-line team members as well as centrally based executives. These visits, which are unchaperoned, provide the Non-Executive Directors with the knowledge necessary to facilitate strong debate and supportive challenge.

Conflicts of interest

The duties to avoid potential conflicts and to disclose such situations for authorisation by the Board are the personal responsibility of each Director. All Directors are required to ensure that they keep these duties under review and to inform the Group Company Secretary on an ongoing basis of any change in their respective positions.

The Company's conflict of interest procedures are reflected in its Articles of Association ("Articles"). In line with the Companies Act 2006, the Articles allow the Directors to authorise conflicts and potential conflicts of interest, where appropriate. The decision to authorise a conflict can only be made by non-conflicted Directors. The Board considers conflicts or potential conflicts at each Board meeting.

The Articles require the Company to indemnify its officers, including officers of wholly-owned subsidiaries, against liabilities arising from the conduct of the Group's business, to the extent permitted by law. For a number of years, the Group has purchased Directors' and officers' liability insurance and this is anticipated to continue.

Development

Following appointment, new Directors are subject to an in-depth tailored induction process. In the case of Non-Executive Directors, this includes meeting with key members of senior management, visiting operational locations, including showrooms, factories, support offices, Customer Distribution Centres and delivery and service functions, as well as professional advisors including brokers, lawyers and auditors.

In addition, each Director receives key information and policies that are relevant to their position. For new Executive Directors, and Non-Executive Directors for whom the appointment is their first to a UK-listed company, the induction includes details of the legal duties and obligations of being a Director of the Company. In the case of the new CEO designate, this included a shadowing of the current CEO at relevant external and internal meetings.

Corporate governance statement

continued

Board evaluation

The Board carried out its third review of its own effectiveness, and that of its various Committees, during the year. For the first time, this review was externally facilitated by NJMD Corporate Services Limited, who have no connection with the Company or individual directors. The process involved each Director, the Group Company Secretary and each Executive Board member completing a formal questionnaire and attending a follow-up one-to-one interview on the performance of the Board and each of the Board committees, considering the balance of skills, diversity, independence and knowledge of the Company on the Board, how the Board works together, and other factors relevant to its effectiveness. This external review included attendance at, and observation of, one Board meeting.

The consensus was that the Board, and its Committees, had performed effectively and had addressed many of the areas previously identified as requiring further attention. Nevertheless, the Board recognised areas for ongoing development which should form the focus for the Board, and its Chair, in the following year.

The Governance Code, including the recently published 2018 version, provides that evaluation of the Board of FTSE 350 companies should be externally facilitated at least every three years. Therefore, in line with this best practice, it is intended that the next such externally-facilitated review will take place during 2021 at the latest.

The Senior Independent Director, Luke Mayhew, together with the Independent Non-Executive Directors, evaluated the performance of the Chair and discussed the results with him.

Election of Directors

The Board can appoint any person to be a Director, either to fill a vacancy or as an addition to the existing Board. Any Director so appointed by the Board shall hold office only until the next following AGM and shall then be eligible for election by shareholders. In accordance with the Articles, Alison Hutchinson and Tim Stacey will be offering themselves for election at the forthcoming AGM, along with all the other Directors for re-election, with the exception of Ian Filby and Julie Southern who have announced their intention to step-down. The AGM is to be held at DFS Head Office, 1 Rockingham Way, Redhouse Interchange, Adwick-le-Street, Doncaster, DN6 7NA, on 30 November 2018, full details of which are set out in the notice of meeting accompanying this Annual Report.

As noted above, following the formal internal evaluation process of the effectiveness of the Board, the Board is satisfied that each Director remains competent to discharge his/her responsibilities as a member of the Board.

External appointments

The Executive Directors may accept outside appointments provided that such appointments do not in any way prejudice their ability to perform their duties as Executive Directors of the Company. Ian Filby continues to be a director of IFF Life and Business Solutions Limited, a trustee of The Pennies Foundation charity, a member of the British Retail Consortium Board and, from 1 August 2018, the Chair of Joules Group plc. The Board considers that these appointments do not adversely impact his ability to carry out his role. Nicola Bancroft and Tim Stacey, do not currently hold any outside appointments.

The Non-Executive Directors' appointment letters anticipate a minimum time commitment of two days per month, recognising that there is always the possibility of an additional time commitment and ad hoc matters arising from time to time, particularly when the Company is undergoing a period of increased activity. The average time commitment inevitably increases where a Non-Executive Director assumes additional responsibilities such as being appointed to a Board Committee.

Relations with shareholders

The Board recognises its responsibility for overseeing a satisfactory dialogue with shareholders takes place which includes regular briefings by the executive team in association with trading updates and biannual results announcements. In May 2018, a capital markets presentation featuring the wider executive team was held at the Croydon showrooms, of DFS, Dwell and Sofology, and was well attended by analysts and investors.

In addition to the extensive engagement carried out by the CEO, CFO and Director of Corporate Finance, the Chairman, SID and Chair of the Remuneration Committees met or spoke to a number of shareholders during the year. The Chair makes himself available to shareholders so that any major issues and concerns are communicated to the Board through the Chair.

In particular, the Company communicates with both the institutional and private shareholders through the following means:



Interaction with all shareholders

- the Company's corporate website (www.dfscorporate.co.uk), where investor information and news is regularly updated.
- the Annual Report, which sets out details of the Company's strategy, business model and performance over the past financial year and plans for future growth.
- the Annual General Meeting, where all shareholders have the opportunity to vote on the resolutions proposed and to put questions to the Board and executive team.
- presentations of full-year and interim results to analysts and shareholders, which are also available on the Company's corporate website.



Interaction with institutional shareholders

- the Chief Executive Officer, Chief Financial Officer and Director of Corporate Finance hold meetings with institutional investors following the full-year and interim results.
- the Chair meets with institutional shareholders where appropriate.



Interaction with private shareholders

- dial-in facility to live presentations of the full-year and interim results.
- dedicated email point of contact to answer shareholder questions and queries.

Investor relations activity, analysis of the share register, comments by analysts, views of major shareholders and advice from the Company's brokers are all ongoing items of review by the Board in order to maintain an understanding of market perceptions.

In particular, the potential effects of MiFID II on market awareness of our investment proposition are closely monitored by the Director of Corporate Finance so that any adverse trends can be identified and reported to the Board in a timely manner. Although no material effect has been experienced to date, this issue remains under review to enable the approach to investor relations to be tailored as appropriate.

Relations with other stakeholders

The Group considers our customers, colleagues, suppliers, the environment and community as our principal stakeholders in addition to our shareholders. The Corporate Responsibility report on pages 32 to 37 sets out more detail on how we manage our relationships with them. The Board's engagement with each of these is set out below:

Customers

- monthly customer KPIs included in the Board packs, including Net Promoter scores
- all Directors visit stores regularly
- customer insight research presented to the Board

Colleagues

- Chief People Officer updates the Board twice a year on Health and Safety matters and the results of our colleague engagement survey
- monthly colleague KPIs included in the Board packs, including average earnings and staff turnover
- annual conference for senior head office, retail, supply chain, operations and manufacturing colleagues, attended by all Board members where possible
- all Directors visit operational locations regularly accompanied by a member of the Executive Board or senior management team

Suppliers

- selected key suppliers attend the annual conference (noted above)
- Chief Executive Officer and relevant Executive Board members meet regularly with key suppliers

Environment/community

- charity fundraising activities attended by all Board members where possible
- all Directors visit operational locations regularly

The Non-Executive Directors are available to discuss any matter stakeholders might wish to raise. The Chair and Non-Executive Directors are also available to attend investor relations meetings or to request meetings with investors or analysts independently of the Group's management, if required.

DTR Disclosure

The disclosures required under DTR 7.2 of the Disclosure and Transparency Rules are contained in this report, and the Audit Committee and Nomination Committee Reports, except for information required under DTR 7.2.6 which is contained in the Directors' Report on pages 40 and 41.

Audit Committee report



Julie Southern
Chair of the
Audit Committee
3 October 2018



The integration of all subsidiary trading companies into the Group's internal control environment, particularly with the recent acquisition of Sofology, has been an area of focus.



2018 highlights

- reviewing the integrity of the Group's financial reporting
- reviewing Group risk management and reporting
- overseeing the implementation of the General Data Protection Regulations

I am pleased to present this year's Audit Committee report.

The Committee plays an important role in the governance of the Company and this report sets out details of the work undertaken by the Committee during the year. The Committee's main activities focused on the integrity of financial reporting, the quality, scope and effectiveness of both the internal audit function and the external audit, ensuring appropriate systems of internal control and reviewing all aspects of risk facing the Group.

This year, the integration of all subsidiary trading companies into the Group's internal control environment, particularly with the recent acquisition of Sofology, has been an area of focus which will continue to feature prominently within future internal audit plans.

In addition, the Committee has overseen the implementation of the General Data Protection Regulation and I am pleased with the high level of engagement shown by our colleagues throughout the Group. Furthermore, I am encouraged by the work undertaken to date in relation to the implementation of the changes to lease accounting which is likely to have a significant impact on the Group's financial statements.

As part of the externally facilitated annual Board evaluation this year, the performance of the Audit Committee was reviewed and I am happy to report that there were no areas of concern and the results of the evaluation showed that the Committee was operating effectively.

Lastly, as previously announced, I have confirmed my intention to step-down as a Non-Executive Director and Chair of the Audit Committee at the forthcoming AGM in November 2018. I would like to thank the Company and my fellow Committee members for their support during my tenure and I look forward to continued progress in the future.

Composition

The Audit Committee is chaired by Julie Southern and its other current members are Luke Mayhew and, more latterly, Alison Hutchinson who was appointed on 1 May 2018 to replace Gwyn Burr who stepped down on 30 April 2018.

The Governance Code recommends that all members of the Audit Committee are Non-Executive Directors, independent in character and judgement and free from any relationship or circumstance which may, could or would be likely to, or appear to, affect their judgement and that one such member has recent and relevant financial experience. The Board considers that, by virtue of her current and former executive and non-executive roles, details of which are set out on page 39, Julie Southern has recent and relevant financial experience and the Company complies with the requirements of the Governance Code in this respect. Furthermore, all Committee members have extensive relevant commercial and operational experience in large retail/customer-facing organisations which both benefit the Committee and collectively illustrate its competence relevant to the sector in which the Group operates.

Biographies of the Independent Non-Executive Directors are included on pages 38 and 39 and a summary of their principal skills and experience is shown on page 46.

The Chief Executive Officer, Chief Financial Officer and Chair of the Board attend meetings of the Audit Committee by invitation, as do KPMG LLP's Audit Partner and members of the Executive Board and senior management as appropriate. The Company Secretary also attends by invitation in order to maintain a record of the meetings.



Roles and responsibilities

The Audit Committee assists the Board in discharging its responsibilities with regard to the oversight of:

- financial reporting;
- internal controls and risk management systems;
- compliance, whistleblowing and fraud; and
- internal and external audit.

In particular, this includes:

- monitoring the integrity of the financial statements of the Group, including its annual and half-yearly reports, and any other formal announcement relating to its financial performance including a review of any significant financial reporting judgements contained therein;
- reviewing the Group's processes and procedures for ensuring that material business risks are properly identified and managed;
- reviewing the adequacy and effectiveness of the Group's internal financial controls and risk management systems;
- receiving regular reports on significant litigation and compliance issues;
- reviewing the Group's arrangements with regard to employee/contractor whistleblowing, fraud detection, prevention of bribery and money-laundering;
- monitoring and reviewing the effectiveness of the Group's internal audit function in the context of the Group's overall risk management system;
- overseeing the Group's relationship with its external auditor, including their appointment, remuneration, independence and the effectiveness of the audit process; and
- developing and implementing a policy on the supply of non-audit services by the external auditor.

The ultimate responsibility for reviewing and approving the annual report and accounts and the half-yearly reports remains with the Board. The Audit Committee will give due consideration to laws and regulations, the provisions of the UK Corporate Governance Code and the requirements of the Listing Rules.

The Audit Committee reviews the content of the annual report and accounts and advises the Board on whether, taken as a whole, they are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Audit Committee report

continued



Activities of the Audit Committee

The Audit Committee of the Group met three times during the year and attendance at those meetings is shown on page 47. At each meeting, standing agenda items relating to internal audit, reputational risk, whistleblowing and litigation issues were reviewed.

In addition, the other matters covered at each meeting are summarised in the table below:



September 2017

- approval of the full year results for FY17, including reviews of going concern and the viability statement
- review of the FY17 full year external audit, including KPMG LLP's performance and subsequent re-appointment
- review of the Group risk report
- initial consideration of the proposal to change the accounting year-end date



March 2018

- initial review of the implementation of the requirements of the General Data Protection Regulation
- review of the Group risk profile update
- initial review of the acquisition accounting for Sofology Ltd and KPMG LLP's planning for its associated audit



June 2018

- review and approval of KPMG LLP's continuing appointment, audit strategy and fees for the audit of the FY18 full year results
- further review of the implementation of the requirements of the General Data Protection Regulation
- review of the Group risk report
- review of the plan to implement the forthcoming changes to lease accounting under IFRS16
- further consideration of the proposal to change the accounting year-end date
- review of the results of the externally-facilitated evaluation of the Committee's effectiveness

Following the FY18 year end, at the September 2018 meeting, the Committee reviewed and approved, for consideration by the Board, the financial results for the 52 weeks ended 28 July 2018 including a review of the full year external audit. As part of that review process, the members of the Committee reviewed the Annual Report, the adequacy of the disclosure with respect to going concern and viability reporting in order to conclude whether the Annual Report taken as a whole was fair, balanced and understandable.

This additional review by the Audit Committee, supplemented by advice received from external advisors during the drafting process, assisted the Board in determining that the report was fair, balanced and understandable at the time that it was approved. The Committee considered the appropriateness of preparing the accounts on a going concern basis, including consideration of forecast plans and supporting assumptions and concluded that the Company's financial position was such that it continued to be appropriate for accounts to be prepared on a going concern basis.

Significant issues considered in relation to the financial statements

The Committee, together with management and the Group's external auditor, considered the following significant matters in relation to the financial statements and how these were addressed.

Acquisition accounting

During the year, the Group completed the acquisition of Sofology Limited, which significantly increased the amount of goodwill and intangible assets recognised in the Group's financial statements. The application of accounting standards for acquisition accounting requires significant judgement in determining the value of the acquisition balance sheet and, in particular, the value of its component parts. In addition to management's own procedures, the Group has engaged with external specialist advisors to support this valuation process which has been reviewed and agreed by the Group's external auditor.

Impairment of intangible assets

The Group holds significant goodwill in the business following the acquisition of the DFS Group in 2010 by Advent and the DFS Group's subsequent acquisition of The Sofa Workshop Limited and, more recently, Sofology Limited. In addition, the Group has recognised the value of the respective brands of Sofa Workshop, Dwell, DFS Spain and Sofology as intangible assets. As required by accounting standards, management have completed an annual impairment review of the carrying value of these assets for each cash-generating unit, and in total, details of which are set out in note 9 to the financial statements. This review concluded that no impairment charge was required.

Provisions

Several of the Group's provisions, which primarily relate to the estimated cost of the retail customer guarantees provided, claims relating to historical sales of Payment Protection Insurance, and the valuation of finished goods stock, continue to require significant judgement in assessing their appropriateness and quantum. Management have considered the rationale and basis for these provisions to assess their reasonableness and adequacy which has been reviewed and agreed by the Group's external auditor in conjunction with their substantive testing.

Viability reporting

The Committee, along with the Group's external auditor, has reviewed management's assessment of the prospects of the Group for the four years from 28 July 2018, being the period over which the various growth initiatives are anticipated to have a key impact and which corresponds to the normal planning cycle. This review included the challenging of assumptions and stress-testing of the scenario modelling and concluded that the Board is able to make the viability statement on page 17 of the Strategic Report.

Assessment of effectiveness of the external audit process

The Audit Committee oversees the relationship with the external auditor and considers the re-appointment of the Company's auditor, KPMG LLP, before making a recommendation to the Board to be put to shareholders. As part of this responsibility, the Committee approved the audit plan for the 52 weeks ended 28 July 2018 and reviewed the auditor's findings and management representation letters. Prior to recommending the appointment of KPMG LLP at the forthcoming AGM to the Board, the Audit Committee reviewed the audit process, the performance of the auditor and its ongoing independence, taking into consideration input from management, responses to questions from the Committee and the audit findings reported to the Committee. Based on this review, the Committee concluded that the external audit process had been run efficiently and that KPMG LLP has been effective in its role as external auditor.

Approach to appointing the external auditor and how objectivity and independence are safeguarded relative to non-audit services

The Audit Committee does not currently consider it necessary to have a bespoke policy for the rotation of the external audit firm other than continuing to comply with the audit tender rules applying to the Company.

Following the implementation of the EU Audit reforms, the Audit Committee has agreed a policy intended to maintain the independence and integrity of the Company's auditor when acting as auditor of the Group's accounts. The policy governs the provision of non-audit services provided by the auditor and, in summary, categorises the types of non-audit services as:

- **prohibited** – services that have the potential to impair or appear to impair the independence of their audit role
- **permissible (subject to approval limits)** – services which primarily relate to work that is outside the required scope of the statutory audit, but is consistent with the role of the external statutory auditor
- **services to be considered on case-by-case basis** – all other services of an advisory or other nature that do not compromise the independence of the external auditor.

In any event, within each of the Group's legal entities, the cumulative total of non-audit fees paid to the external auditors within each financial year must not exceed 70% of that financial year's audit fee.

The above policy has been adhered to throughout the year.

Independence safeguards

The current audit firm was appointed while the Group was under private ownership and has served the DFS business for over 20 years. In accordance with best ethical standards, external auditors are required to adhere to a rotation policy whereby the audit engagement partner is rotated after five years but can only serve for up to two years following the initial listing of the Group in March 2015. Therefore, our current external auditor, KPMG LLP, introduced a new engagement partner last year who, it is intended, will continue to take responsibility for the audit up to 2021.

The Company is fully committed to continually developing the highest standards of corporate governance and therefore the Audit Committee will continue to apply the practice that the audit should be put out to tender at least every ten years.

As a consequence, KPMG LLP may remain as external auditor until the completion of the 2025 annual audit, however, the Committee will continue to consider annually the need to tender the audit for audit quality or independence reasons. There are no contractual obligations in place that restrict the choice of statutory auditor.

The external auditor is also required periodically to assess whether, in its professional opinion, it is independent and those views are shared with the Audit Committee.

The Committee has authority to take independent advice as it deems appropriate in order to resolve issues on auditor independence. No such advice has been required to date.

Independence assessment by the Audit Committee

The Committee is satisfied that the independence of the external auditor is not impaired and notes that the audit firm's engagement partner rotation policy has been complied with. Furthermore, the level of fees paid for non-audit services, details of which are set out in note 3 to the financial statements, does not jeopardise its independence.

The Committee has assessed the performance and independence of the external auditor and recommended to the Board the re-appointment of KPMG LLP as auditor until the AGM in 2019.

Internal audit

The scope and focus of the Internal Audit function continued to be developed during the year with an Internal Audit Director appointed to lead the strategy. The established subsidiary trading companies are fully integrated into the Group internal audit programme with the full integration of Sofology planned to be concluded during the first half of FY19.

As guided by the biannual review of the risk register/profile and specific business requirements, emphasis continues to be placed on:

- key identified risk areas including sales culture and the associated compliance with GDPR and FCA regulations for credit broking, including complaints handling, along with Fire & Furniture Regulations compliance;
- the store environment, particularly in relation to conduct risk;
- Customer Distribution Centres (CDCs), particularly in relation to stock management; and
- production and supply chain, to ensure consistent implementation of operational/compliance procedures, including Health and Safety.

Increased focus is placed on the corrective actions identified in audit reports to ensure standards are continually developed. In every case, clear ownership, coupled with strict deadlines, is complimented by an Internal Audit-owned verification process which must be completed before the action is closed. Improved risk-based audit planning is utilised to ensure the Internal Audit resource is used to best effect.

Audit Committee report

continued



Internal audit reports continue to be issued to key management highlighting significant issues and making relevant recommendations. Separate monthly meetings are held with Retail and Supply chain management to ensure issues are proactively identified and the appropriate action taken. High level reporting is made to the Operating Board and Conduct & Compliance Committee on a monthly basis, and to the Audit Committee three times per year.

The effectiveness of the internal audit team, and its level of resource, is reviewed by the Committee at least annually. This assessment includes the ongoing review of the:

- audit agenda and operational plans (including resource requirements);
- results of the audit fieldwork and any significant issues highlighted; and
- management of any corrective actions implemented.

Internal control and risk management

The Board is responsible for the overall system of internal controls for the Group and for reviewing its effectiveness. In accordance with FRC guidance, it carries out such a review at least annually, covering all material controls including financial, operational and compliance controls and risk management systems.

The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. The Group has operating policies and controls in place covering a range of issues including financial reporting, capital expenditure, business continuity and information technology, including cyber security, and appropriate employee policies. These policies are designed to ensure the accuracy and reliability of financial reporting and govern the preparation of financial statements.

In particular, a Conduct & Compliance committee (formerly a Reputational risk committee), comprising management from all relevant areas of the business, meets on a monthly basis to review key regulatory areas including:

- complaints management relating to legacy Payment Protection Insurance issues;
- FCA regulated credit broking activities relating to the provision of interest-free credit to customers;
- data protection in all areas of the business, including the implementation and ongoing management of the General Data Protection Regulation;
- health and safety across all business activities and premises; and
- compliance with the Modern Slavery Act, within both internal manufacturing and supply chain operations as well as our external supplier base.

This committee places emphasis on key metrics and management information designed to provide oversight of performance and highlight any potential detriment or risk to the Company while seeking to achieve the very best customer outcomes and provide a safe environment for staff, customers and data alike. During the year, this management information has continued to be developed and refined in direct association with the ongoing review of the risk register.

The Board is ultimately responsible for the Group's system of internal controls and risk management and discharges its duties in this area by:

- holding regular Board meetings to consider the matters reserved for its consideration;
- receiving regular management reports which provide an assessment of key risks and controls;
- scheduling annual Board reviews of strategy including reviews of the material risks and uncertainties facing the business;
- ensuring there is a clear organisational structure with defined responsibilities and levels of authority;
- ensuring there are documented policies and procedures in place; and
- scheduling regular Board reviews of financial budgets and forecasts with performance reported to the Board monthly.

In reviewing the effectiveness of the system of internal controls, the Committee will continue to:

- review the risk register compiled and maintained by senior managers within the Group and question and challenge where necessary;
- regularly review the system of financial and accounting controls; and
- report to the Board on the risk and control culture within the Group.

In respect of the Group's financial reporting, the Finance Department is responsible for preparing the Group financial statements using a well-established process and ensuring that accounting policies are in accordance with International Financial Reporting Standards. All financial information published by the Group is subject to the approval of the Audit Committee.

There have been no changes in the Company's internal control during the financial year under review that have materially affected, or are reasonably likely to materially affect, the Company's control over financial reporting.

The Board, with advice from the Audit Committee, is satisfied that an effective system of internal controls and risk management is in place which enable the Company to identify, evaluate and manage key risks and which accord with the guidance published by the FRC. These processes have been in place since the start of the financial year and up to the date of approval of the accounts. Further details of specific material risks and uncertainties facing the business can be found on pages 12 to 16.

Whistleblowing

The Group is committed to the highest standards of openness, honesty, integrity and accountability and, as a result, has a whistleblowing policy in place. This policy is intended to make employees or third parties aware that they should report any serious concerns or suspicions about any wrongdoing or malpractice on the part of any employee of the Group. Examples include fraud, breakdown in internal controls, misleading customers, bribery, dishonesty, corruption and breaches of data protection or health and safety. This facility was reviewed during the year and it was agreed that appropriate arrangements are in place for proportionate and independent investigation of such matters.

During the year, there were five instances of whistleblowing all of which were fully investigated and addressed in accordance with the policy.

Control environment

The Board is committed to business integrity, high ethical and moral values and professionalism in all its activities. The Group has policies in place for:

- anti-bribery;
- equal opportunities;
- gifts and entertainment; and
- share dealing.

In accordance with the obligations under the Reporting on Payment Practices and Performance Regulations 2017, the Company has submitted its bi-annual reports in line with the legislation during the year.

Following an externally-facilitated risk-assessment exercise, the Company has also reviewed its practices and processes in order to ensure that reasonable prevention procedures are in place to prevent the facilitation of tax evasion in line with the new Criminal Finances Act 2017.

DFS Furniture plc's Modern Slavery Statement, which sets out details of the policies in relation to slavery and human trafficking, as well as its due diligence processes with its partners, has been published on the Company's website (www.dfscorporate.co.uk).

The Company has also published its Tax Strategy Statement on the Company's website (www.dfscorporate.co.uk) in compliance with its duty under the Finance Act 2016, which sets out details of the Company's attitude to tax planning and tax risk.

Accountability

The Board is required to present a fair, balanced and understandable assessment of the Company's financial position and prospects. The responsibilities of the Directors and external auditor are set out on pages 53 and 89. As set out in the Directors' report, the Directors consider the Company's business to be a going concern. The Company's viability statement can be found on page 17.

Julie Southern

Chair of the Audit Committee
3 October 2018

Nomination Committee report



Ian Durant
Chair of the
Nomination
Committee
3 October 2018



This year, the Nomination Committee has focused on succession planning and leadership development.



2018 highlights

- planning the succession of the Chief Executive
- appointing a new Non-Executive Director
- developing the strength of the senior management team

The Nomination Committee exists to ensure that the Group has the appropriate skills, knowledge, experience and diversity on the Board and in executive leadership positions, both now and in the future. This should enable DFS to operate and compete successfully, and to develop strategies and execute them effectively in a rapidly changing and challenging market.

This year, the Committee has focused on succession planning and leadership development primarily due to Ian Filby's decision to retire as Chief Executive Officer after 8 years of service. On behalf of the Board, I would like to express our sincere gratitude to Ian for his steadfast leadership over the years and, at the same time, welcome Tim Stacey to the Board, as his successor from November 2018.

Further Board changes during the year included the appointment of Alison Hutchinson, to succeed Gwyn Burr, as a Non-Executive Director and Chair of the Remuneration Committee. I would like to thank Gwyn for her support and Luke Mayhew for his transitional chairing of the Remuneration Committee and to welcome Alison Hutchinson to the Board.

The year has also seen further strengthening of the senior management team with Group roles on the Executive Board being developed to maximise the benefits of the enlarged brand portfolio and support the new Chief Executive Officer in achieving the Group's strategic goals.

Finally, as part of the externally facilitated annual Board evaluation this year, the performance of the Nomination Committee was reviewed and I am pleased to report that there were no areas of concern and the results of the evaluation showed that the Committee was operating effectively.

Ian Durant

Chair of the Nomination Committee
3 October 2018

Composition

The Nomination Committee is chaired by Ian Durant and all of the Non-Executive Directors. Alison Hutchinson was appointed on 1 May 2018 to replace Gwyn Burr who stepped-down on 30 April 2018.

The Governance Code recommends that a majority of the Nomination Committee be Non-Executive Directors, independent in character and judgement and free from any relationship or circumstance which may, could or would be likely to, or appear to, affect their judgement. As such, the Board considers that the Company complies with the Governance Code.

Only members of the Committee have the right to attend Committee meetings, but the Committee may invite others, including the Chief Executive Officer, the Chief People Officer and external advisers, to attend all or part of any meeting if it thinks it is appropriate or necessary or pursuant to the terms of any agreement with shareholders.

The Nomination Committee will meet as often as it deems necessary but, in accordance with its terms of reference, at least once a year.

Roles and responsibilities

The Nomination Committee is responsible for regularly reviewing the structure, size and composition of the Board and its committees (including an appraisal of skills, knowledge, experience and diversity, including gender) and for making recommendations to the Board with regard to any changes.

It is also responsible for identifying and nominating for the approval of the Board, candidates to fill Board vacancies as and when they arise.

The Committee's terms of reference are available on the Company's corporate website at www.dfscorporate.co.uk.

Activities of the Nomination Committee

The Nomination Committee formally met six times during the year and was advised on planning for the Chief Executive's succession by Calibro Consulting (who have no connection with the Company or individual Director). The main activities of the Committee included:

- management of the market-wide selection process, engaging the services of Spencer Stuart and YSC Consulting (neither of whom have a connection with the Company or individual Director), for the appointment of Tim Stacey as Chief Executive Officer Designate on 1 August 2018, and as Chief Executive Officer on 1 November 2018, to replace Ian Filby. Further details of this process are shown opposite;

- management of the search and selection process, engaging the services of Spencer Stuart for the appointment of Alison Hutchinson on 1 May 2018, as an Independent Non-Executive Director and member of the Remuneration Committee (and to become Chair from 1 October 2018), to replace Gwyn Burr. Further details of this process are given below;
- ongoing review of the talent and succession planning for the Board and senior management, including assessment of their training and development needs;
- providing support and guidance to the new CEO Designate with regards to the development of his senior management team, resulting in recent additions to the Executive Board to include Group roles for Retail, Technology, Development and Supply Chain, along with the recruitment of an in-house General Counsel;
- externally-facilitated review of the Committee's effectiveness;
- review of Directors' time commitments and independence; and
- consideration of the re-election of Directors at the AGM.



Recruitment process for CEO succession

As part of the CEO succession planning process, the Nomination Committee had previously identified two potential internal candidates who were provided with the appropriate preparation and support, including mentoring, during the year to develop their potential as a possible leader of the Group. Following this, the internal candidates also underwent a leadership assessment by YSC and interviews with Spencer Stuart.

Stage 1

During this time, a job description and person specification was prepared, considering the likely strategic direction of the Group, and Spencer Stuart reviewed the population of external candidates and formally reported back to the Nominations Committee on both internal and potential external candidates, from which a short-list was prepared.



Stage 2

Formal presentations were made by the short-listed candidates to the Nomination Committee, supported by the opinions of the retiring CEO who played no other part in the selection process, from which the Nomination Committee made a recommendation to the Board which was endorsed.



Stage 3

Throughout this process, the Nomination Committee proactively considered transition management issues in order to ensure the handover to the new Chief Executive Officer is as smooth as possible, given the challenging market conditions prevailing in the upholstery furniture sector and the choice of an internal candidate.

This involved regular liaison with the Remuneration Committee and agreeing a transition plan which involves Ian Filby becoming Chair of the Board of Sofology, from 1 November 2018, but continuing to provide support to the new CEO until October 2019. Although Ian Filby will not attend DFS Group Board meetings after 1 November 2018, he will be available to provide valuable counsel to the Board as well as management during the coming year.

With regards to the replacement of Gwyn Burr as a Non-Executive Director, the Nomination Committee was advised by Spencer Stuart and a brief was developed based on an assessment of the strategy for the business, including the likely challenges in the years ahead, as well as defining the best cultural fit for success.

Several potential candidates were considered from which a short-list was prepared and subsequently met by the Nomination Committee. Given her extensive work with the retail industry and background in IT, retail financial services and marketing, Alison Hutchinson was recommended to the Board which was endorsed.

All new Directors are subject to an in-depth and tailored induction process.

Diversity

Whilst the Company pursues diversity, including gender diversity, throughout the business, the Board has not committed to any specific targets. However, we are pleased our Board continues to have three female Directors and therefore a 50:50 gender split. We will continue to give due consideration to talent, balance and diversity when making new appointments to the Board and look to this approach being applied across the business.

Ian Durant

Chair of the Nomination Committee
3 October 2018

Directors' remuneration report



Luke Mayhew
Interim Chair of the
Remuneration
Committee
3 October 2018



The revised Policy increases the alignment of management's interests with shareholders' long-term return.



This report has been prepared in accordance with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended in 2013, the provisions of the current Code and the Listing Rules.

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Part A: Annual statement

Dear Shareholder

DFS had a satisfactory first half of the year. However, tough trading conditions over the summer months and the wider challenges faced by the UK retail market have meant that the financial results did not meet targets. Despite that the business made good progress on its longer term strategic priorities.

As last year, the annual bonus was modest and there has been no payout under the Long-Term Incentive Plan ("LTIP") award.

Key financial results FY18

- Gross sales £1,125.6m (FY17: £990.8m)
- Revenue £870.5m (FY17: £762.7m)
- Underlying EBITDA £76.1m (FY17: £82.4m)
- Underlying profit before tax £37.2m (FY17: £50.1m)
- Underlying earnings per share 14.0p (FY17: 18.7p)

Historic remuneration outcomes

	CEO (Ian Filby)			
	2018	2017	2016	2015
Single figure (£000)	673	666	804	790
Annual bonus (% of salary)	36.0%	37.5%	71.9%	85.2%
LTIP vesting (% of salary)	0%	0%	n/a ¹	n/a ¹

	CFO (Nicola Bancroft)			
	2018	2017	2016 ²	2015 ²
Single figure (£000)	429	388	n/a	n/a
Annual bonus (% of salary)	34.8%	38.0%	n/a	n/a
LTIP vesting (% of salary)	0%	0%	n/a ¹	n/a ¹

During the year we announced that Ian Filby, the CEO, would be retiring and he would be succeeded by Tim Stacey. Tim has been part of the DFS senior management team for seven years. He takes over as CEO on 1 November. The details of Tim's remuneration package are set out on page 79. We have deliberately started Tim's salary at a lower level than Ian's to reflect that this is his first CEO position. We have however, set out how that salary will increase to bring it to an appropriate level as he gains experience. Any such increase would depend on acceptable company performance.

It has also been two years since Nicola Bancroft was appointed as CFO and during the year the Committee reviewed Nicola's base salary in line with the commitment we made on her appointment to bring her salary to a level more in line with her peers as she became experienced in her role. Detailed information on this is set out on page 60 of this Annual Statement.

1. No LTIP was due to vest.
2. Nicola Bancroft was not an Executive Director in 2015 or 2016.

This year we have conducted a comprehensive review of the Remuneration Policy ("Policy"), consulting with major shareholders. We concluded that, despite the relatively low payouts since the IPO, the Policy was still largely fit for purpose. We are confident that the revised Policy has sufficient flexibility within it to support the future of the business while still giving clarity to shareholders. It was also important to the Committee that the Policy not only enables management to be rewarded for the delivery of strong financial performance and shareholder returns in a challenging economic environment but increases the alignment of management's interests with shareholders' long-term return.



Summary of key changes to the Policy

- **Bonus:** Maximum annual opportunity may increase in steps over 2 years from 100% of salary to 120% from FY20 – at the point the opportunity increases, deferral into shares for 3 years will be introduced (deferral will apply where the bonus payment is greater than 75% of salary);
- **LTIP:** Introduction of a 2 year post-vesting holding period (for LTIP awards granted from 2018);
- **Minimum shareholding guidelines:** Increased from 200% of salary to 250%; and
- **Recruitment and promotions:** Reduction of the maximum variable remuneration from 450% of salary to 350%.

We consider the increase of the maximum bonus opportunity to 120% of salary from 100% is appropriate. However, we do not want to implement that increase immediately on the CEO's appointment; any increase to the bonus would only happen from 2019 in stages if the Board believes company performance has been satisfactory. An element of deferral into shares for three years will be introduced at the same time as any increase.

The current Policy allows LTIP awards of up to 150% of salary and we have applied this level for the incoming CEO with the CFO's LTIP increasing to 120% of salary. All the LTIP awards to be granted from 2018 will be subject to a two year post-vesting holding period. The Board is reviewing the future strategy with the new CEO; for this reason the LTIP awards for 2018 will be granted later than usual and performance targets will be communicated when the awards are granted (expected to be no later than mid November 2018).

As part of the Policy review, we consulted extensively with our major shareholders and representative bodies and listened to their views. We are pleased that the vast majority of shareholders with whom we engaged are supportive of the Policy and feel the changes being proposed are justified and measured.

In this year's report, we have included a new section on pay fairness throughout the Group including details about DFS' employee value proposition, gender pay gap statistics and DFS' diversity policy. The Company has been focused on increasing opportunities for all; there is much more work to do and this will continue to be high on the agenda of the Committee in the year ahead.

As discussed on pages 30-31, the Company is changing its accounting record date to 30 June and therefore, FY19 will be 11 months. The Committee has considered the impact of the year end change when setting financial targets for the FY19 bonus and we will provide relevant details of financial and non-financial targets in next year's Director's Remuneration Report.

I am writing this report as Interim Committee Chair. I took over in April from Gwyn Burr who retired from the Board. In May, we welcomed Alison Hutchinson to the Board and to the Committee. Alison formally took over from me as Committee Chair on 1 October 2018.

I would like to thank the shareholders who we have engaged with for their time and valuable input. The Board recommend the Report and revised Policy to shareholders.

Luke Mayhew

Senior Independent Director
Interim Chair of the Remuneration Committee
3 October 2018

What remuneration decisions did we make as a result of performance over 2018?

It has been a challenging year for the Group with external factors leading to significantly lower than expected order intake and macroeconomic factors placing pressure on the industry as a whole. This has been reflected in the modest bonus outcomes and the continued lack of an LTIP payout.

The 2018 Annual Bonus was dependent on performance against stretching targets for revenue, underlying profit before tax, cash flow, Net Promoter Score and personal performance targets (each measure is equally weighted at 20%). The Committee agreed that Ian Filby and Nicola Bancroft would receive a cash bonus equal to 36.0% and 34.8% of the maximum opportunity, respectively. Details of the financial and personal performance measures and targets can be found on page 76.

As noted earlier, the Committee also assessed relative TSR performance and EPS growth over a three-year performance period for the 2015 LTIP awards. Disappointingly, both the relative TSR and EPS growth targets were not met and as a result, vesting was nil and the awards lapsed in full.

What changes are we proposing to the Remuneration Policy?

During the year, the Committee conducted a detailed review of remuneration arrangements for the Executive Directors and considered what changes, if any, should be made to the Policy. As part of the review process, we consulted with our largest shareholders and the main representative bodies (Glass Lewis, the IA and ISS) to listen to and understand their points of view on our proposals. The proposed Policy remains largely unchanged except for a number of modest changes.

Directors' remuneration report

continued

Part A: Annual statement continued



Summary of changes to the Policy

- **Annual Bonus:** The bonus opportunity for FY19 remains 100% of salary but from FY20 onwards, it is proposed that the maximum annual opportunity will increase in steps over 2 years from 100% to 120% of salary but only if the corporate performance has been satisfactory in the Board's view. At the point the opportunity increases, annual bonus deferral into shares for three years will be introduced with deferral applying on the portion of the bonus payment that is greater than 75% of salary.
- **LTIP:** For LTIP awards granted from FY19, a 2 year post-vesting holding period will be introduced. The holding period will continue beyond an Executive Director's cessation of employment.
- **Minimum shareholding requirement:** From FY19, minimum shareholding requirements will increase from 200% to 250% of salary for both the CEO and the CFO.
- **Maximum variable remuneration for recruitment and promotions:** This will be reduced from 450% of salary (i.e., annual bonus and LTIP awards) to 350% of salary and as a result, there will be a reduction in the maximum LTIP award in exceptional circumstances from 300% to 230% of salary.

The proposed changes are set out in detail in this report on page 62.

What are the other key remuneration decisions we made in 2018?

Remuneration arrangements for the incoming CEO

The Committee reviewed Tim Stacey's remuneration package in line with the Policy and made the following decisions in respect of FY19:

Tim Stacey – remuneration package

Base salary	£400,000 p.a.
Pension	£50,000 p.a. (capped fixed contribution)
Annual bonus	100% of base salary
LTIP	150% of base salary
Shareholding requirement	250% of base salary

As Tim is an internal appointment, the Committee considered it right to set his salary at a lower level compared to his predecessor. However, we want to be transparent to shareholders now that the intention is to increase Tim's salary to £440,000 p.a. on a stepped basis over a two-year period subject to corporate performance being deemed satisfactory by the Board. This will result in increases to his base salary for those two years that are likely to exceed that of the wider workforce.

The Committee has also increased the LTIP award levels to 150% of base salary to bring the CEO role in line with the maximum allowed for under the current Policy. The Committee at the same time has applied a two-year holding period. We believe this and the increased shareholding guidelines provide stronger alignment for the CEO with the long-term interests of shareholders.

Changes to CFO remuneration

The Committee reviewed Nicola's remuneration package in line with the approved Policy and made the following decisions in respect of FY19:

Nicola Bancroft – remuneration package

Base salary	£300,000 p.a.
Pension	£40,000 p.a. (capped fixed contribution)
Annual bonus	100% of base salary
LTIP	120% of base salary
Shareholding requirement	250% of base salary

On appointment as CFO in August 2016, the Committee determined that Nicola's salary would be £240,000 p.a. and that it in line with the approved Policy, her salary would be reviewed annually. As set out in the 2016 Directors' Remuneration Report, it was always the Committee's intention that over time and subject to performance, Nicola's salary would be adjusted to a level more in line with peers in the industry. This supports the Committee's principle that Executive Directors appointed internally should start on a lower remuneration package and graduate to the appropriate level after a few years, subject to Company performance.

In 2017, the Committee decided, taking into account the Company's wider financial performance at that time, that Nicola would receive a salary increase of 2% which was in line with the average increase awarded to the wider employee group. As a result, Nicola's salary at the start of the 2018 Financial Year was £244,800.

The Committee undertook a further review of Nicola's salary in 2018. The review confirmed that Nicola's salary was still positioned well below her peers and was either at or below the lower quartile when compared to similar sized companies in the FTSE SmallCap and FTSE General Retailers of a similar size.

Therefore, in line with the commitment made on Nicola's appointment as CFO and the current Policy, the Committee determined that it was appropriate to increase Nicola's salary to £300,000 p.a. with effect from 1 February 2018. The Committee will continue to review Nicola's salary in line with the approved Policy.

Remuneration arrangements for the outgoing CEO

The Committee also considered remuneration arrangements for Ian Filby during the year. Ian will be stepping down as CEO effective 31 October 2018 and details of his leaving arrangements will be disclosed on the DFS corporate website then and in next year's Directors' Remuneration Report. Ian will continue to provide the Group with his extensive business experience and expertise including taking on the role of part-time Chairman of Sofology and driving the continued integration of Sofology into the Group. All arrangements with Ian Filby are within the framework of the approved Policy.

2018 LTIP awards

We will be retaining relative TSR and EPS growth in the LTIP (each measure will continue to be weighted at 50%). The Committee has reviewed the comparator groups within the TSR measure and discussed this specifically with shareholders. We have decided that looking ahead over the next three years the UK retail sector is the more relevant group. Therefore, for the 2018 LTIP award, the split between the FTSE 350 General Retailers Index and the FTSE 250 Index (excluding Investment Trusts) will be 35:15 (50% of the LTIP award).

We have not yet set EPS growth targets for the 2018 LTIP awards because the new CEO and the Board of Directors are in the process of reviewing our long-term business plan. Accordingly, the 2018 LTIP grants will be delayed this year, however, we will communicate performance targets to shareholders when we grant the LTIP awards in November 2018.

Directors' remuneration report

continued



Part B: Remuneration at a glance

i. Summary of implementation of the Remuneration Policy for FY19 and key changes to the Policy

The section below summarises the implementation of the Remuneration Policy for FY19 for the Executive Directors as well as the minor changes we are proposing to make to the Policy with their supporting rationale. Note, throughout this report we have included details of FY18 outcomes for Ian Filby who will be the CEO until 31 October 2018. Tim Stacey will be formally appointed to the Board on 1 November 2018 and was not an Executive Director during FY18 and so details regarding his remuneration outcomes for FY18 are not set out.

Element	Changes we have made to the Policy	Rationale	Implementation for FY19
Executive Directors			
Base salary	<ul style="list-style-type: none"> The Policy clarifies that individuals who are recruited or promoted to the Board may have their salaries set below the targeted Policy level until they become established in their role. Subsequent increases in salary may be higher than the general rises for employees until the target positioning is achieved. 	<ul style="list-style-type: none"> Consistent with existing Policy in respect for recruitment and promotions. Allows for flexibility to set salary at appropriate levels for newly recruited/promoted individuals. 	<ul style="list-style-type: none"> CEO (Ian Filby): £449,670 p.a. CEO Designate (Tim Stacey): £400,000 p.a. CFO: £300,000 p.a.
Benefits and pension	<ul style="list-style-type: none"> Maximum pension contributions are unchanged but the Policy will provide the Committee with the flexibility to review the approach for new joiners to ensure it is aligned with best practice. 	<ul style="list-style-type: none"> Allows for the flexibility to review operation of the pension Policy in the future to ensure it takes into account corporate governance best practice/market practice. 	<ul style="list-style-type: none"> CEO: £50,000 p.a. CEO Designate: £50,000 p.a. CFO: £40,000 p.a. <p>Pensions are in the form of fixed contributions which are capped at the above levels. Benefits will be in line with the Policy.</p>
Annual bonus	<ul style="list-style-type: none"> Maximum awards will be increased in steps to 120% of base salary over the Policy period, subject to company performance. Where there is an increase to the maximum bonus, this will be accompanied by the introduction of bonus deferral into shares for three years. Deferral will apply where the bonus payment is greater than 75% of salary. 	<ul style="list-style-type: none"> Flexibility to increase to the maximum bonus opportunity from 100% to 120% of base salary is part of a modest rebalancing of remuneration towards variable pay and ensures that levels can be adjusted to more market competitive levels. The ability to defer into shares has been introduced to provide further alignment with shareholder interests and to ensure the overall remuneration framework is aligned with corporate governance best practice. 	<ul style="list-style-type: none"> CEO: 100% of base salary CFO: 100% of base salary <p>Bonuses will be in the form of cash and assessed over one financial year with pay-outs based on the achievement of a range of financial and non-financial targets:</p> <ul style="list-style-type: none"> – Revenue (15%) – Profit before tax (25%) – Cash Flow (20%) – Net Promoter Score (20%) – Personal objectives (20%) <p>This year we have shifted a higher proportion of the financial component of the annual bonus into PBT and reduced the proportion in relation to revenue.</p>
LTIP	<ul style="list-style-type: none"> Introduction of 2 year post vesting LTIP holding periods - this will apply to all LTIP grants from 2018 onwards. Maximum variable remuneration for recruitment and promotion awards in exceptional circumstances have been reduced to 230% of base salary from 300%. 	<ul style="list-style-type: none"> The holding period helps ensure greater and sustained alignment with shareholder value and aligns the overall remuneration framework with corporate governance best practice. The Committee recognises that in the current environment it is important to exercise restraint in relation quantum and felt reducing the overall maximum in exceptional circumstances was appropriate. 	<ul style="list-style-type: none"> CEO: 150% of base salary CFO: 120% of base salary <p>Awards vest after three years subject to the achievement of performance measures (see above for discussion on 2018 LTIP awards). Post-vesting holding period for two years will apply.</p>
Minimum shareholding requirement	<ul style="list-style-type: none"> Increase from 200% to 250% of salary for Executive Directors to be built over five years. 	<ul style="list-style-type: none"> Recognises the importance of aligning the long-term interests of Executive Directors with shareholders. 	<ul style="list-style-type: none"> CEO: 250% of salary CFO: 250% of salary
Non-Executive Directors			
Fees	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> Chairman: £180,000 Senior Independent Director: £60,000 Audit/Remuneration Committee Chair: £57,000 Independent Non-Executive Director: £50,000

The full Policy is set on pages 65 to 74 and this includes detailed information on key changes to the Policy.

ii. Key FY18 business highlights and impact on incentive plan results

The bonus targets for FY18 were determined prior to the acquisition of Sofology in November 2017 and accordingly were based on the expected performance of the pre-acquisition Group only. The financial results discussed below, including the targets and actual performance for FY18 therefore also exclude the contribution of Sofology to the Group's reported results for FY18.

- Revenue decreased by 2.0% to £747.7 million;
- Underlying EBITDA decreased by 11.9% to £72.6 million;
- £32.3 million cash flow; and
- Established Customer Net Promotor Score up from 34.2% to 35.8%.

FY18 annual bonus assessment: At the start of the 2018 Financial Year, we set stretching performance targets for the Annual Bonus plan. Below we summarise the targets and the outcomes for both Ian Filby and Nicola Bancroft.

Measure (weighting)	Targets	Actual	% of maximum achieved
Revenue (20%)	£761.7m	£747.7m	24.9%
PBT (20%)	£52.8m	£38.4m	0%
Cash flow (20%)	£36.5m	£32.3m	0%
Net Promoter Score (20%)	36.1%	34.8%	61.5%
Personal (20%)	see below	see below	see below
Ian Filby	Four personal objectives were set in relation to the following areas: (i) property strategy; (ii) senior leadership development; (iii) online progress; and (iv) integration of customer acquisition with brand portfolio. All personal objectives are equally weighted. See page 76 for a detailed description of personal targets for FY18.	Three out of the four personal objectives were achieved in full during FY18. The only objective that was not achieved in full was "integration of customer acquisition with brand portfolio". The Committee determined that there was partial achievement in relation to this objective. This was evidenced through work undertaken on the assessment of the Group's brand portfolio and brand positioning and the development of action plans for each brand.	93.8%
Nicola Bancroft	Four personal objectives were set in relation to the following areas: (i) cash management; (ii) the Sofology acquisition; (iii) the 4-year business plan and (iv) strategic KPIs and management of external stakeholders. All personal objectives are equally weighted. See page 76 for a detailed description of personal targets for FY18.	Three out of the four personal objectives set were achieved in full during FY18. The only objective that was not achieved in full was "cash management". The Committee determined there was partial achievement, as strong progress was still made in relation to this objective. This was evidenced through achievements such as cash savings, minimisation of interest charges and effective working capital management.	87.5%

Based on an assessment against the FY18 bonus scorecard the Committee determined that Ian Filby would receive a bonus of £157,933 (36.0% of maximum) and £94,517 for Nicola Bancroft (34.8% of maximum).

The FY18 bonuses for Ian Filby and Nicola Bancroft will be paid in cash.

LTIP vesting: The 2015 award was granted in October 2015 and was assessed against relative TSR and EPS growth performance targets at the end of FY18. Based on the assessment of actual performance against targets, the final level of vesting of these awards was determined to be nil.

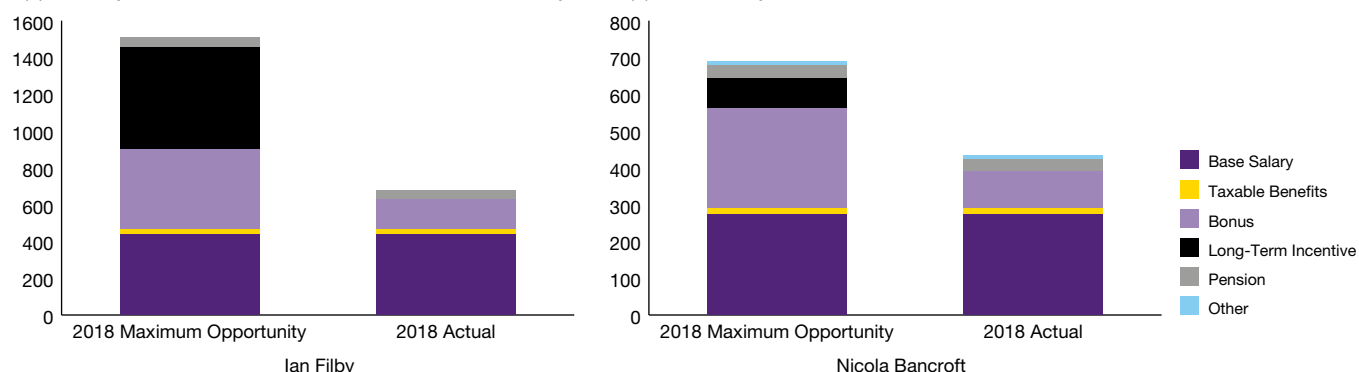
Directors' remuneration report

continued

iii. Levels of remuneration for 2018 and executive shareholdings

Single figure remuneration and maximum remuneration opportunity

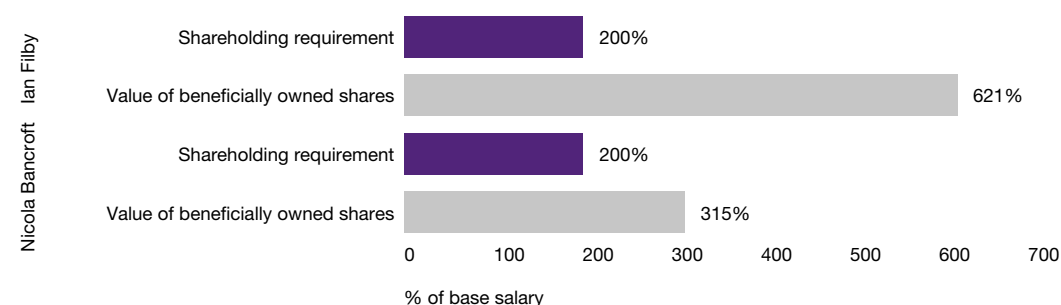
The charts below illustrate how the 2018 total single figure of remuneration for the CEO and CFO compared to the maximum potential opportunity in accordance with the Remuneration Policy that applied in the year.



- Notes
- 1 Other payment for Nicola Bancroft represents the allowance she is entitled to for opting for a lower value company car (Nicola is entitled to an allowance for the difference)
 - 2 The LTIP award used for the 2018 maximum opportunity for Nicola Bancroft is based on the conditional shares she was granted in October 2015 (Nicola was not a Board Director at this point)

Level of shareholdings

Below we present a summary of the level of shareholdings for both the Executive Directors at 28 July 2018.



At the year end the value of both Executive Directors' shares exceeded the shareholding requirement of 200% of salary as well as the proposed requirement of 250% under the new Policy.

iv. Alignment of strategy and remuneration

The Group's focus is to deliver long-term, sustainable growth for shareholders; key to this are five growth levers that are core elements of our long-term strategy. As part of the Remuneration Policy review, the Committee carefully considered these five growth levers and whether the incentive structure sufficiently supports their development and execution. The Committee was of the view that the performance measures within the annual bonus and LTIP do directly relate to the delivery of the five growth levers. The following table sets out the performance measures chosen for the annual bonus and LTIP and how these align with these strategic priorities.

		Enhance our omnichannel proposition and maintain online leadership	Broadening our sales product and brand appeal	Exploit UK and ROI revenue roll-out opportunities	Full utilisation of store retail space and distribution cost efficiency	Establish presence in international markets
Measure (weighting)						
Annual Bonus	Revenue (15%)	✓	✓	✓		✓
	Profit before tax (25%)		✓		✓	
	Cash flow (20%)			✓	✓	✓
	Net Promoter Score (20%)	✓	✓			✓
	Personal (20%)	✓	✓		✓	✓
LTIP	EPS growth (50%)	✓	✓	✓	✓	✓
	Relative TSR (50%)		✓	✓	✓	

PART C: OUR REMUNERATION POLICY

The following section sets out the Directors' Remuneration Policy, which is to be subject to a binding ordinary resolution to the AGM of the Company to be held in November 2018 and will take effect following the AGM. The Policy is intended to apply for three years from the date of approval. All awards granted under the previous Directors' Remuneration Policy will be honoured as will any legacy arrangements for the Executive Directors.

The Remuneration Policy has been prepared in accordance with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended in 2013, the provisions of the current Code and the Listing Rules.

Remuneration principles

The Committee concluded that the Company's remuneration principles remain appropriate and that the proposed Remuneration Policy is in line with the relevant principles. The remuneration principles are set out below:

- Attract, motivate and retain Executives and senior management in order to deliver the Company's strategic goals and business outputs.
- Encourage and support a high-performance sales and service culture ensuring good customer outcomes.
- Reward delivery of the Company's business plan and key strategic goals.
- Adhere to the principles of good corporate governance and appropriate risk management.
- Align employees with the interests of shareholders and other external stakeholders and encourage widespread equity ownership amongst the Group.

Changes to the Remuneration Policy

In the Chairman's statement and on page 62 we have set out the key changes that are being proposed to the levels and structure of remuneration under the Policy. Note that the Committee has made a number of changes to wording in the Policy to ensure that its operation is aligned with provisions of the UK Corporate Governance Code (e.g. the Code expects the Committee to be able to override formulaic outcomes of incentives and this is reflected in the annual bonus and LTIP).

Remuneration Policy Table

Base salary

Element, purpose and link to strategy	To provide competitive fixed remuneration that will attract and retain key employees and reflect their experience and position in the Group
Operation	Salaries are reviewed annually, and any changes normally take effect from 1 October. When determining the salary of the Executives the Committee takes into consideration: <ul style="list-style-type: none"> • the performance of the individual Executive Director; • the individual Executive Director's experience and responsibilities; • pay and conditions throughout the Group, including the level of salary increases awarded to other employees; and • the levels of base salary for similar positions with comparable status, responsibility and skills, in organisations of broadly similar size and complexity.
Maximum opportunity	Annual percentage increases are generally consistent with the range awarded across the Group. Percentage increases in salary above this level may be made in certain circumstances, such as a change in responsibility or a significant increase in the role's scale or the Group's size and complexity. Individuals who are recruited or promoted to the Board may have their salaries set below the targeted Policy level until they become established in their role. In such cases subsequent increases in salary may be higher than the general rises for employees until the target positioning is achieved.
Performance measures/assessment and recovery provisions	A broad assessment of individual and business performance is used as part of the salary review. No recovery provisions apply.

Benefits

Element, purpose and link to strategy	To provide competitive benefits and to attract and retain high calibre employees.
Operation	Reviewed periodically to ensure benefits remain market competitive. Benefits currently include: <ul style="list-style-type: none"> • Car and fuel allowance; • Life insurance; • Directors' & Officers' liability insurance; • Private medical insurance (including cover for spouses and dependants); • Professional subscriptions; • Critical illness cover; • Staff discounts; and • Other minor benefits as provided from time to time, including seasonal gifts.
Maximum opportunity	Benefit values vary year-on-year depending on premiums and the maximum potential value is the cost of the provision of these benefits.
Performance measures/assessment and recovery provisions	No performance or recovery provisions apply.

Directors' remuneration report

continued



Pension

Element, purpose and link to strategy	To provide a competitive Company contribution that enables effective retirement planning.
Operation	<p>Pension is provided by way of a contribution to a personal pension scheme or cash allowance in lieu of pension benefits.</p> <p>The Committee may review pension contributions for new joiners to the Board to ensure the approach is aligned with corporate governance best practice/market practice.</p>
Maximum opportunity	The maximum contribution to a personal pension scheme or cash in lieu is equal to £50,000.
Performance measures/assessment and recovery provisions	No performance or recovery provisions apply.

Annual bonus

Element, purpose and link to strategy	Incentivises achievement of annual objectives which support the Group's short-term performance goals.
Operation	<p>Bonus awards are granted annually following the signing of the Report and Accounts, usually in October.</p> <p>Performance period is one financial year with pay-out determined by the Committee following the year end, based on achievement against a range of financial and non-financial targets.</p> <p>The Committee can determine that part of the bonus earned under the annual bonus is provided as an award of shares under the Deferred Bonus Plan.</p> <p>If the Committee determines that deferral will apply, the main terms are:</p> <ul style="list-style-type: none"> • Deferral will apply where the bonus payment is greater than 75% of salary; • The minimum deferral period is three years; and • Vesting is conditional on the participant's continued employment with the Group at the end of the deferral period unless he or she is a "good leaver" (specific circumstances are set out on page 71 in the "Payments for loss of office" policy). <p>The Committee may award dividend equivalents on those shares to Plan participants to the extent that they vest.</p>
Maximum opportunity	<p>Maximum awards under the Annual Bonus are equal up to 120% of salary.</p> <p>Threshold performance: 0% of maximum.</p> <p>Where maximum awards are increased above 100% of salary, then the Committee will determine that bonus deferral shall apply to part of the annual bonus earned.</p>
Performance measures/assessment and recovery provisions	<p>Performance targets will be set by the Committee annually based on a range of financial and non-financial measures.</p> <p>Financial targets govern the majority of bonus payments, which may include those related to profit, cash flow and revenue. Non-financial measures may include customer satisfaction targets and individual personal objectives.</p> <p>The Committee will also determine the weighting of the measures to ensure that they support the business strategy and objectives for the relevant year.</p> <p>The Committee has the discretion to adjust targets or performance measures or weightings for any exceptional events that may occur during the performance year if there is a significant and material event which causes the Committee to believe the original measures, weightings and targets are no longer appropriate.</p> <p>The Committee retains discretion in exceptional circumstances to change performance measures and targets and the weightings attached to performance measures part-way through a performance period if there is a significant and material event which causes the Committee to believe the original measures, weightings and targets are no longer appropriate.</p> <p>Discretion may also be exercised in cases where the Committee believes that the outcome is not a fair and accurate reflection of business performance. The exercise of this discretion may result in a downward or upward movement in the amount of the bonus pay-out resulting from the application of the performance measures.</p> <p>Any adjustments or discretion applied by the Committee will be fully disclosed in the following year's Remuneration Report.</p> <p>In accordance with the rules of the Deferred Annual Bonus Plan, malus and clawback provisions apply at the discretion of the Committee where the Committee considers such action is reasonable and appropriate. Circumstances where malus and/or clawback could apply include: a participant's material underperformance, material brand or reputational damage, material misstatement of the accounts, gross misconduct by the participant and fraud or any other reason as determined by the Committee.</p> <p>Malus applies before the determination of the bonus or the vesting of any deferred component under the bonus. Clawback applies up until three years after the date of any cash bonus payment. Malus and clawback will continue to apply following cessation of employment.</p>

LTIP

Element, purpose and link to strategy	The DFS Furniture plc 2015 Long-Term Incentive Plan (LTIP) incentivises executives to achieve superior returns to shareholders over a three-year period, to retain key individuals and align their interests with shareholders.
Operation	<p>Under the LTIP, the Committee may award annual grants of performance share awards in the form of nil-cost options or conditional shares (LTIP Awards) on an annual basis.</p> <p>LTIP awards under the plan will vest after a three year performance period subject to the achievement of the performance measures.</p> <p>A two year holding period will apply following the three year vesting period for LTIP Awards granted to the Executive Directors. Upon vesting, sufficient shares can be sold to pay tax.</p> <p>Participants may be entitled to dividend equivalents representing the dividends paid during the performance period on LTIP awards that have vested.</p>
Maximum opportunity	<p>Maximum LTIP Awards are equal to 150% of base salary.</p> <p>In exceptional circumstances, the Committee retains the discretion to increase this to 230% of salary.</p> <p>Targets are typically structured as a challenging sliding scale, with no more than 20% of the maximum award vesting for achieving the threshold performance level through to full vesting for substantial out-performance of the threshold.</p>
Performance measures/assessment and recovery provisions	<p>Awards vest based performance against challenging targets, aligned with the delivery of the Company's long-term strategy.</p> <p>Adjusted EPS and Relative Total Shareholder Return measures will determine the vesting of awards granted in any year (50% weighting for each measure).</p> <p>The Committee will review performance measures annually, in terms of the range of targets, the measures themselves and weightings applied to each element of the LTIP. Any revisions to the metrics and/or weightings will only take place if it is necessary because of developments in the Group's strategy and, where these are material, following dialogue with the major shareholders.</p> <p>The Committee retains discretion in exceptional circumstances to change performance measures and targets and the weightings attached to performance measures part-way through a performance period if there is a significant and material event which causes the Committee to believe the original measures, weightings and targets are no longer appropriate.</p> <p>Discretion may also be exercised in cases where the Committee believes that the outcome is not a fair and accurate reflection of business performance. The exercise of this discretion may result in a downward or upward movement in the amount of the LTIP vesting resulting from the application of the performance measures.</p> <p>Any adjustments or discretion applied by the Committee will be fully disclosed in the following year's Remuneration Report.</p> <p>In accordance with the rules of the LTIP, malus and clawback provisions apply at the discretion of the Committee where the Committee considers such action is reasonable and appropriate.</p> <p>Circumstances where malus and/or clawback could apply include: a participant's material underperformance, material brand or reputational damage, material misstatement of the accounts, gross misconduct by the participant and fraud or any other reason as determined by the Committee.</p> <p>Malus applies before the vesting of any LTIP award. Clawback applies up until three years after the date of vesting. Malus and clawback will continue to apply following cessation of employment.</p>

Directors' remuneration report

continued



All-employee incentives

Element, purpose and link to strategy	Encourage all employees to become shareholders and thereby align their interests with shareholders.
Operation	Eligible employees may participate in the SAYE and Share Incentive Plan or country equivalent. Executive Directors will be entitled to participate on those same terms.
Maximum opportunity	Maximum participation levels for all staff, including Executive Directors, are set by relevant UK legislation or other relevant legislation.
Performance measures/assessment and recovery provisions	Not applicable.

Minimum shareholding requirements

Element, purpose and link to strategy	To ensure that Executive Directors' interests are aligned with those of shareholders over a longer time horizon.
Operation	The Executive Directors are required to build or maintain (as relevant) a minimum shareholding in the Company. Shares included in this calculation are those held beneficially by the Executive Director and their spouse/life partner. This includes vested LTIP shares subject to the two year post-vesting holding period but does not include any potential deferred bonus shares.
Minimum requirement	The shareholding requirement is 250% of salary for Executive Directors to be built up over five years.
Performance measures/assessment and recovery provisions	Not applicable.

Legacy awards

The Committee reserves the right to honour any remuneration payments or awards to Executive Directors, notwithstanding that they are not in line with the Policy set out above where the terms of the payment or award were agreed before the Policy came into effect. Such payments or awards will be set out in the Annual Report on Remuneration for the relevant year.

Performance measures and targets

The table below sets out the rationale for performance measures chosen in respect of the Annual Bonus and LTIP:

Element	Performance measures	Rationale	How targets are set
Annual bonus	A range of financial and non-financial performance measures.	The Committee selected the financial measures based on the Group's Key Performance Indicators (KPIs) and personal objectives are individually set and based on key strategic goals.	The performance targets are determined annually by the Committee taking into account market conditions and forecasts.
LTIP	<ul style="list-style-type: none"> • EPS • Relative Total Shareholder Return 	<p>EPS is an important measure of shareholder value over which Executive Directors have clear line of sight.</p> <p>Relative Total Shareholder Return reflects DFS performance relative to other companies in which investors could choose to invest.</p>	<p>EPS targets are set in reference to business plans and take into account shareholder expectations.</p> <p>Relative Total Shareholder Return targets are determined taking into account the comparative market returns and the expected level of returns for DFS shareholders.</p>

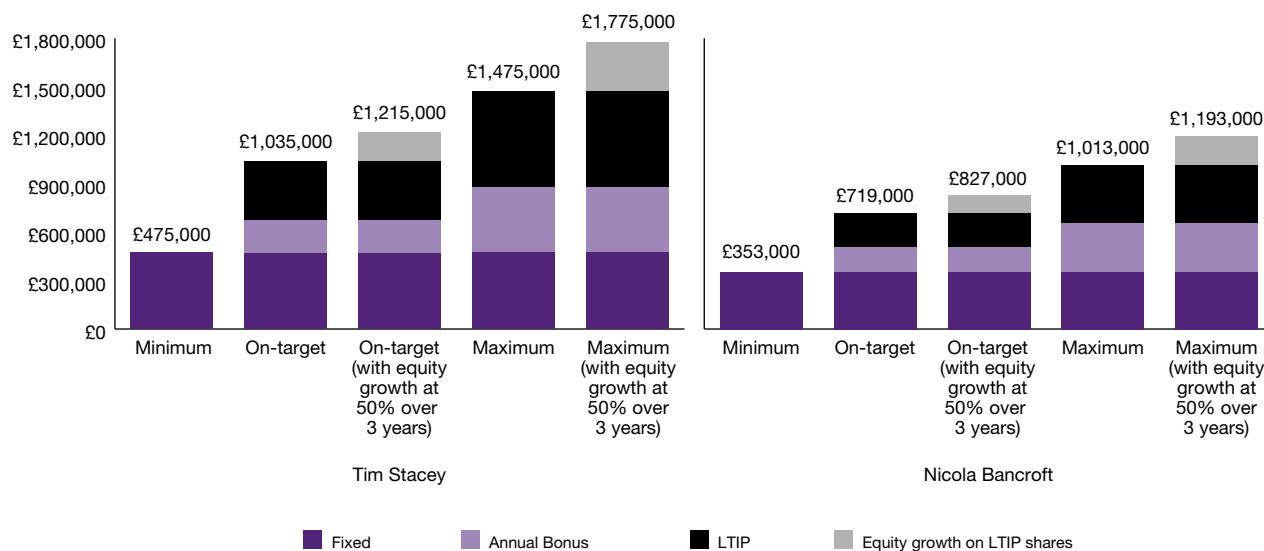
The Committee is of the opinion that, given the commercial sensitivity of the Company's operations, disclosing precise targets for the Annual Bonus in advance would not be in shareholders' interests. Except in circumstances where elements remain commercially sensitive, actual targets, performance achieved and awards made will be published at the end of the performance periods so shareholders can fully assess the basis for any payouts.

Discretion with the Directors' Remuneration Policy

The Committee has discretion in several areas of Policy as set out in this report. The Committee may also exercise operational and administrative discretions under relevant plan rules approved by shareholders as set out in those rules. In addition, the Committee has the discretion to amend Policy with regard to minor or administrative matters where it would be, in the opinion of the Committee, disproportionate to seek or await shareholder approval.

Illustrations of application of Policy

The charts below seek to demonstrate how pay varies with performance for the Executive Directors based on the stated remuneration Policy. The charts show an estimate of the remuneration that could be received by Executive Directors under the Policy set out in this report. Each of the bars is broken down to show how the total under each scenario is made up of fixed elements of remuneration, the annual bonus and the LTIP. The charts indicate that a significant proportion of both target and maximum pay is performance related. In line with changes to the Directors' Remuneration Reporting Regulations, scenarios including share price growth of 50% over the period of the Policy are shown. A scenario chart for Ian Filby, the outgoing CEO, is not shown.



Assumptions used in determining the level of pay-out under given scenarios are as follows:

Element	Minimum	On-Target	Maximum
Fixed elements	<ul style="list-style-type: none"> Base salary of £400,000 for Tim Stacey and £300,000 for Nicola Bancroft. Pension £50,000 for Tim Stacey and £40,000 for Nicola Bancroft. Estimated value of benefits provided under the Policy in line with 2017 figures for CEO and CFO role. 		
Annual bonus	Nil	50% of maximum	100% of salary for both Executive Directors
LTIP	Nil	60% of maximum	Tim Stacey: 150% of salary Nicola Bancroft: 120% of salary

Notes

- For both the Annual Bonus and LTIP on-target assumptions, the mid-point between threshold and maximum has been selected.
- For the Annual Bonus, the Policy allows for award levels to increase up to 120% of salary, however, the current levels remain at 100% of salary.

Directors' remuneration report

continued



Approach to recruitment and promotions

The Company will pay total remuneration for new Executive Directors that enables the Company to attract appropriately skilled and experienced individuals, but is not, in the opinion of the Committee, excessive. The remuneration package for any new recruit would be assessed following the same principles as for the Executive Directors, as set out in the remuneration Policy table.

For a new Executive Director who is an internal appointment, the Company may also continue to honour contractual commitments made prior to the internal appointment even if those commitments are otherwise inconsistent with the Policy in force when the commitments are satisfied. Any relevant incentive plan participation may either continue on its original terms or the performance targets and/or measures may be amended to reflect the individual's new role, as the Committee considers appropriate.

Under the new Policy, the Committee is proposing to reduce the maximum annual variable remuneration to 350% of salary from 450% of salary previously. This recognises the fact that it is important to exercise restraint in relation to quantum. The Committee felt that reducing the maximum variable remuneration to 350% was appropriate but still allowed for competitive award levels.

The table below summarises our key policies with respect to recruitment remuneration:

Element	Policy description
Base salary and benefits	<ul style="list-style-type: none"> The salary level will be set taking into account a number of factors including market factors, the individual's experience and responsibilities and other pay structures within the Company and will be consistent with the salary Policy for existing Executive Directors. This may mean that the Executive Director is recruited on a salary below the market rate with a view that it would be increased subject to performance over a number of years. Benefits may be provided in line with DFS' benefits Policy as set out in the remuneration Policy table.
Pension	<ul style="list-style-type: none"> An Executive Director will be able to receive either a contribution to a personal pension scheme or cash allowance in lieu of pension benefits in line with DFS' Policy as set out in the remuneration Policy table.
Annual Bonus	<ul style="list-style-type: none"> An Executive Director will be eligible to participate in the Annual Bonus as set out in the remuneration Policy table. Awards may be granted up to the maximum opportunity allowable in the remuneration Policy table at the Committee's discretion.
LTIP	<ul style="list-style-type: none"> An Executive Director will be eligible to participate in the Long-Term Incentive Plan as set out in the remuneration Policy table. Awards may be granted up to the maximum opportunity allowable under scheme rules at the Committee's discretion.
Maximum variable remuneration	<ul style="list-style-type: none"> The maximum annual variable remuneration that an Executive Director can receive may be up to 350% of salary (i.e. Annual Bonus and LTIP Awards).
Share buy-outs/ replacement awards	<ul style="list-style-type: none"> The Company may, where appropriate, compensate a new Executive Director for variable or share based remuneration that has been forfeited as a result of accepting the appointment with the Company. Where the Company compensates a new Executive Director in this way, it will seek to do so under the terms of the Company's existing variable remuneration arrangements, but may compensate on terms that are more bespoke than the existing arrangements where the Committee considers that to be appropriate. In such instances, the Company will disclose a full explanation of the detail and rationale for such recruitment related compensation. In making such awards the Committee will seek to take into account the nature (including whether awards are cash or share-based), vesting period and performance measures and/or conditions for any remuneration forfeited by the individual when leaving a previous employer. Where such awards had outstanding performance or service conditions (which are not significantly completed) the Company will generally impose equivalent conditions. The value of the buy-out awards will broadly be the equivalent of, or less than, the value of the award being bought out.
Relocation policies	<ul style="list-style-type: none"> In instances where the new Executive is relocated from one work location to another, the Company will provide compensation to reflect the cost of relocation for the Executive in cases where they are expected to spend significant time away from their home location in accordance with its normal relocation package for employees. The level of the relocation package will be assessed on a case by case basis but will take into consideration any cost of living differences; housing allowance; and schooling in accordance with the Company's normal relocation package for employees.

Executive Director service contracts and payment for loss of office

Service contracts

When setting notice periods, the Committee has regard to market practice and corporate governance best practice. The table below summarises the service contracts for our Executive Directors.

	Date of contract	Notice period
Ian Filby	13 July 2010	6 months (Executive) or 12 months (Company)
Tim Stacey	21 May 2018	
Nicola Bancroft	1 August 2016	6 months (Executive) or 6 months (Company)

All service contracts are available for viewing at the Company's registered office and at the AGM. The Executive Directors may accept outside appointments subject to approval of the Board and provided that such appointments do not in any way prejudice their ability to perform their duties as Executive Directors of the Company. The Executive Directors concerned may retain fees paid for these services.

Payments for loss of office

When determining any loss of office payment for a departing director the Committee will always seek to minimise cost to the Company whilst complying with the contractual terms and seeking to reflect the circumstances in place at the time. The Committee reserves the right to make additional payments where such payments are made in good faith in discharge of an existing legal obligation (or by way of damages for breach of such an obligation); or by way of settlement or compromise of any claim arising in connection with the termination of an Executive Director's office or employment.

The table below sets out, for each element of total remuneration, the Company's Policy on payment for loss of office in respect of Executive Directors and any discretion available:

Element	Approach	Discretion
Base salary	<p>The Company is entitled to terminate an Executive Director's employment without notice and without compensation for resignation or in the event of termination by the Company due to gross misconduct, willful neglect or certain other specified circumstances.</p> <p>In other circumstances the Company may determine that an Executive Director will be entitled to receive payment in lieu of notice equivalent to the salary payments that he would have been entitled to receive during any required period of notice or unexpired part thereof.</p>	None.
Annual bonus	<p>Where an Executive Director's employment is terminated after the end of a financial year but before the bonus payment is made, the Executive Director may be eligible for a bonus award for that financial year subject to an assessment based on financial and personal performance achieved over the period.</p> <p>Where an Executive Director's employment is terminated during a financial year, a pro-rata bonus award for the period worked in that financial year may be payable subject to an assessment based on financial and personal performance.</p> <p>In respect of Ian Filby (but not part of the Company's Policy for any other Executive Directors), where the Company decides to invoke the contractual payment in lieu of notice clause, he will be entitled to receive a bonus equivalent to 75% of his maximum bonus opportunity based on financial performance, pro-rated for any required period of notice or unexpired part thereof. Any such payment shall be made promptly following the Board's approval and signing of the audited accounts for the year concerned.</p> <p>However, there may be no payment in the event of gross misconduct, willful neglect or certain other specified circumstances</p>	<p>In respect of Ian Filby (but not part of the Company's Policy for other Executive Directors) the Committee has discretion to increase the payment in respect of any pro-rata bonus by the amount of bonus based on personal performance that the Committee determines would have been payable had the Executive Director's employment not been terminated.</p> <p>Further, and for Ian Filby only, where a payment is made in lieu of notice, the Committee has discretion to increase the bonus payment in respect of financial performance to an amount equivalent to 100% of the maximum bonus opportunity. The Committee also retains discretion to increase the payment in respect of bonus based on personal performance that the Committee determines would have been payable had Ian Filby's employment not been terminated.</p> <p>The Committee confirms that it will explain the reasons should it ever have to invoke these discretions.</p>

Directors' remuneration report

continued



Element	Approach	Discretion
Deferred Annual Bonus Plan and LTIP – cessation of employment	<p>Set out below is a summary of the treatment of awards under the Deferred Annual Bonus Plan and LTIP for “good leavers”. A participant is a “good leaver” if a participant ceases employment as a result of:</p> <ul style="list-style-type: none"> • death; • ill-health, injury or disability; • the participant’s employing company ceasing to be a Group member or the transfer of an undertaking or part of an undertaking (in which the participant is employed) to a person who is not a Group member; or • other reason, permitted by the Committee in its absolute discretion except where the participant is summarily dismissed. <p>Deferred Annual Bonus Plan</p> <p>Unless the Committee determines otherwise, all subsisting deferred share awards will continue and vest on the normal vesting date.</p> <p>If a participant in the Deferred Annual Bonus Plan ceases employment for any other reason, his awards will lapse in full on the date of such cessation.</p> <p>The Committee has discretion to determine whether to pro-rate the maximum number of shares to the time from the date of grant to the date of cessation. The Remuneration Committee’s normal policy is that it will not pro-rate awards for time. The Remuneration Committee will determine whether or not to pro-rate based on the circumstances of the Executive Directors’ departure.</p> <p>LTIP</p> <p>Unless the Committee determines that an LTIP Award will vest as soon as practicable after the date of cessation, an LTIP Award which has not yet vested as at the date of cessation will continue and vest on the normal vesting date subject to earlier vesting on certain corporate events taking place.</p> <p>If a participant in the LTIP ceases employment for any other reason, his awards will lapse in full (whether vested or not) on the date of such cessation.</p> <p>Unless otherwise determined by the Committee in its absolute discretion the number of shares in respect of which an award shall vest will be calculated on a pro rata basis, taking into account the extent to which any performance conditions have been satisfied at the end of the performance period (or at the date of cessation, if vesting following cessation is permitted) and the period of time that has elapsed from the grant date to the date of cessation.</p> <p>Unless otherwise determined by the Committee and except in the event of the participant’s death, any applicable post-vesting holding period will continue to apply post cessation of employment.</p> <p>General</p> <p>All vested LTIP Awards or Deferred Annual Bonus Awards in the form of nil-cost options may be exercised following cessation for such period as set out in the relevant rules or otherwise determined by the Committee.</p>	<p>Under the rules of the LTIP and the Deferred Annual Bonus Plan the Committee has discretion to determine whether the reason for termination of employment is “any other reason” (as described in the previous column) – such classification effectively governs the treatment of awards post-cessation of employment.</p> <p>Deferred Annual Bonus Plan</p> <p>The Committee has the discretion to vest deferred shares at the end of the original deferral period or at the date of cessation. The Remuneration Committee will make this determination depending on the type of “good leaver” reason resulting in the cessation.</p> <p>LTIP</p> <p>The Committee has discretion to determine that vesting will take place as soon as practicable following the date of cessation. The Committee has discretion to determine whether or not vesting of an award shall be reduced on a pro rata basis to take account of the extent to which any performance conditions have been satisfied and the period of time that has elapsed from the grant date to the date of cessation.</p> <p>General</p> <p>It should be noted that it is the Committee’s Policy only to apply its discretion if the circumstances at the time are, in its opinion, sufficiently exceptional, and to provide a full explanation to shareholders where discretion is exercised.</p>

Element	Approach	Discretion
Deferred Annual Bonus Plan and LTIP – change of control	<p>In the event of a takeover or scheme of arrangement awards will automatically vest on the date of such event (subject to provisions in the LTIP and Annual Bonus Deferred Plan rules which allow for exchanges of awards). On a voluntary/compulsory winding-up of the Company (other than in the nature of an internal re-organisation), demerger or other events deemed appropriate by the Committee awards will vest at the discretion of the Committee on the date of such event.</p> <p>Deferred Annual Bonus Plan Unless otherwise determined by the Board, subsisting Deferred Annual Bonus Awards will vest in full. To the extent awards do not vest or are exchanged (in case of a takeover or scheme of arrangement only) they shall lapse in full immediately.</p> <p>LTIP Unless otherwise determined by the Board, the number of shares in respect of which an award shall vest will be calculated on a pro-rata basis taking into account the extent any performance conditions have been satisfied at the date of the relevant event and the period of time that has elapsed from the grant date to the date of the relevant event. To the extent awards do not vest or are exchanged (in the case of a takeover or scheme of arrangement only) they shall lapse in full immediately. On a change of control, the post-vesting holding period will not apply.</p>	<p>The Committee has discretion to determine that awards vest on a date prior to the date of the corporate event taking place.</p> <p>Deferred Annual Bonus Plan The Committee has discretion regarding whether to pro-rate the award to time. The Committee's normal policy is that it will not pro-rate awards for time. The Committee will make this determination depending on the circumstances of the change of control.</p> <p>LTIP The Committee has discretion to determine whether or not vesting of an award shall be reduced on a pro rata basis to take account of the extent to which any performance conditions have been satisfied and the period of time that has elapsed from the grant date to the date of the relevant event.</p> <p>General It should be noted that it is the Committee's Policy only to apply its discretion if the circumstances at the time are, in its opinion, sufficiently exceptional, and to provide a full explanation to shareholders where discretion is exercised.</p> <p>The Committee has discretion for existing unvested awards to be exchanged in the event of a takeover.</p>

Consideration of employee remuneration and shareholders

Consideration of shareholder views

The Committee takes the views of the shareholders seriously and these views are taken into account in shaping the Policy and practice. Shareholder views are considered when evaluating and setting remuneration strategy and the Committee welcomes an open dialogue with its shareholders on all aspects of remuneration. The Committee consulted its major shareholders (over 50% of shareholders based on Issued Share Capital) and the main shareholder representative bodies (IA, ISS and Glass Lewis) on the proposed new Remuneration Policy for which we are seeking shareholder approval at the 2018 AGM. The Committee is grateful for the time that shareholders have taken to consider proposals and provide feedback. At the end of the consultation a large majority of shareholders consulted indicated they were supportive of the proposed new Remuneration Policy.

The Committee will continue to maintain an open and constructive dialogue with its major shareholders and the representative bodies and where appropriate, will always seek to consult.

Consideration of employee views and employment conditions elsewhere in the Group

In setting the Policy for directors, the pay and conditions of other employees of DFS are taken into account, including any base salary increases awarded. The Committee is provided with data on the remuneration structure for management level tiers below the Executive Directors, and uses this information to ensure consistency and fairness of approach throughout the Company.

Formal consultation on the remuneration of Executive Directors is not undertaken with employees. However, currently a survey on employee engagement is undertaken annually and includes discussion on parts of the Group's remuneration approach. The Committee is looking at ways that practice in this area can evolve.

The Policy described above applies specifically to Executive Directors of the Company. The Committee believes that the structure of management and employee reward at DFS should be linked to DFS's strategy and performance. The table below illustrates how the remuneration framework operates below the Executive Directors:

Level	Employee numbers	Fixed remuneration	Annual bonus or incentive/ commission plans	Restricted share plan	Long-term incentive plan	All employee HMRC plans	Shareholding guidelines
Senior management	9	x	x	x	x	x	x
Head of divisions and or functions	c.35	x	x	x		x	
Managers	c.180	x	x	x		x	
All employees	5000+	x	x			x	

Directors' remuneration report

continued



Non-Executive Director remuneration Policy and letters of appointment

Remuneration Policy table

The Chairman and the Executive Directors of the Board are responsible for setting the remuneration of the Non-Executive Directors, other than the Chairman whose remuneration is determined by the Committee and recommended to the Board.

The table below sets out the key elements of the Policy for Non-Executive Directors:

Purpose	Operation	Maximum opportunity	Performance measures and assessment
To provide compensation that attracts high calibre individuals and reflects their experience and knowledge	Fee levels are reviewed periodically taking into account independent advice and the time commitment required of Non-Executive Directors.	Any increase in Non-Executive Director fees may be above the level awarded to other employees, given that they may only be reviewed periodically and may need to reflect any changes to time commitments or responsibilities.	Non-Executive Director fees are not performance related.
	The fees paid to the Chairman and the fees of the other Non-Executive Directors aim to be competitive with other fully listed companies which the Committee (in the case of the Chairman) and the Board (in respect of the Non-Executive Directors) consider to be of equivalent size and complexity.		
	Non-Executive Directors may receive a base fee and additional fees for the role of Senior Independent Director or membership and/or Chairmanship of certain committees.	The Company will pay reasonable expenses incurred by the Chairman and Non-Executive Directors.	
	Non-Executive Directors also receive reimbursement of reasonable expenses (and any tax thereon) incurred undertaking their duties and or Company business.		
	Non-Executive Directors do not receive any variable remuneration element.		
	Non-Executive Directors are entitled to staff discount on Group merchandise on the same basis as other employees, and may also receive seasonal gifts.		

The Company's policy when setting fees for the appointment of new Non-Executive Directors is to apply the Policy which applies to current Non-Executive Directors.

Letters of appointment

The Non-Executive Directors do not have service contracts but are appointed under letters of appointment which provide for a review after an initial three year term terminable by either the Non-Executive Director or the Company with one month's prior written notice. Each Non-Executive Director is subject to annual re-election at the Company's AGM. The table below sets out the dates that each Non-Executive Director was first appointed as a Group Director.

	Date of appointment
Ian Durant	2 May 2017
Alison Hutchinson	1 May 2018
Luke Mayhew	1 October 2014
Julie Southern	2 February 2015

No compensation is payable in the event of early termination apart from the notice period. All letters of appointment are available for viewing at the Company's registered office and at the AGM.

PART D: 2018 ANNUAL REPORT ON REMUNERATION

This 2018 Annual Report on Remuneration contains details of how the Company's Policy for Directors was implemented during the Financial Year ended 28 July 2018. The Policy was approved by shareholders at the 2015 AGM on 4 December 2015 and we are seeking approval for the revised Policy at the 2018 AGM. A copy of the proposed Policy can be found on pages 65 to 74 of this Remuneration Report.

This report has been prepared in accordance with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended in 2013, the provisions of the current Code and the Listing Rules. An advisory resolution to approve this report, the Annual Statement and the revised Policy will be put to shareholders at the AGM on 30 November 2018.

1. Executive Director Remuneration

Single figure remuneration table – audited

The remuneration of Executive Directors showing the breakdown between components with comparative figures for the prior financial year is shown below. Figures provided have been calculated in accordance with the Regulations.

		Base salary £'000	Taxable benefits ¹ £'000	Bonus £'000	Long-term incentives £'000	Pension £'000	Other £'000	Total £'000
Ian Filby	2018	439	26	158	—	50	—	673
	2017	430	25	161	—	50 ²	—	666
Nicola Bancroft	2018	272	17	95	—	35	10	429
	2017	240	13	91	—	35	9 ³	388

Notes

1. Taxable benefits comprise car and fuel allowance, private medical insurance (including cover for spouses and dependents), relevant professional subscriptions, seasonal gifts and reimbursement of home telephone line and telephone expenses – the value of which has been included in the Taxable Benefits column.
2. Ian Filby waived his entitlement to a pension contribution from the Group and a charitable donation of £50,000 (2017: £50,000) has been made as an alternative.
3. Nicola Bancroft opted for a company car of lower value and received an allowance for the difference.

Annual bonus outcomes for the Financial Year ending 28 July 2018 – audited

For 2018 the CEO and the CFO had a maximum annual bonus opportunity of 100% of salary. For each Executive Director, the 2018 annual bonus determination was based on performance against five performance measures namely: Group revenue, Group underlying profit before tax ("PBT"), Group underlying cash flow, Net Promoter Score and personal objectives. Group revenue has been selected as a performance measure rather than Group gross sales as disclosed in the FY17 Remuneration Report in order to improve alignment with statutory financial measures. In the current environment of stable VAT and interest rates the two measures are aligned: in FY18 both gross sales and revenue for the pre-acquisition Group decreased by 2.0%

The table below provides information on the targets for each measure, actual performance and resulting bonus payment for each Executive Director. Performance targets and actual performance are based on the pre-acquisition Group, excluding Sofology:

Performance measure	Weighting (% of maximum bonus opportunity)	Threshold performance target (0% of performance measure maximum opportunity earned)	Target level of performance	Maximum performance target (100% of performance measure maximum opportunity earned)	Actual performance outcome	% of performance measure maximum opportunity earned
Group revenue (£m)	20%	739.0	761.7	774.0	£747.7m	24.9%
Group underlying PBT (£m)	20%	49.1	52.8	54.8	£38.4m	0%
Group underlying cash flow (£m)	20%	33.8	36.5	38.0	£32.3m	0%
Net Promoter Score	20%	34.2%	36.1%	36.8%	35.8%	61.5%
Personal objectives - IF/NB	20%		See below		See below	93.8%/87.5%
Overall extent to which the bonus targets were achieved				Ian Filby Nicola Bancroft		36.0% 34.8%

Notes

1. Between threshold, target and maximum, pay-out for the measures was calculated on a straight-line basis.
2. Revenue and underlying PBT are presented on the income statement on page 90. Underlying cash flow means the net movement in cash and cash equivalents during the Financial Year as adjusted for cash flows associated with non-underlying items.

Directors' remuneration report

continued



Performance against the personal objectives and the Committee's assessment of performance for both Executive Directors is set out in the table below. As part of its assessment, the Committee also took into account Group health and safety objectives to ensure that a safe environment was in place for all employees and customers. The Committee was satisfied that timely reporting of health and safety and risk mitigation activities had been undertaken throughout the year with no major instances.

Each of the objectives have specific measures and targets. There are some measures where we have not disclosed detailed performance against objectives as the targets themselves are commercially sensitive and to disclose specific figures would not be in the best interests of the Group and our shareholders.

Director	Personal objectives set at the start of the year	Assessment against targets	Outcome
Ian Filby	Property strategy: Prepare a 5 year plan on optimising the Property Portfolio	<ul style="list-style-type: none"> Development of the Group property strategy and sign-off by the Board Positive feedback from investors on Capital Markets Day 	Fully achieved
	Senior leadership development: Demonstrably invest to develop the Senior Team	<ul style="list-style-type: none"> All personal development plans are in place for the senior executive team Successful development of processes to achieve a smooth transition to future successor 	Fully achieved
	Online progress: Drive e-commerce and m-commerce revenues and online experience for customers	<ul style="list-style-type: none"> Increase in e-commerce and m-commerce revenues 	Fully achieved
	Integration of Customer Acquisition with Brand Portfolio: Provide a strategy for the future acquisition of customers and how they will be prioritised to our brand portfolio	<ul style="list-style-type: none"> Significant work undertaken on the assessment of the Group's brand portfolio Leading presentations to the Group Board on brand positioning and developing action plans for each brand 	Partially achieved
Nicola Bancroft	Cash management: Lead the implementation of initiatives to deliver an incremental material cash improvement	<ul style="list-style-type: none"> Management of daily and weekly cash flow Minimisation of interest charges Generating savings from the implementation of cash improvement initiatives 	Partially achieved
	Sofology Acquisition: Effective management of the regulatory matters clearance and integration process in accordance with the agreed milestone plan	<ul style="list-style-type: none"> Acquisition completed after sign off at phase 1 Delivering in line with the agreed milestone plan 	Fully achieved
	4 Year Planning and Strategic KPIs: Facilitate a high quality strategy dialogue process with the Group Board to reach agreement on a revised 4 year plan, including explicit agreement on strategic KPIs	<ul style="list-style-type: none"> Delivering successful presentation at the Board strategy day leading to the agreement of the 4 year plan and strategic KPIs 	Fully achieved
	External Stakeholder relationships: Complete successfully full year and half year reporting and relevant regulatory requirements and external communications	<ul style="list-style-type: none"> Ongoing management of calls with banks, analysts and investors measured through satisfactory investor reaction and feedback Banks signed up to change in year-end timetable 	Fully achieved

As a result of the performance results shown above, the bonuses awarded to the Executive Directors are £157,933 for Ian Filby (36.0% of maximum) and £94,517 for Nicola Bancroft (34.8% of maximum). The 2018 bonuses for Ian Filby and Nicola Bancroft will be paid in cash. No part of the bonus will be subject to deferral and no discretion was exercised by the Committee when determining the bonus outcomes.

LTIP vesting for the year ended 28 July 2018 – audited

The 2016 award was granted in October 2015 and was assessed against the performance targets at the end of FY18. The final level of vesting of these awards was nil as set out in the table below.

Performance measure	Weighting (% of maximum bonus opportunity)	Threshold performance target (20% of performance measure maximum opportunity earned)	Maximum performance target (100% of performance measure maximum opportunity earned)	Actual performance outcome	% of performance measure maximum opportunity earned
Earnings per share	50%	8% (23.3p)	18% (30.4p)	8.9% (14.0p)	0%
TSR vs FTSE 250 (ex. Investment Trusts)	50%	Equal to Index performance	Index performance + 12% p.a.	13% p.a. below Index performance	0%
Total	100%		n/a		0%

Defined benefit pension

The Executive Directors do not have a prospective right to a defined benefit pension by reference to qualifying service.

Payments to past Directors or for loss of office – audited

There have been no payments to past Directors or payments for loss of office during the 2018 financial year. However, as announced on 22 May 2018, Ian Filby will be stepping down as CEO effective 31 October 2018. As a result, the leaving arrangements for Ian will be disclosed in full on the corporate website at that time and in next year's Directors' Remuneration Report. Ian will continue to provide the Group with his extensive business experience and expertise including by taking on the role of part-time Chairman of Sofology and driving the continued integration of Sofology and DFS' businesses. All arrangements with Ian Filby are within the framework of the approved Remuneration Policy.

2. Implementation of remuneration Policy for the Executive Directors for 2019

Base salary

In setting salary levels for the 2019 Financial Year for the Executive Directors, the Committee considered a number of factors, including individual performance and experience, pay and conditions for employees across the Group, the general performance of the Company, pay levels in other comparable companies and the economic environment. The salaries for 2018 and the relative increases are set out below. Details regarding the Committee's decision on Nicola Bancroft's salary for 2019 are set out on page 60.

	Base salary p.a. £		% change
	2019	2018	
Ian Filby	449,670	438,702	+2.5%
Tim Stacey	400,000	N/A	N/A
Nicola Bancroft	300,000	271,600	+10.5%

Notes

1. Tim Stacey was not an Executive Director in the 2018 Financial Year and therefore, his 2018 base salary and percentage change is not shown.
2. Nicola Bancroft's 2018 salary is based on Nicola's salary at the start of the 2018 Financial Year and takes into account the increase to £300,000 p.a. effective 1 February 2018.

Pension and benefits

The maximum contribution to a personal pension scheme or cash in lieu will continue to be capped at £50,000 for Tim Stacey and £40,000 (less employers NI cost) for Nicola Bancroft.

Benefits will be provided to the Executive Directors in line with the Policy.

Annual bonus

	Threshold bonus	Maximum bonus
Ian Filby	0% of salary	100% of salary
Tim Stacey	0% of salary	100% of salary
Nicola Bancroft	0% of salary	100% of salary

For FY19, performance measures comprise: Group revenue (15%), Group underlying profit before tax (25%), Group underlying cash flow (20%), growth in Established Customer Net Promoter Score (20%) and personal objectives (20%).

The Committee is of the opinion that the precise financial and personal performance targets for the annual bonus are commercially sensitive and that it would be detrimental to the interests of the Company to disclose them before the start of the financial year. Actual targets, performance achieved and awards made will be published at the end of the performance period so shareholders can fully assess the basis for any pay-outs.

Directors' remuneration report

continued



LTIP Awards

Details of the LTIP Awards to be made in FY19 are provided below. Due to his retirement, Ian Filby will not receive an LTIP award for FY19.

	Type of award	Maximum value of award at grant date	Vesting period	Exercise price
Tim Stacey	Conditional Share Award	150% of salary	Three years	Nil
Nicola Bancroft	Conditional Share Award	120% of salary	Three years	Nil

The awards will vest subject to achieving two challenging measures, namely Adjusted EPS¹ (50% weighting) and Relative Total Shareholder Return² (50% weighting). Awards will also be subject to a two-year holding period.

As set out on page 82, we will be retaining relative TSR and EPS growth in the LTIP (each measure will continued to be weighted at 50%). The Committee has reviewed the comparator groups within the TSR measure and discussed this specifically with shareholders. We have decided that looking ahead over the next three years the UK retail sector is the most relevant group. Therefore, for the 2018 LTIP award, the split between the FTSE 350 General Retailers Index and the FTSE 250 Index (excluding Investment Trusts) will be 35:15 (50% of total LTIP award).

We have not yet set EPS growth targets for the 2018 LTIP awards because the new CEO and the Board of Directors are in the process of reviewing our long-term business plan. Accordingly, the 2018 LTIP grants will be delayed this year, and in accordance with the Market Abuse Regulation rules, we will disclose TSR and EPS performance targets when we grant the LTIP awards in November 2018.

Notes

- Adjusted earnings per share will be calculated on a compound annual growth basis.
- Growth in Total Shareholder Return will be calculated on a simple average annual growth rate and split evenly between the two peer group indices.

3. Consideration by the Committee of matters relating to Directors' remuneration for 2018

The Committee complies with the UK Corporate Governance Code. The Committee makes recommendations to the Board, within agreed terms of reference, on remuneration for the Executive Directors and Chair of the Board and has oversight of remuneration arrangements for senior management. The Committee's full terms of reference are available on the Company's website at www.dfscorporate.co.uk.

Members of the Committee during 2018 were:

- Gwyn Burr (Chair – stepped down 30 April)
- Luke Mayhew (Interim Chair from 1 May)
- Alison Hutchinson (appointed to the Board on 1 May 2018)
- Julie Southern

Further details regarding members of the Committee and their attendance at meetings during the course of the year are available on page 47 of this Annual Report.

None of the Committee members has any personal financial interest (other than as shareholders) in the decisions made by the Committee, conflicts of interests arising from cross-directorships or day-to-day involvement in running the business. The Chair, the CEO and the CFO attend meetings at the invitation of the Committee, but are not present when their own remuneration is being discussed. The Committee is supported by the Chief People Officer, Finance and Company Secretariat functions.

During the year, there were five Committee meetings. One of the meetings was specifically called to approve CEO succession arrangements in light of Ian Filby's retirement and his replacement in Tim Stacey. In addition to this, the other main item of concern for the Committee during the year was the review of the Directors' Remuneration Policy. The matters covered at the other four meetings are covered in the table below.

September 2017	January 2018	June 2018	July 2018
<ul style="list-style-type: none"> Salary review for Executive Board members 2017 bonus scorecard assessment Approving the 2018 bonus scorecard Approving the 2018 LTIP Awards Approving the 2017 Directors' Remuneration Report LTIP vesting calculation review for IPO award 	<ul style="list-style-type: none"> Gender pay reporting Market practice and corporate governance update Approach to Review of Directors' Remuneration Policy CFO salary review 	<ul style="list-style-type: none"> Review of Directors' Remuneration Policy Initial discussions on the 2018 Director' Remuneration Report Annual bonus and in-flight LTIP performance updates Update on corporate governance, 2018 AGM season and market trends 	<ul style="list-style-type: none"> Proposal for revisions of Directors' Remuneration Policy Consultation with shareholders on the review of Policy Performance measures for the LTIP

The Committee received external advice in 2018 from PwC during the year. The Committee appointed PwC as its advisers after a tender process in July 2015. PwC are considered by the Committee to be objective and independent. PwC are members of the Remuneration Consultants Group and, as such, voluntarily operate under the code of conduct in relation to executive remuneration consulting in the UK.

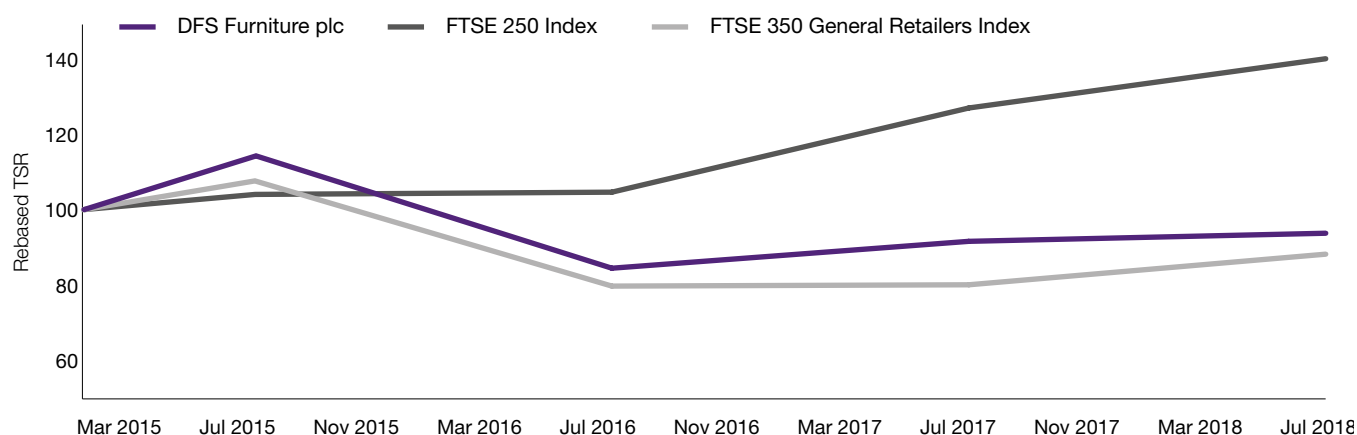
The Committee reviewed the nature of all the services provided during the year by PwC and was satisfied that no conflict of interest exists or existed in the provision of these services. The total fees paid to PwC in respect of services to the Committee during the year were £124,000. Fees were determined based on the scope and nature of the projects undertaken for the Committee.

4. Chief Executive Officer and employee pay

Total Shareholder Returns and Chief Executive Officer pay since IPO

The Committee believes that the current Executive Director Policy and the supporting reward structure provide clear alignment with the Company's performance. The Committee believes it is appropriate to monitor the Company's performance against the FTSE 250 Index and the FTSE 350 General Retailers Index as these both represent the broad equity markets against which the Company compares itself.

The chart below illustrates our Total Shareholder Return performance against the FTSE 250 Index and FTSE 350 General Retailers Index since 5 March 2015, the date of IPO, to the end of FY18, being 28 July 2018.



Chief Executive Officer	2018	2017	2016	2015
Single figure of total remuneration (£'000)	673	666	804	790
Bonus pay-out (% maximum)	36.0%	37.5%	71.9%	85.2%
Long-term incentive vesting rates (% maximum)	0%	0%	n/a	n/a

Percentage change in the Chief Executive Officer's remuneration

The table below compares the percentage increase in the Chief Executive Officer's pay with the wider employee population. The Company considers DFS employees other than those whose remuneration includes piecework or commission, and excluding the Executive Directors, to be an appropriate comparator group.

% change from FY17 to FY18	Base salary	Benefits	Annual bonus
Chief Executive Officer (Ian Filby)	+2.0%	3.7%	-1.8%
Employee pay	+2.0%	n/a	-5.4%

The change in the Chief Executive Officer's base salary was in line with the general employee award. The smaller change in the annual bonus of the Chief Executive in FY18 compared to employees reflects the smaller percentage decrease in employee bonus in FY17.

Relative importance of spend on pay

The table below sets out the overall spend on pay for all employees compared with the returns distributed to shareholders.

Significant distributions	2018	2017	% change
Employee spend ²	£156.3m	£141.6m	+10.4%
Distributions to shareholders (ordinary dividends and purchase of own shares)	£23.7m	£23.7m	0%
Distributions to shareholders (special dividends)	—	£20.1m	—

Notes

- The above figures are taken from notes 4 and 20 to the financial statements.
- Employee spend includes salary costs at acquired businesses.

Directors' remuneration report

continued



5. Pay fairness throughout the Group

Wider workforce views and the employee value proposition

In setting the remuneration Policy for Directors, the pay and conditions of other employees of DFS are taken into account, including any base salary increases awarded. The Committee is provided with data on the remuneration structure for management level tiers below the Executive Directors, and uses this information to ensure consistency and fairness of approach throughout the Company.

Formal consultation on the remuneration of Executive Directors is not undertaken with employees. However, a survey on employee engagement is undertaken annually and includes discussion on parts of the Group's remuneration approach.

As part of our commitment to fairness, we have set out further information on our employee offering. The various factors which make up our "Fair Deal" proposition is below. The Remuneration Policy on page 73 also sets out how we cascade our remuneration framework throughout the organisation.

Area	Detail
Pay and benefits	<ul style="list-style-type: none"> We aim to be the market median payer of remuneration for good individual performance, believing that this approach balances fairness to the employee as well as responsible use of shareholders funds. Employees can share in our success via bonus schemes and the SAYE.
Working environment	<ul style="list-style-type: none"> We strive to create a positive working environment and promote the right behaviours through evidence of objective decision making, equity of treatment and trust in doing the right things in the right way
Development opportunities	<ul style="list-style-type: none"> We provided access to development opportunities enabling growth within function or cross functionally
Recognition	<ul style="list-style-type: none"> We provide monetary and non-monetary recognition We have visible celebrations of achievements We have opportunities for peer led and hierarchical recognition

Gender pay gap reporting and diversity

Gender pay reporting legislation which came into force in April 2017 requires all UK employers with 250 or more employees to publish annual information illustrating pay differences between male and female employees. Fairness and diversity are very important to DFS and we are committed to ensuring that all our employees have the opportunity to thrive and prosper and so we welcome the legislation. The Group is confident our male and female employees receive equal pay for equivalent jobs. We published our Gender Pay Gap Reporting in February 2018 and it is available online: <http://www.dfscorporate.co.uk/media/40041/DFS-Gender-Pay-Gap-Feb-2018.pdf>

We recognise that there is a gender pay gap in the business. DFS' employee base has a two-thirds male, one-third female split driven mainly by the fact that historically our manufacturing, supply chain and retail business areas have, for various reasons, attracted a male bias workforce. Our analysis shows that our 19% mean and 14% median pay gap is a result of more men in senior positions throughout all business areas.

The Company is committed to addressing the gender pay gap. The Company's recently formed Diversity Steering Committee – led by senior members of our executive board – is committed to helping close the gap. Whilst the Diversity Steering Committee looks at all aspects of diversity within the business, its primary focus currently is to seek to understand potential barriers to attracting female talent into specific areas of our business, while ensuring women feel inspired and enabled to reach their full potential at DFS and are encouraged to take up senior leadership positions. The Board is kept aware of progress and initiatives in this area. In addition, we have also introduced a number of broader initiatives relating to flexible working, recruitment and promoting cultural change.

6. Non-Executive Director remuneration

Single figure remuneration table – audited

The remuneration of Non-Executive Directors showing the breakdown between components, with comparative figures for the prior year, is shown below. Figures provided have been calculated in accordance with the Regulations.

Director		Fees £'000	Other £'000	Total £'000
Ian Durant ¹	2018	180	0	180
	2017	45	0	45
Luke Mayhew	2018	60	0	60
	2017	60	0	60
Gwyn Burr ²	2018	42	0	42
	2017	50	0	50
Julie Southern	2018	56	0	56
	2017	50	0	50
Alison Hutchinson ³	2018	13	0	13
	2017	0	0	0

Notes

1. Ian Durant was appointed to the Board on 2 May 2017
2. Gwyn Burr stepped down from the Board on 30 April 2018
3. Alison Hutchinson was appointed to the Board on 1 May 2018

Fees to be provided in FY19 to the Non-Executive Directors

The following table sets out the annual fee rates for the Non-Executive Directors:

	2019 £	2018 £	% change
Chair fee	180,000	180,000	0%
Senior Independent Director fee	60,000	60,000	0%
Chair of Audit/Remuneration Committee fee	57,000	57,000	0%
Independent Non-Executive Director fee	50,000	50,000	0%

Fees for the Chair of the Board were set at £180,000 on his appointment in May 2017. For Non-Executive Directors, base fees have not changed for FY19. Non-Executive fees will be kept under review for future periods.

7. Directors' shareholdings and share interests

Shareholding and other interests at 28 July 2018 – audited

Directors' share interests and, where applicable, achievement of shareholding requirements are set out below. In order that their interests are aligned with those of shareholders, Executive Directors are expected to build up and maintain (as relevant) a personal shareholding equal to 200% of their base salary in the Company.

Director	Shareholding at 28 July 2018			Interests in shares under the LTIP (Conditional shares)			
	Number of beneficially owned shares ¹	% of salary held ²	Shareholding requirement met	Subject to conditions	Vested but unexercised	Unvested SAYE awards	Total at 28 July 2018
Ian Filby	1,313,208	594%	Yes	548,205	–	9,782	1,871,195
Nicola Bancroft	371,352	252%	Yes	235,311	–	–	606,663
Ian Durant	15,000	n/a	n/a	n/a	n/a	n/a	15,000
Luke Mayhew	44,121	n/a	n/a	n/a	n/a	n/a	44,121
Gwyn Burr	0	n/a	n/a	n/a	n/a	n/a	–
Julie Southern	3,921	n/a	n/a	n/a	n/a	n/a	3,921
Alison Hutchinson	0	n/a	n/a	n/a	n/a	n/a	–
Total	1,747,602	0	0	783,516	0	9,782	2,540,900

Notes

- Beneficial interests include shares held directly or indirectly by connected persons.
- Shareholding requirement calculation is based on the share price at the end of the year (£2.035 at 28 July 2018).

At 1 October 2018 there had been no movement in Directors' shareholdings and share interests from 28 July 2018.

LTIP awards granted in FY18 – audited

The table below sets out the details of the LTIP Awards granted on 17 November 2017 where vesting will be determined according to the achievement of relative TSR and EPS growth performance measures. Non-Executive Directors do not receive LTIP awards.

Director	Type of award	Face value/maximum value of award at grant date (% of salary)	Number of shares	Percentage of award receivable for threshold performance	Performance period end date	Exercise price
Ian Filby	Conditional Share Award	130%	298,593	20%	25 July 2020	Nil
Nicola Bancroft	Conditional Share Award	100%	128,168	20%	25 July 2020	Nil

Notes

- In line with the Rules of the plan, awards were determined using an average share price prior to grant of £1.90.
- Awards will only vest subject to the achievement of the performance conditions which will be measured at the time the Group publishes its full year financial results.

Directors' remuneration report

continued



The awards will vest subject to achieving two challenging performance measures, namely Adjusted EPS (50% weighting) and Relative Total Shareholder Return (50% weighting). The targets are contained in the table below:

Measure	Weighting	Performance period	Performance target	Vesting (% of Award)
Adjusted earnings per share growth	50%	3 financial years ending FY20	Less than 4% per annum	0%
			4% per annum	20%
			10% per annum	100%
Total Shareholder Return versus FTSE 250 Index (excluding Investment Trusts)	25%	3 financial years ending FY20	Below Index return	0%
			Equal to Index return	20%
			10% p.a. above the Index return	100%
FTSE 350 General Retailers Index	25%	3 financial years ending FY20	Below Index return	0%
			Equal to Index return	20%
			10% p.a. above the Index return	100%

Notes

- Growth in Total Shareholder Return will be calculated on a simple average annual growth rate.
- Adjusted earnings per share will be calculated on a compound annual growth basis.

SAYE awards – audited

There were no SAYE awards granted to Executive Directors during the year.

Dilution

The Company intends to fund its share incentives through a combination of new issue and market purchased shares. The Company monitors the levels of share grants and the impact of these on the ongoing requirement for shares. In accordance with guidelines set out by the Investment Association ("IA") the Company can issue a maximum of 10% of its issued share capital in a rolling 10-year period to employees under all its share plans.

8. Outstanding share awards

The following share awards remain outstanding as at 28 July 2018 (excluding the 2015 LTIP award which lapsed):

Director	Type of award	Date of grant	Number of awards	Awards vested	Awards lapsed	Outstanding awards as at 28 July 2018	Market price on date of grant	Normal vesting date
Ian Filby	LTIP	15-Nov-16	249,612	–	–	249,612	224p	15-Nov-19
		16-Nov-17	298,593	–	–	298,593	191p	16-Nov-20
	SAYE	07-Dec-16	9,782	–	–	9,782	184p	1-Feb-20
Nicola Bancroft	LTIP	15-Nov-16	107,143	–	–	107,143	224p	15-Nov-19
		16-Nov-17	128,168	–	–	128,168	191p	16-Nov-20

Details of LTIP award performance conditions

LTIP award	Performance conditions	Weighting (% award)	Detail	Entry level performance	Max performance	Threshold level vesting	Maximum vesting
2016 LTIP	EPS growth	50%	Reporting underlying EPS	4% p.a.	13% p.a.	20%	100%
	Relative TSR	25%	TSR vs FTSE 250 (excluding Financials)	Index	Index + 12%	20%	100%
		25%	TSR vs FTSE 350 General Retailers	Index	Index + 12%	20%	100%
2017 LTIP	EPS growth	50%	Reporting underlying EPS	4% p.a.	10% p.a.	20%	100%
	Relative TSR	25%	TSR vs FTSE 250 (excluding Financials)	Index	Index + 10%	20%	100%
		25%	TSR vs FTSE 350 General Retailers	Index	Index + 10%	20%	100%

9. Shareholder voting

The table below shows the binding vote approving the Policy in 2015 and the advisory vote to approve the 2017 Annual Report on Remuneration at the AGM in December 2017.

	Votes for	%	Votes against	%	Votes withheld
2015 Directors' Remuneration Policy	174,166,632	99.91	153,151	0.09	0
2017 Annual Report on Remuneration	165,409,850	99.41	980,999	0.59	1,911

By order of the Board

Luke Mayhew

Interim Chair of the Remuneration Committee
3 October 2018

Statement of Directors' responsibilities in respect of the annual report and the financial statements

The Directors are responsible for preparing the Annual Report and the Group and parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) and applicable law and have elected to prepare the parent Company financial statements in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent Company and of their profit or loss for that period. In preparing each of the Group and parent Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent Company financial statements, state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the parent Company financial statements;
- assess the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement of the Directors in respect of the annual financial report

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report and Directors' Report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

We consider the Annual Report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

On behalf of the Board

Ian Filby
Chief Executive Officer
3 October 2018

Nicola Bancroft
Chief Financial Officer

Independent auditor's report

Independent auditor's report to the members of DFS Furniture plc

1. Our opinion is unmodified

We have audited the financial statements of DFS Furniture plc ("the Group") for the 52 weeks ended 28 July 2018 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Balance Sheet, the Consolidated Statement of Changes in Equity, the Consolidated Cash Flow Statement, the Company Balance Sheet, the Company Statement of Changes in Equity, and the related notes, including the accounting policies in note 1.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 28 July 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 *Reduced Disclosure Framework*; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the shareholders on 6 July 2015. The period of total uninterrupted engagement is for the 4 financial years ended 28 July 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

Overview

Materiality: Group financial statements as a whole	£2.2m (2017: £2.4m) 5.9% (2017: 4.8%) of Group profit before tax excluding non-underlying items
Coverage	100% (2017: 100%) of Group profit before tax
Risks of material misstatement	vs 2017
Recurring risks	Recoverability of DFS Trading Limited goodwill and of the parent's investment in subsidiaries ◀▶
	Guarantee Provision ▶▶
Event driven	New: Valuation of intangible assets identified on acquisition of Sofology ▲

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
<p>Recoverability of DFS Trading Limited goodwill and of the parent's investment in subsidiaries</p> <p>(Group's goodwill £479.6 million; 2017: £479.6 million; parent Company's investment in subsidiaries £241.5m 2017: £238.7m).</p> <p>Refer to page 52 (Audit Committee Report), page 98 (accounting policy) and pages 106 to 108 (financial disclosures).</p>	<p>Forecast-based valuation</p> <p>There is a risk, particularly in light of current political and economic uncertainty and more challenging market conditions, that the business may not meet expected growth projections in order to support the carrying value of goodwill in relation to DFS Trading Limited or the parent company's investment in subsidiaries.</p> <p>This risk remains significant in light of recent years of trading performance for DFS Trading Limited falling behind internal and market expectations.</p> <p>The Group support the goodwill balance through a value in use calculation that has underlying assumptions of varying sensitivities. The estimated recoverable amount is subjective due to the inherent uncertainty involved in forecasting and discounting future cash flows.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • Historical comparisons: Analysing the Group's previous projections against actual outcomes to assess the historical reliability of the forecasting. • Benchmarking assumptions: Comparing the Group's trading forecasts against current trading performance and against anticipated growth in the furniture retail sector, and investigating any significant deviations, in order to challenge the assumptions present within the forecasts. This was performed through review of industry projections and using our knowledge of DFS Furniture plc and the retail sector. • Sensitivity analysis: Performing sensitivity analysis over revenue, profit margins, terminal growth rate, and discount factor in order to determine their impact on the value in use calculations. • Our sector experience: Engaging our own valuation specialists to assess and challenge the discount rate by obtaining the detail of the inputs used in the discount rate calculation, benchmarking each input against our own expectations, and comparing the overall rate to an expected range based on our own benchmarks. • Comparing valuations: Comparing the sum of the discounted cash flows for all CGUs to the Group's market capitalisation to assess the reasonableness of those cash flows; and • Assessing transparency: Considering the adequacy of the Group's disclosures around the carrying value of goodwill and the impairment analysis. <p>Our results</p> <ul style="list-style-type: none"> • We found the resulting estimate of the recoverable amount of goodwill in the Group and the parent Company's investment in DFS Trading Limited to be acceptable (2017: acceptable).
<p>Guarantee provision</p> <p>(£6.0 million; 2017: £7.0 million)</p> <p>Refer to page 52 (Audit Committee Report), page 98 (accounting policy) and page 111 (financial disclosures).</p>	<p>Subjective estimate</p> <p>The guarantee provision reflects the estimated cost of fulfilling the obligations arising from the product guarantee provided to retail customers of DFS Trading Limited. The amount of the provision is inherently uncertain and there is significant estimation involved in the provision model, including assumptions around: average cost per claim, volume of claims, and the average period over which calls are received.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • Historical comparisons: Comparing expected volumes of calls against historical data. • Test of details: Testing key inputs of the calculated cost per call to supporting internal documentation and benchmarking to third party costs per call. • Expectation vs. outcome: Comparing the timing of when items were sold to the timing over which calls are expected to arise. • Test of details: Assessing the reasonableness of the timing profile of service calls by selecting a sample of calls and vouching the original sales date to which the call relates to delivery data. • Methodology evaluation: Assessing the reasonableness of Group's forecasting methodology by comparing prior period's provision recognised in respect of sales incurred during prior period against staff costs incurred during the current year in relation to calls received in year in relation to last year's sales. • Sensitivity analysis: Performing sensitivity testing on certain inputs to the calculation of the provision including average cost per claim, average period over which calls are received and the percentage of orders on which calls are received, in order to determine their impact on the calculations. • Assessing transparency: Determining whether the Group's disclosures in relation to the provision, the assumptions on which it is based and sensitivities around those assumptions are adequate. <p>Our results</p> <ul style="list-style-type: none"> • We found the resulting estimate of the guarantee provision to be acceptable (2017: acceptable).

Independent auditor's report

continued

2. Key audit matters: our assessment of risks of material misstatement *continued*

	The risk	Our response
Valuation of intangible assets identified on acquisition of Sofology Brand intangible asset identified at £13.8m and goodwill of £28.4m. Refer to page 52 (Audit Committee Report), page 98 (accounting policy) and page 107 (financial disclosures).	<p>On 30 November 2017 the Group acquired Sofology Limited for £25m.</p> <p>Accounting treatment In accounting for the acquisition, the Group needs to ensure all identifiable assets are recognised at their acquisition-date fair values. There is a risk that not all intangibles which have previously not been recognised by Sofology are appropriately identified on acquisition.</p> <p>Subjective estimate In addition, the valuation of the brand intangible asset of £13.8m requires a significant degree of judgement with estimates including the timing of future cash flows and the discount rate applied.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • Our sector expertise: using our knowledge of the business and industry to challenge the key assumptions used in identifying separately recognisable intangible assets. • Methodology evaluation: assessing and evaluating the methodology used by the Group to value the brand asset acquired. • Benchmarking assumptions: with the assistance of our valuation specialists challenging the key assumptions used in the valuation of the brand intangible such as the timing of future cash flows and discount rate. • Assessing transparency: considering the adequacy of the financial statement disclosures in respect of critical accounting estimates and judgements relating to intangible assets recognised on acquisitions. <p>Our results</p> <ul style="list-style-type: none"> • We found the resulting identifiable intangible assets recognised on acquisition of Sofology (namely the brand intangible) to be acceptable.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £2.2m, determined with reference to a benchmark of Group profit before tax normalised to exclude non-underlying items as disclosed in note 3, of which it represents 5.9% (2017: 4.8%).

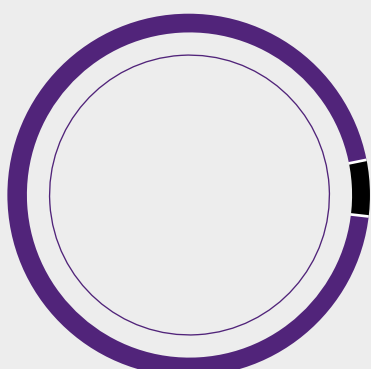
Materiality for the parent Company financial statements as a whole was set at £2.1m (2017: £2.4m), determined with reference to a benchmark of Company total assets, of which it represents 0.4% (2017: 0.6%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.11m, in addition to other identified misstatements that warranted reporting on qualitative grounds.

The Group team performed the full-scope audits for Group purposes of all 9 (2017: all 8) of the Group's components, including the audit of the parent Company. The components were audited to component materialities, which ranged from £0.04m to £2.1m, having regard to the mix of size and risk profile of the Group across the components.

Group profit before tax normalised for non-underlying items

£37.2m (2017: profit before tax £50.1m)



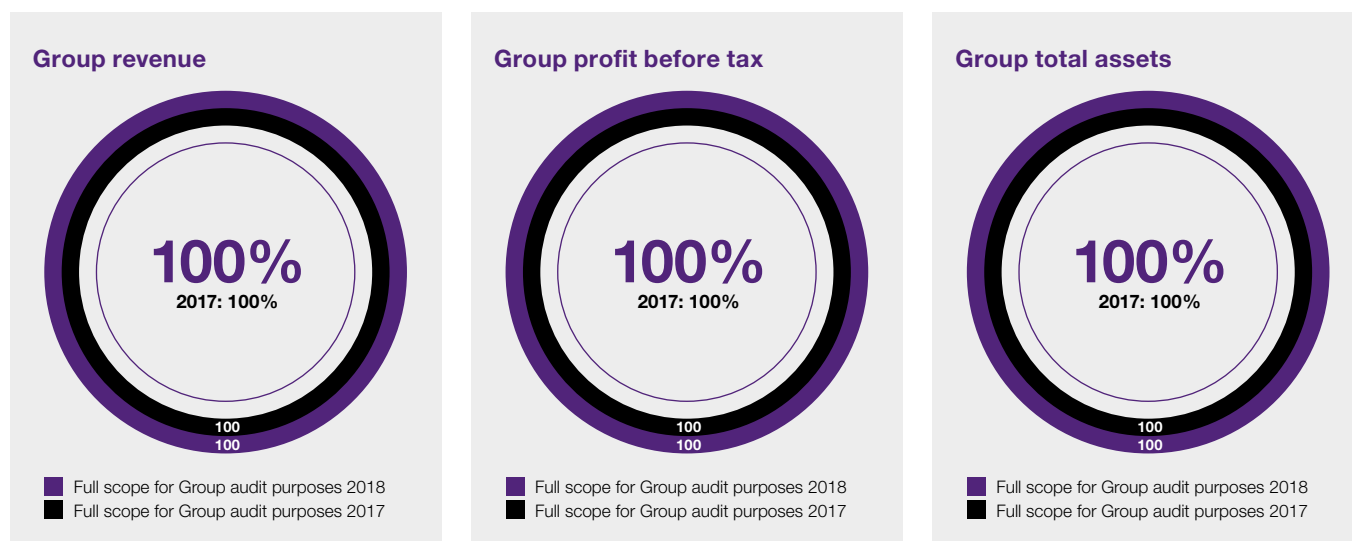
Group Materiality

£2.2m
(2017: £2.4)

£2.2m
Whole financial statements materiality (2017: £2.4m)

£2.1m
Range of materiality at 9 components (£0.4m to £2.1m) (2017: £0.2m to £2.4m)

£0.11m
Misstatements reported to the Audit Committee (2017: £0.12m)



4. We have nothing to report on going concern

We are required to report to you if:

- we have anything material to add or draw attention to in relation to the Directors' statement in note 1 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or
- the related statement under the Listing Rules set out on page 17 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects.

5. We have nothing to report on the other information in the Annual Report

The Directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and Directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the Strategic report and the Directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Directors' remuneration report

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

- the Directors' confirmation within the Strategic Report on page 12 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;
- the Risks and Uncertainties disclosures describing these risks and explaining how they are being managed and mitigated; and
- the Directors' explanation in the Viability Statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Under the Listing Rules we are required to review the Viability Statement. We have nothing to report in this respect.

Independent auditor's report

continued

5. We have nothing to report on the other information in the Annual Report *continued*

Corporate governance disclosures

We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the Directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We are required to report to you if the Corporate Governance Statement does not properly disclose a departure from the eleven provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 83, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our sector experience, through discussion with the Directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence.

We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related company legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related financial statement items.

In addition we considered the impact of laws and regulations in the specific areas of financial service regulation recognising the nature of the Group's activities. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the Directors and other management and inspection of regulatory and legal correspondence.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

As with any audit, there remained a higher risk of non-detection of non-compliance with relevant laws and regulations (irregularities), as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Chris Hearld (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

1 Sovereign Square

Sovereign Street

Leeds

LS1 4DA

3 October 2018

Consolidated income statement
for 52 weeks ended 28 July 2018 (52 weeks ended 29 July 2017)

	Note	2018			2017
		Underlying £m	Non- underlying £m	Total £m	Total £m
Gross sales	1,2	1,125.6	–	1,125.6	990.8
Revenue	2	870.5	–	870.5	762.7
Cost of sales		(363.6)	–	(363.6)	(314.2)
Gross profit		506.9	–	506.9	448.5
Selling and distribution costs		(380.6)	–	(380.6)	(328.0)
Administrative expenses	3	(50.2)	(9.9)	(60.1)	(38.1)
Operating profit before depreciation and amortisation		76.1	(9.9)	66.2	82.4
Depreciation		(24.1)	–	(24.1)	(19.4)
Amortisation		(4.2)	–	(4.2)	(2.5)
Operating profit	2,3	47.8	(9.9)	37.9	60.5
Finance income	5	0.1	–	0.1	0.2
Finance expenses	5	(10.7)	(1.5)	(12.2)	(10.6)
Profit before tax		37.2	(11.4)	25.8	50.1
Taxation	6	(7.7)	0.7	(7.0)	(10.6)
Profit for the year		29.5	(10.7)	18.8	39.5
Earnings per share					
Basic	7	14.0p	(5.1)p	8.9p	18.7p
Diluted	7	13.9p	(5.0)p	8.9p	18.6p

Consolidated statement of comprehensive income

for 52 weeks ended 28 July 2018 (52 weeks ended 29 July 2017)

	2018 £m	2017 £m
Profit for the year	18.8	39.5
Other comprehensive income		
<i>Items that are or may be reclassified subsequently to profit or loss:</i>		
Effective portion of changes in fair value of cash flow hedges	4.7	1.8
Net change in fair value of cash flow hedges reclassified to profit or loss	6.3	(5.8)
Income tax on items that are or may be reclassified subsequently to profit or loss	(1.6)	0.8
Other comprehensive expense for the year, net of income tax	9.4	(3.2)
Total comprehensive income for the year	28.2	36.3

Consolidated balance sheet

at 28 July 2018 (29 July 2017)

	Note	2018 £m	2017 £m
Non-current assets			
Property, plant and equipment	8	91.1	74.2
Intangible assets	9	537.0	491.8
Other financial assets	11	1.6	–
Deferred tax assets	12	8.0	9.8
		637.7	575.8
Current assets			
Inventories	13	54.4	36.6
Other financial assets	11	3.7	–
Trade and other receivables	14	31.2	24.5
Cash and cash equivalents		47.2	61.0
		136.5	122.1
Total assets		774.2	697.9
Current liabilities			
Trade payables and other liabilities	15	(228.5)	(165.6)
Provisions	19	(4.9)	(5.1)
Other financial liabilities	16	(0.1)	(3.5)
Current tax liabilities		(2.7)	(3.8)
		(236.2)	(178.0)
Non-current liabilities			
Interest bearing loans and borrowings	17	(195.7)	(198.8)
Provisions	19	(5.9)	(5.2)
Other financial liabilities	16	(1.1)	(3.5)
Other liabilities	15	(82.9)	(67.3)
		(285.6)	(274.8)
Total liabilities		(521.8)	(452.8)
Net assets		252.4	245.1
Equity attributable to owners of the Company			
Share capital	21	319.5	319.5
Share premium	21	40.4	40.4
Merger reserve	21	18.6	18.6
Treasury shares	21	(3.3)	(3.7)
Cash flow hedging reserve	21	4.0	(7.0)
Retained earnings		(126.8)	(122.7)
Total equity		252.4	245.1

These financial statements were approved by the Board of Directors on 3 October 2018 and were signed on its behalf by:

Ian Filby
Chief Executive Officer

Nicola Bancroft
Chief Financial Officer

Company registered number: 7236769

Consolidated statement of changes in equity

	Share capital £m	Share premium £m	Merger reserve £m	Treasury shares £m	Cash flow hedging reserve £m	Retained earnings £m	Total equity £m
Balance at 30 July 2016	319.5	40.4	18.6	(3.7)	(3.0)	(121.2)	250.6
Profit for the year	–	–	–	–	–	39.5	39.5
Other comprehensive income/(expense)	–	–	–	–	(4.0)	0.8	(3.2)
Total comprehensive income/(expense) for the year	–	–	–	–	(4.0)	40.3	36.3
Dividends	–	–	–	–	–	(43.8)	(43.8)
Share based payments	–	–	–	–	–	2.0	2.0
Balance at 29 July 2017	319.5	40.4	18.6	(3.7)	(7.0)	(122.7)	245.1
Profit for the year	–	–	–	–	–	18.8	18.8
Other comprehensive income/(expense)	–	–	–	–	11.0	(1.6)	9.4
Total comprehensive income/(expense) for the year	–	–	–	–	11.0	17.2	28.2
Dividends	–	–	–	–	–	(23.7)	(23.7)
Treasury shares issued	–	–	–	0.4	–	(0.4)	–
Share based payments	–	–	–	–	–	2.8	2.8
Balance at 28 July 2018	319.5	40.4	18.6	(3.3)	4.0	(126.8)	252.4

Consolidated cash flow statement
for 52 weeks ended 28 July 2018 (52 weeks ended 29 July 2017)

	Note	2018 £m	2017 £m
Operating profit		37.9	60.5
<i>Adjustments for:</i>			
Depreciation, amortisation and impairment		28.3	21.9
Gain on sale of property, plant and equipment		(0.9)	(0.8)
Accrued acquisition consideration		5.0	–
Share based payment expense		2.8	2.0
Increase in trade and other receivables		(1.7)	1.9
Increase in inventories		(4.7)	(1.7)
Increase in trade and other payables		11.0	2.2
Decrease in provisions		(1.1)	(1.5)
		76.6	84.5
Tax paid		(9.1)	(9.7)
Net cash from operating activities		67.5	74.8
Cash flows from investing activities			
Proceeds from sale of property, plant and equipment		1.0	1.0
Interest received		0.1	0.2
Acquisition of subsidiaries		(20.1)	–
Acquisition of trade assets		(1.2)	–
Acquisition of property, plant and equipment		(17.3)	(25.2)
Acquisition of other intangible assets		(4.7)	(3.1)
Net cash from investing activities		(42.2)	(27.1)
Cash flows from financing activities			
Proceeds from new loan		197.0	–
Interest paid		(7.4)	(7.3)
Exceptional refinancing costs		(1.9)	–
Repayment of borrowings		(200.0)	–
Payment of finance lease liabilities		(3.1)	(2.3)
Ordinary dividends paid		(23.7)	(23.7)
Special dividends paid		–	(20.1)
Net cash from financing activities		(39.1)	(53.4)
Net decrease in cash and cash equivalents		(13.8)	(5.7)
Cash and cash equivalents at beginning of year		61.0	66.7
Cash and cash equivalents at end of year	26	47.2	61.0

Notes to the consolidated financial statements

at 28 July 2018

1 Accounting policies

DFS Furniture plc ("the Company") is a company incorporated and domiciled in the United Kingdom.

The consolidated financial statements consolidate those of the Company and its subsidiaries (together referred to as "the Group"). The parent company financial statements present information about the Company as a separate entity and not about its Group.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these consolidated financial statements. Judgements made by the Directors, in the application of these accounting policies that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 1.16.

1.1 Basis of preparation

The consolidated financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the EU ("Adopted IFRS"). The financial statements are prepared on the historical cost basis except for certain financial instruments and share based payment charges which are measured at their fair value. The financial statements are for the 52 weeks to 28 July 2018 (last year 52 weeks to 29 July 2017).

The Company has elected to prepare its parent company financial statements in accordance with UK GAAP; these are presented on pages 118 to 121.

Presentation of financial statements

Following the acquisition of Sofology Limited, the Directors have reflected on the continuing need to provide relevant financial information to shareholders as the Group grows and develops. As a consequence, with effect from the financial year commencing 30 July 2017 the analysis of operating expenses on the face of the income statement has been expanded to separate direct cost of sales (cost of goods, related costs of shipping) from other selling and distribution costs (advertising, wages and other store costs, delivery and customer service costs). Disclosures of amounts charged to operating profit in respect of cost of inventories has also been revised to align with the new presentation.

In addition, segmental analysis presented in accordance with IFRS 8 has been amended to provide a separate analysis of the Group's major brands in order to more closely reflect the way in which the enlarged Group reviews and manages its operations. The directors consider that this revised presentation will provide shareholders and other users of the financial statements with useful additional relevant information in order to evaluate the nature and financial effects of the different business activities in which the Group engages.

These changes have no effect on reported operating profit and all comparatives presented have been restated in line with the new presentation.

Going concern

The market in which the Group operates continues to present a number of challenges. Nevertheless, the Group remains highly cash generative and currently has sufficient medium and long term facilities in place, including a £230.0 million revolving credit facility in place until August 2022. Further details of these facilities and the Group's financial management objectives are detailed in the financial statements.

On the basis of their assessment of the Group's financial position, forecasts and projections, the Company's Directors have a reasonable expectation that the Company and the Group will be able to continue in operational existence as detailed in the Viability Statement on page 17. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

1.2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control exists when the Group is exposed to or has rights to variable returns from its investment with the investee and has the ability to affect those returns through its power over the investee. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the date that control commences until the date that control ceases. The acquisition method is used to account for the acquisition of subsidiaries. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

1.3 Gross sales and revenue

Revenue is measured at the fair value of the consideration receivable by the Group for the provision of goods to external customers, being the total amount payable by the customer ("gross sales") less: value added and other sales taxes, the costs of obtaining interest free credit on behalf of customers and the amounts payable to third parties relating to products for which the Group acts as an agent. For products where the Group acts as an agent, the amount recognised in revenue is the net fee receivable by the Group.

Many of the Group's customers choose to take advantage of the interest-free credit that the Group makes available. This credit is provided by external finance houses, who pay the Group the gross sales value of the customer order on delivery, less a fee for taking responsibility for payment collection and bearing the full credit risk for any future default by the customer. The fee due to the finance house varies depending on the amount borrowed by the customer, the length of the repayment term and the LIBOR rate at the time of the transaction.

Notes to the consolidated financial statements *continued*

at 28 July 2018

1 Accounting policies *continued*

1.3 Gross sales and revenue *continued*

In calculating reported revenue in accordance with IFRS the Group is required to deduct these fees from the value of the customer order. Reported revenue will therefore vary depending on the proportion of customers who choose to take up the interest free credit offer, the average duration of the interest free loan period and the prevailing LIBOR rates.

For the purposes of managing its business the Group focuses on gross sales, which is defined as the total amount payable by customers, inclusive of VAT and other sales taxes and prior to any accounting adjustments for interest-free credit fees or aftercare product costs. The Directors believe gross sales is a more transparent measure of the activity levels and performance of its stores and online channels as it is not affected by customer preferences on payment options. Accordingly gross sales is presented in this annual report in addition to statutory revenue as an alternative performance measure, with a reconciliation between the two measures provided in note 2 to the financial statements.

Both gross sales and revenue are stated net of returns and sales allowances, and are recognised when goods have been delivered to the customer, the revenue and costs in respect of the transaction can be measured reliably and collectability is reasonably assured.

1.4 Expenses

Non-underlying and exceptional items

Items that are material in size, unusual or non-recurring in nature are disclosed separately in the income statement in order to provide an indication of the Group's underlying business performance without distortion from significant non-trading events. The principal items which may be included as non-underlying are:

- significant profit or loss on the disposal of non-current assets
- impairment charges
- significant non-recurring tax charges or credits
- costs associated with significant corporate, financial or operating restructuring, including acquisitions or the establishment of operations in new geographical territories

Material finance income or expenses associated with significant changes in the Group's borrowings are disclosed separately as exceptional items below operating profit.

Royalty payments

Royalties payable to brand partners on sales of branded products are charged to cost of sales when the related product is delivered to the customer.

Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Finance income and expenses

Finance expenses comprise interest payable, finance charges on finance leases recognised in profit or loss using the effective interest method and unwinding of the discount on provisions and other liabilities measured at present value. Finance income comprises interest receivable on funds invested, dividend income, and net foreign exchange gains.

Interest income and interest payable is recognised in profit or loss as it accrues, using the effective interest method. Dividend income is recognised in the income statement on the date the Group's right to receive payments is established.

1.5 Employee benefits

Defined contribution plans

Payments to defined contribution pension plans are recognised as an expense in the income statement as they fall due.

Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

Share based payments

The fair value of equity settled share based payments is recognised as an expense over the vesting period of the related awards, with a corresponding increase in equity. Fair values are calculated using option pricing models appropriate to the terms and conditions of the awards. The amount charged as an expense is regularly reviewed and adjusted to reflect the achievement of service and non-market based performance conditions.

1 Accounting policies continued

1.6 Taxation

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to a business combination, or items recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of goodwill; the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss; and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

At interim reporting periods the tax charge is calculated in accordance with IAS 34, adjusted for material non-taxable items.

A deferred tax asset is recognised on deductible temporary differences only to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

1.7 Foreign currency

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at the foreign exchange rate ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement except for differences arising on qualifying cash flow hedges, which are recognised directly in other comprehensive income.

1.8 Business combinations

Subject to the transitional relief in IFRS 1, all business combinations are accounted for by applying the acquisition method. Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group.

Goodwill is initially measured at cost, being the excess of the acquisition cost over the Group's interest in the assets and liabilities recognised. When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss.

Costs related to the acquisition, other than those associated with the issue of debt or equity securities, are expensed as incurred.

Any contingent consideration payable is recognised at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognised in profit or loss.

Acquisitions prior to 31 July 2011 (date of transition to IFRSs)

IFRS 1 grants certain exemptions from the full requirements of Adopted IFRSs in the transition period. The Group and Company elected not to restate business combinations that took place prior to 31 July 2011. In respect of acquisitions prior to transition, goodwill is included at 31 July 2011 on the basis of its deemed cost, which represents the amount recorded under UK GAAP which was broadly comparable save that goodwill was amortised. On transition, amortisation of goodwill ceased as required by IFRS 1.

1.9 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Leases in which the Group assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Where land and buildings are held under leases the accounting treatment of the land is considered separately from that of the buildings. Leased assets acquired by way of finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and less accumulated impairment losses. Lease payments are accounted for as described in 1.4 above.

Notes to the consolidated financial statements *continued*

at 28 July 2018

1 Accounting policies *continued*

1.9 Property, plant and equipment *continued*

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows:

- buildings 50 years
- plant and equipment 3 to 10 years
- motor vehicles 4 years

Depreciation methods, useful lives and residual values are reviewed at each balance sheet date.

1.10 Intangible assets and goodwill

Goodwill

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash generating units and is not amortised but is tested annually for impairment.

Other intangible assets

Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

Other intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and accumulated impairment losses.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets unless such lives are indefinite. Intangible assets with an indefinite useful life and goodwill are systematically tested for impairment at each balance sheet date. Other intangible assets are amortised from the date they are available for use. Estimated useful lives are as follows:

- computer software and website costs 3 years
- acquired brand names 10 to 20 years

1.11 Inventories

Inventories are stated at the lower of cost and net realisable value. The cost of finished goods manufactured by the Group includes direct materials, direct labour and appropriate overhead expenditure.

1.12 Impairment

The carrying amounts of the Group's tangible and intangible assets other than goodwill are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time.

An impairment loss is recognised if the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

1.13 Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, that can be reliably measured and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects risks specific to the liability.

Details of provisions recognised are in note 19 and the related significant estimates and judgments in note 1.16.

1.14 Non-derivative financial instruments

Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Trade and other receivables

Trade and other receivables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method, less any impairment losses.

1 Accounting policies continued

1.14 Non-derivative financial instruments continued

Trade and other payables

Trade and other payables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits.

Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using the effective interest method.

1.15 Derivative financial instruments and hedging

Derivative financial instruments

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged (see below).

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in the hedging reserve. Any ineffective portion of the hedge is recognised immediately in the income statement.

When the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss remains in the hedging reserve and is reclassified into profit or loss in the same period or periods during which the asset acquired or liability assumed affects profit or loss.

For other cash flow hedges the associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects profit or loss.

When a hedging instrument expires or is sold, terminated or exercised, or the Group revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised in the income statement immediately.

1.16 Significant areas of estimation and judgment

In the application of the Group's accounting policies, the directors are required to make judgments, estimates and assumptions that affect the value of reported assets, liabilities, revenues and expenses. The estimates and associated assumptions are based on historical experience and other relevant factors, but may differ from actual results. Significant areas of estimation for the Group include the costs of meeting customer guarantees and the period over which guarantee claims arise (note 19), the selling prices applied in determining net realisable values of inventories (note 13), the assessment of the fair value of acquired assets and liabilities (note 9), and the assumptions underlying the value in use calculation for the impairment of goodwill (note 9).

1.17 New accounting standards

A number of new or revised standards and interpretations have been issued which are not yet effective or endorsed by the EU, and which have not therefore been applied by the Group in these financial statements. These include IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments, which both apply to the Group from FY19, and IFRS 16 Leases, which applies to the Group from FY20.

IFRS 15 and IFRS 9 are not expected to have a material impact on the Group's financial statements, but may result in additional disclosures being provided.

IFRS 16 will have a material impact on the future financial statements of the Group since it would require the substantial majority of the Group's operating lease commitments to be brought on to the balance sheet, resulting in the recognition of significant lease assets and liabilities which would be depreciated and amortised separately. IFRS 16 will first apply to the Group for the financial year ending July 2020 and work is underway to collect the required data and assess the necessary changes in processes and systems that will be required to implement the standard. The complexities of this implementation are such that it is not yet possible to quantify the effect on the Group's financial statements. Disclosures on the Group's operating lease commitments under current accounting standards are provided in note 25 to the financial statements.

Notes to the consolidated financial statements *continued* at 28 July 2018

2 Segmental analysis

The Group's operating segments under IFRS 8 have been determined based on management accounts reports reviewed by the Executive Board. Segment performance is assessed based upon brand contribution. Brand contribution is defined as underlying EBITDA (being earnings before interest and tax excluding depreciation charges and non-underlying items) excluding property costs and central administration costs.

The Group reviews and manages the performance of its operations on a retail brand basis, and the identified reportable segments and the nature of their business activities are as follows:

DFS: the manufacture and retailing of upholstered furniture and related products through DFS branded stores and websites.

Sofology: the retailing of upholstered furniture and related products through Sofology branded stores and website.

Other segment activities comprise the retailing of upholstered and other furniture and related products through other brands, including Dwell and Sofa Workshop, which both fall below the thresholds in IFRS 8 for separate reporting

Segment revenue and profit

Segment revenue and profit	External sales		Internal sales		Total gross sales	
	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m
DFS	898.5	925.0	–	–	898.5	925.0
Sofology	155.2	–	–	–	155.2	–
Other segments	71.9	65.8	0.6	0.6	72.5	66.4
Eliminations	–	–	(0.6)	(0.6)	(0.6)	(0.6)
Gross sales	1,125.6	990.8	–	–	1,125.6	990.8
					2018 £m	2017 £m
Total segments gross sales					1,125.6	990.8
Less: value added and other sales taxes					(175.8)	(153.8)
Less: costs of interest free credit and aftercare products					(79.3)	(74.3)
Revenue					870.5	762.7
2018			DFS £m	Sofology £m	Other £m	Total £m
Revenue			689.2	122.8	58.5	870.5
Cost of sales			(276.7)	(61.0)	(25.9)	(363.6)
Gross profit			412.5	61.8	32.6	506.9
Selling & distribution costs (excluding property costs)			(223.9)	(35.3)	(22.3)	(281.5)
Brand contribution (segment profit)			188.6	26.5	10.3	225.4
Property costs						(99.1)
Underlying administrative expenses						(50.2)
Underlying EBITDA						76.1
2017			DFS £m	Sofology £m	Other £m	Total £m
Revenue			709.2	–	53.5	762.7
Cost of sales			(289.3)	–	(24.9)	(314.2)
Gross profit			419.9	–	28.6	448.5
Selling & distribution costs (excluding property costs)			(227.4)	–	(20.1)	(247.5)
Brand contribution (segment profit)			192.5	–	8.5	201.0
Property costs						(80.5)
Underlying administrative expenses						(38.1)
Underlying EBITDA						82.4

2 Segmental analysis continued

	2018 £m	2017 £m
Underlying EBITDA	76.1	82.4
Non-underlying items	(9.9)	–
Depreciation & amortisation	(28.3)	(21.9)
Operating profit	37.9	60.5
Finance income	0.1	0.2
Finance expenses	(12.2)	(10.6)
Profit before tax	25.8	50.1

A geographical analysis of revenue is presented below:

	2018 £m	2017 £m
United Kingdom	839.7	736.6
Europe	30.8	26.1
Total revenue	870.5	762.7

Segment assets and liabilities

	Assets		Liabilities	
	2018 £m	2017 £m	2018 £m	2017 £m
DFS	662.4	676.5	(249.6)	(233.5)
Sofology	87.3	–	(61.7)	–
Other segments	33.5	29.4	(33.2)	(27.5)
Total segments	783.2	705.9	(344.5)	(261.0)
Loans and financing	–	–	(195.7)	(198.8)
Financial assets/(liabilities)	5.3	–	(1.2)	(7.0)
Current tax	–	–	(2.7)	(3.8)
Deferred tax	8.0	9.8	–	–
Eliminations	(22.3)	(17.8)	22.3	17.8
Total Group	774.2	697.9	(521.8)	(452.8)

Segment assets comprises tangible and intangible non-current assets including goodwill and brand names, inventories, trade and other receivables, cash and cash equivalents. Segment liabilities comprises trade payables and current and non-current other liabilities and provisions.

	Additions to non-current assets		Depreciation and amortisation	
	2018 £m	2017 £m	2018 £m	2017 £m
DFS	20.7	26.6	21.4	20.0
Sofology	2.3	–	4.3	–
Other segments	4.1	5.2	2.6	1.9
Total Group	27.1	31.8	28.3	21.9

Additions to non-current assets represents includes both tangible and intangible non-current assets but excludes amounts arising on acquisition.

Notes to the consolidated financial statements *continued* at 28 July 2018

3 Operating profit

Group operating profit is stated after charging/(crediting):

	2018 £m	2017 £m
Depreciation on tangible assets	24.1	19.4
Net gain on disposal of property, plant and equipment	(0.9)	(0.8)
Amortisation of intangible assets	4.2	2.5
Cost of inventories recognised as an expense	371.2	326.4
Write down of inventories to net realisable value	0.6	0.6
Other cost of sales variances	(8.2)	(12.8)
Operating lease rentals	74.2	61.6
	2018 £m	2017 £m
<i>Non-underlying items</i>		
Acquisition related professional fees	2.6	–
Additional acquisition consideration	5.0	–
Integration costs	2.0	–
Restructuring costs	0.3	–
	9.9	–

Acquisition related fees, additional consideration and integration costs arose on the Group's acquisitions of Sofology Limited and certain assets from Multiyork (see note 9). Restructuring costs relate to the closure of the Group's national distribution centre.

	2018 £m	2017 £m
<i>Auditor's remuneration:</i>		
Audit of these financial statements	0.1	0.1
Audit of the financial statements of Group subsidiaries	0.1	0.1
<i>Amounts receivable by the Company's auditor and its associates in respect of:</i>		
All other services	0.1	–
	0.3	0.2

4 Staff numbers and costs

The average number of persons employed by the Group during the year, analysed by category, was as follows:

	Number of employees	
	2018	2017
Production	1,088	1,136
Warehouse and transport	1,033	837
Sales and administration	2,751	2,319
	4,872	4,292

The aggregate payroll costs of these persons were as follows:

	2018 £m	2017 £m
Wages and salaries	136.7	124.7
Social security costs	13.7	12.4
Other pension costs	3.1	2.5
	153.5	139.6
Share based payment expense (equity settled)	2.8	2.0
	156.3	141.6

5 Finance income and expense

	2018 £m	2017 £m
<i>Finance income</i>		
Interest income on bank deposits	0.1	0.2
Total finance income	0.1	0.2
<i>Finance expense</i>		
Interest payable on senior loan facility	(0.1)	(7.1)
Interest payable on senior revolving credit facility	(7.0)	–
Bank fees	(0.1)	(0.2)
Fair value lease adjustment unwind (note 15)	(3.0)	(2.9)
Unwind of discount on provisions	(0.1)	(0.1)
Finance lease interest	(0.4)	(0.3)
Underlying finance expense	(10.7)	(10.6)
Non-underlying refinancing costs	(1.5)	–
Total finance expense	(12.2)	(10.6)

Non-underlying finance costs relate to the refinancing of the Group's borrowings (note 17).

6 Taxation

Recognised in the income statement

	2018 £m	2017 £m
<i>Current tax</i>		
Current year	8.2	11.3
Adjustments for prior years	(0.1)	(0.8)
Current tax expense	8.1	10.5
<i>Deferred tax</i>		
Origination and reversal of temporary differences	(0.9)	(0.7)
Deferred tax rate change	–	0.6
Adjustments for prior years	(0.2)	0.2
Deferred tax expense	(1.1)	0.1
Total tax expense in income statement	7.0	10.6

Reconciliation of effective tax rate

	2018 £m	2017 £m
Profit before tax for the year	25.8	50.1
Tax using the UK corporation tax rate of 19.0% (2017: 19.67%)	4.9	9.8
Non-deductible expenses	2.4	0.8
Deferred tax rate change	–	0.6
Adjustments in respect of prior years	(0.3)	(0.6)
Total tax expense	7.0	10.6

The Finance Act 2016, which was substantively enacted in September 2016, included provisions to reduce the rate of UK corporation tax to 19% with effect from 1 April 2017 and 17% with effect from 1 April 2020. Deferred taxation is measured at tax rates that are expected to apply in the periods in which temporary timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted at the balance sheet date. Accordingly, 17% has been applied when calculating deferred tax assets and liabilities at 28 July 2018.

Income tax recognised in other comprehensive income

	2018 £m	2017 £m
Effective portion of changes in fair value of cash flow hedges	0.8	0.3
Net change in fair value of cash flow hedges reclassified to profit or loss	1.0	(0.9)
Deferred tax asset in respect of share based payments	(0.2)	(0.2)
	1.6	(0.8)

Notes to the consolidated financial statements *continued*

at 28 July 2018

7 Earnings per share

Statutory earnings per share

Basic earnings per share is calculated by dividing the net profit or loss for the financial period attributable to ordinary equity holders of the parent Company by the weighted average number of ordinary shares outstanding during the period. The weighted average number of shares reflects the movements in share capital detailed in note 21 and the impact of movements in treasury shares held by the Company. Changes in the Company's capital structure with no corresponding change in resources are reflected as if they had occurred at the beginning of the earliest period presented.

Diluted earnings per share is calculated using the same net profit or loss for the financial period attributable to ordinary equity holders of the parent Company, but increasing the weighted average number of ordinary shares by the dilutive effect of potential ordinary shares.

	2018 pence	2017 pence
Basic total earnings per share	8.9	18.7
Diluted total earnings per share	8.9	18.6

	2018 £m	2017 £m
Profit for the year attributable to equity holders of the parent Company	18.8	39.5

	2018 No.	2017 No.
Weighted average number of shares in issue for basic earnings per share	211,631,564	211,530,721
Dilutive effect of employee share based payment awards	1,301,607	753,518
Weighted average number of shares in issue for diluted earnings per share	212,933,171	212,284,239

Underlying earnings per share

Underlying basic earnings per share and underlying diluted earnings per share are calculated by dividing the profit for the period attributable to ordinary equity holders of the parent Company, as adjusted to exclude the effect of non-underlying items, by the same weighted average numbers of ordinary shares above used for basic and diluted earnings per share respectively.

	2018 £m	2017 £m
Profit for the year attributable to equity holders of the parent Company	18.8	39.5
Non-underlying loss after tax	10.7	–
Underlying profit for the year attributable to equity holders of the parent Company	29.5	39.5

	2018 pence	2017 pence
Underlying basic earnings per share	14.0	18.7
Underlying diluted earnings per share	13.9	18.6

8 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Motor vehicles £m	Total £m
Cost				
Balance at 30 July 2016	6.5	95.2	19.8	121.5
Additions	1.2	19.6	7.9	28.7
Disposals	–	–	(3.1)	(3.1)
Balance at 29 July 2017	7.7	114.8	24.6	147.1
Additions	0.9	15.8	5.7	22.4
Acquisitions	–	17.1	1.6	18.7
Disposals	(0.2)	(3.7)	(4.7)	(8.6)
Balance at 28 July 2018	8.4	144.0	27.2	179.6
Depreciation and impairment				
Balance at 30 July 2016	0.9	46.7	8.8	56.4
Depreciation charge for the year	0.2	13.7	5.5	19.4
Disposals	–	–	(2.9)	(2.9)
Balance at 29 July 2017	1.1	60.4	11.4	72.9
Depreciation charge for the year	0.2	17.8	6.1	24.1
Disposals	(0.2)	(3.7)	(4.6)	(8.5)
Balance at 28 July 2018	1.1	74.5	12.9	88.5
Net book value				
At 30 July 2016	5.6	48.5	11.0	65.1
At 29 July 2017	6.6	54.4	13.2	74.2
At 28 July 2018	7.3	69.5	14.3	91.1

Leased plant and machinery

Included in the total net book value of motor vehicles is £9.2m (2017: £5.3m) in respect of assets held under finance leases. Depreciation for the year on these assets was £3.2m (2017: £2.3m).

Capital commitments

At 28 July 2018 the Group had contracted capital commitments of £3.9m (2017: £3.4m) for which no provision has been made in the financial statements.

Notes to the consolidated financial statements *continued* at 28 July 2018

9 Intangible assets

	Computer software £m	Brand names £m	Goodwill £m	Total £m
Cost				
Balance at 30 July 2016	12.0	3.0	485.0	500.0
Additions	3.1	–	–	3.1
Balance at 29 July 2017	15.1	3.0	485.0	503.1
Additions	4.7	–	–	4.7
Acquisitions	1.3	13.8	29.6	44.7
Balance at 28 July 2018	21.1	16.8	514.6	552.5
Amortisation and impairment				
Balance at 30 July 2016	8.5	0.3	–	8.8
Amortisation charge for the year	2.4	0.1	–	2.5
Balance at 29 July 2017	10.9	0.4	–	11.3
Amortisation charge for the year	3.1	1.1	–	4.2
Balance at 28 July 2018	14.0	1.5	–	15.5
Net book value				
At 30 July 2016	3.5	2.7	485.0	491.2
At 29 July 2017	4.2	2.6	485.0	491.8
At 28 July 2018	7.1	15.3	514.6	537.0

Goodwill

The carrying amount of goodwill is allocated to the following cash generating units:

	Goodwill	
	2018 £m	2017 £m
DFS Trading Limited	479.9	479.6
Sofology Limited	28.4	–
The Sofa Workshop Limited	5.3	4.4
DFS Spain	1.0	1.0
	514.6	485.0

Goodwill is tested annually for impairment on the basis of value in use. The key assumptions underlying the calculations are those regarding expected future sales volumes, changes in selling prices and direct costs and the discount rate applied.

Cash flow forecasts are prepared from the latest financial results and internal budgets for the next four years, which take into account external macroeconomic indicators as well as internal growth expectations. Selling prices and related costs are based on past practice and expected future changes in the market. A terminal value was then calculated on the basis of the four year plan and the expected long-term growth rate for the UK living room furniture sector of 2.3%. These cash flow forecasts were then discounted at a pre-tax discount rate of 10.1% (2017: 9.7%). The discount rates are estimated based on the Group's weighted average cost of capital, risk adjusted for an individual unit's circumstances.

The Group has applied sensitivities to assess whether any reasonably possible changes in assumptions could cause an impairment that would be material to these consolidated financial statements. A discount rate in excess of 14.6% would need to be applied to the base case cash flows in order for there to be any indication of an impairment. Even with an assumption of no further growth beyond the four year budgeted period, the calculated value in use remained above the carrying value. An impairment could arise if there was both no growth in future cash flows over the four year budgeted period and the terminal growth rate in the market also reduced to 0.8%.

9 Intangible assets continued

Business combinations

Sofology

On 30 November 2017 the Group acquired 100% of the issued share capital of Sofology Limited, a UK based living room furniture retailer with a focus on upholstered furniture. This acquisition has added a further strong distinctive brand to the Group's current portfolio, supporting the Group's existing strategy of developing its appeal to a broader range of customers.

Initial consideration payable was £26.0m (equivalent to a debt-free cash-free valuation of £25.0m), with deferred contingent consideration payable based on underlying earnings before interest, tax, depreciation and amortisation for the 12 months ended 30 September 2018 (the "earn-out period"). Based on the immediate post-acquisition performance of the acquired business, the Directors estimated that no further consideration would be payable, and this is reflected in the acquisition accounting.

At the date of this annual report, although the earn-out period has just ended the actual results for the 12 months to 30 September are not yet available and accounting confirmation procedures under the sale and purchase agreement have not yet commenced. Performance of the acquired business has strengthened over recent months and it is therefore possible that some additional consideration could become payable. While a high degree of uncertainty remains, the Directors have accrued £5.0m as an estimate of additional consideration potentially payable which has been recognised in the income statement as a non-underlying expense. It is anticipated that the determination and settlement of the final amount due will occur during FY19, and any difference between the amount provided and the final amount paid will be recognised as a non-underlying expense or credit.

The goodwill of £28.4m arising from the acquisition is attributable to the established store network, workforce, designs and technologies of the acquired business and cost savings realised in the combined businesses through economies of scale and other synergies.

The amounts recognised in respect of the identifiable assets acquired and liabilities assumed are as set out below:

Recognised amounts of identifiable assets acquired and liabilities assumed	
Fair value	£m
Property, plant & equipment	18.7
Intangible assets – software	1.3
Intangible assets – brand name	13.8
Inventories	13.1
Cash	5.9
Trade and other receivables	5.0
Trade payables and other liabilities	(51.7)
Fair value lease creditor	(7.4)
Deferred tax	(1.1)
Total identifiable net liabilities	(2.4)
Goodwill	28.4
Total consideration	26.0
Satisfied by:	
Cash consideration	26.0
Contingent consideration	–
Total consideration	26.0
Cash consideration	26.0
Less: cash and cash equivalent balances acquired	(5.9)
Net cash outflow arising on acquisition	20.1

Determining the fair value of the identified assets and liabilities required a number of estimates and judgments to be made. In particular, the valuation of the intangible asset relating to the Sofology brand name involved estimates of the future performance of the business and the determination of an applicable discount rate. A increase in the discount rate of 1% would reduce the value of the brand name intangible by £0.5m. The calculation of the fair value lease creditor also required estimates to be made of current market rentals applicable to the properties leased by the acquired business.

Acquisition related costs of £2.5 million have been charged as non-underlying administrative expenses in the income statement.

In the period from 1 December 2017 to 28 July 2018, Sofology Limited contributed £122.8m to reported Group revenue and a loss before tax of £1.4m. Had Sofology Limited been consolidated from 30 July 2017, reported Group revenue would have been £927.7m, and underlying EBITDA would have been £77.7m. Profit before tax, including the costs of shareholder loans and non-underlying items would have been £23.1m.

Notes to the consolidated financial statements *continued* at 28 July 2018

9 Intangible assets *continued*

Business combinations

Multiyork

On 27 December 2018 the Group acquired eight store leases and certain assets and intellectual property from Multiyork Furniture Limited following that business entering administration. Cash consideration for this transaction, which has been accounted for as a business combination, was £1.2m and has been recognised as goodwill. In addition, £0.1m of related acquisition costs have been recognised in non-underlying administrative expenses.

10 Investments in subsidiaries

The following companies are incorporated in England and Wales, are wholly owned by the Group and have been consolidated:

	Principal activity
Diamond Holdco 2 Limited ¹	Intermediate holding company
Diamond Holdco 7 Limited ¹	Intermediate holding company
DFS Furniture Holdings plc ¹	Intermediate holding company
DFS Furniture Company Limited ¹	Intermediate holding company
DFS Trading Limited ¹	Furniture retailer
Coin Retail Limited (Jersey) ²	Intermediate holding company
Coin Furniture Limited ³	Furniture retailer
The Sofa Workshop Limited ⁴	Furniture retailer
DFS Spain Limited ¹	Furniture retailer
Sofology Limited ⁵	Furniture retailer
C.S Lounge Suites Limited ⁵	Dormant
Soundsofa Limited ⁵	Dormant
Loveseats Limited ⁵	Dormant
Slothworks Limited ⁵	Dormant
Sofasound Limited ⁵	Dormant
Sofaworks Limited ⁵	Dormant
Sleepology Limited ⁵	Dormant
Sofa Traders Limited ⁵	Dormant

Registered offices:

- 1 Rockingham Way, Redhouse Interchange, Adwick-le-Street, Doncaster DN6 7NA
- 2 13-14 Esplanade, St Helier, Jersey JE1 1BD
- 3 The Pavilion, 118 Southwark Street, London, SE1 0SW
- 4 Venture House 4th Floor, 27-29 Glasshouse Street, London W1B 5DF
- 5 Ashton Road, Golborne, Warrington, WA3 3UL

11 Other financial assets

	2018 £m	2017 £m
Non-current		
Foreign exchange contracts	1.6	–
Current		
Foreign exchange contracts	3.7	–

Foreign exchange contracts comprise forward contracts which are used to hedge exchange risk arising from the Group's overseas purchases (note 23).

12 Deferred tax

Deferred tax assets and liabilities are attributable to the following:

	2018 £m	2017 £m
Accelerated capital allowances	3.8	2.7
Fair value lease creditor	5.0	4.0
Revaluation of derivatives to fair value	(0.6)	1.2
Tax losses carried forward	0.9	1.0
Brand names	(2.2)	–
Share based payments	0.8	0.5
Other temporary differences	0.3	0.4
Net tax assets	8.0	9.8

The deferred tax movement in the year is as follows:

	2018 £m	2017 £m
At start of period	9.8	9.1
Credited/(charged) to the income statement:		
Accelerated capital allowances	1.1	–
Fair value lease creditor	(0.2)	(0.3)
Tax losses carried forward	(0.1)	0.3
Brand names	0.3	–
Share based payments	0.1	0.3
Other temporary differences	(0.1)	(0.4)
Acquisition of subsidiaries	(1.3)	–
Recognised in the statement of comprehensive income	(1.6)	0.8
At end of period	8.0	9.8

13 Inventories

	2018 £m	2017 £m
Raw materials and consumables	5.7	4.8
Finished goods and goods for resale	56.2	37.9
	61.9	42.7
Provision for net realisable value	(7.5)	(6.1)
	54.4	36.6

In applying its accounting policy for inventory, the Group identifies those items where there is a risk that net realisable value does not exceed cost, due to either the age or condition of the item. An estimate of the net realisable value of such items is made based on the sale of similar items in the past and their carrying value reduced by an appropriate provision. These estimates are regularly updated and during FY18 the required provision was reduced by £1.0m to reflect more recent selling price experience.

14 Trade and other receivables

	2018 £m	2017 £m
Trade receivables	7.6	10.4
Prepayments and accrued income	23.2	13.7
Other receivables	0.4	0.4
	31.2	24.5

No interest is charged on trade receivables; the Group bears no credit risk in respect of amounts due from retail customers under interest free credit arrangements. Prepayments and accrued income do not include impaired assets.

Notes to the consolidated financial statements *continued* at 28 July 2018

15 Trade payables and other liabilities

	2018 £m	2017 £m
Current		
Payments received on account	37.1	24.9
Trade payables	120.4	81.9
Other creditors including other tax and social security	32.4	29.5
Accruals and deferred income	35.3	27.2
Finance lease liabilities	3.3	2.1
	228.5	165.6
	2018 £m	2017 £m
Non-current		
Fair value lease creditor	25.4	20.0
Accruals and deferred income	50.3	42.7
Finance lease liabilities	7.2	4.6
	82.9	67.3

Trade payables do not bear interest and are paid within agreed credit terms. Property lease incentives are classified as non-current to the extent that they will be credited to the income statement more than one year from the reporting date.

On the acquisition of the DFS business by the current parent Company in 2010 and also on the acquisition of Sofology Limited in 2017 a number of fair value adjustments were made, including the recognition of a liability representing the present value of certain unfavourable lease obligations as assessed at the date of acquisition. This fair value lease creditor is released to the income statement over the remaining life of the related leases (expiring in 2030), with the unwind of the discount recognised as a finance expense (note 5).

16 Other financial liabilities

	2018 £m	2017 £m
Non-current		
Interest rate derivatives	1.1	3.5
Current		
Foreign exchange contracts	0.1	3.5

Foreign exchange contracts comprise forward contracts which are used to hedge exchange risk arising from the Group's overseas purchases (note 23). Interest rate derivatives are used to hedge interest rate risk on the Group's floating rate debt (note 23).

17 Other interest-bearing loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate and foreign currency risk, see note 23.

	2018 £m	2017 £m
Senior loan facility	–	200.0
Senior revolving credit facility	197.0	–
Unamortised issue costs	(1.3)	(1.2)
	195.7	198.8

On the 7 August 2017 the Group refinanced the senior loan facility with a new senior revolving credit facility of £230.0m of which £197.0m was drawn down at 28 July 2018. The revolving credit facility bears interest at a rate of 3 month LIBOR plus 2.35% and is repayable in full on 2 August 2022. The revolving credit facility is secured on a first priority basis with fixed and floating charges over substantially all of the assets of the Company and DFS Furniture Holdings plc.

17 Other interest-bearing loans and borrowings continued

Finance lease liabilities

Finance lease liabilities are payable as follows:

	2018			2017		
	Minimum lease payments £m	Interest £m	Principal £m	Minimum lease payments £m	Interest £m	Principal £m
Less than one year	3.7	(0.4)	3.3	2.3	(0.2)	2.1
Between one and five years	7.6	(0.4)	7.2	4.8	(0.2)	4.6
More than five years	–	–	–	–	–	–
	11.3	(0.8)	10.5	7.1	(0.4)	6.7

18 Employee benefits

Defined contribution pension plans

The Group operates a number of defined contribution pension plans under which contributions by the employees and the Group are administered by trustees in funds separate from the Group's assets. The costs of these schemes are charged to the income statement as they become payable under the rules of the scheme. The total pension cost of the Group for the year was £3.0m (2017: £2.5m).

19 Provisions

	Guarantee provision £m	Property provisions £m	Other provisions £m	Total £m
Balance at 29 July 2017	7.0	2.3	1.0	10.3
Provisions made during the year	4.7	0.2	–	4.9
Acquisitions	1.5	–	–	1.5
Reclassification from accruals	–	–	–	–
Provisions used during the year	(6.3)	(0.2)	(0.1)	(6.6)
Provisions released during the year	0.6	–	–	0.6
Unwind of discount	–	0.1	–	0.1
Balance at 28 July 2018	7.5	2.4	0.9	10.8
Current	4.0	0.2	0.7	4.9
Non-current	3.5	2.2	0.2	5.9
	7.5	2.4	0.9	10.8

The Group offers a long-term guarantee on its upholstery products and in accordance with accounting standards a provision is maintained for the expected future cost of fulfilling these guarantees on products which have been delivered before the reporting date. In calculating this provision the key areas of estimation are the number of future claims, average cost per claim and the expected period over which claims will arise (nearly all claims arise within two years of delivery). The Group has considered the sensitivity of the calculation to these key areas of estimation, and determined that a 10% change in either the average cost per claim or the number of expected future calls would change the value of the calculated provision by £0.6m. The Directors have therefore concluded that reasonably possible variations in estimate would not result in a material difference. The release of £0.6m in the year reflects an update of the assumptions following an improvement in claims rates.

Property provisions relate to onerous contracts and other obligations in respect of the Group's property leases including an estimate of dilapidation costs based on anticipated lease expiries and renewals. Other provisions relate to payment of refunds to customers for payment protection insurance policies and other regulatory costs.

Notes to the consolidated financial statements *continued*

at 28 July 2018

20 Dividends

The following dividends were recognised and paid during the year:

	Pence per ordinary share	2018 £m	2017 £m
Final ordinary dividend for FY16	6.2p	–	15.9
Interim ordinary dividend for FY17	3.5p	–	7.8
Special dividend for FY17	9.5p	–	20.1
Final ordinary dividend for FY17	7.5p	15.9	–
Interim ordinary dividend for FY18	3.7p	7.8	–
		23.7	43.8

The Directors recommend a final dividend of 7.5p per share in respect of the financial period ended 28 July 2018 ("FY18"), resulting in a total proposed dividend of £15.9m. Subject to shareholder approval it is intended that this dividend will be paid on 27 December 2018. DFS Furniture plc shares will trade ex-dividend from 6 December 2018 and the record date will be 7 December 2018. This dividend has not therefore been recognised as a liability in these financial statements.

21 Capital and reserves

Share capital

	Number of shares '000	Ordinary shares £m
Ordinary shares of £1.50 each		
<i>Allotted, called up and fully paid</i>		
At the start and end of the financial period	213,030	319.5

Share premium

The share premium account represents the surplus of consideration received for issued ordinary share capital over its nominal value. This arose on the issue ordinary shares on 11 March 2015.

Merger reserve

The merger reserve arose on the issue of shares in the Company in exchange for minority interests in the issued share capital of a subsidiary company on 10 March 2015.

Treasury shares

Where the Company purchases the Company's equity share capital into treasury (treasury shares), the consideration paid, including any directly attributable incremental costs is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of.

During the period ending 30 July 2016 the Company purchased 1,500,000 of its own ordinary shares at a total cost of £3.7m for the purpose of satisfying employee share based payment awards. During the year 130,729 of these shares (2017: 858) were used to satisfy employee share based payment awards.

Cash flow hedging reserve

The cash flow hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

22 Financial instruments: categories and fair value

	2018 £m	2017 £m
<i>Financial assets</i>		
Derivatives in designated hedging relationships	5.3	–
Loans and receivables	8.0	10.8
Cash	47.2	61.0
<i>Financial liabilities</i>		
Derivatives in designated hedging relationships	(1.2)	(7.0)
Senior loan facility	–	(198.8)
Senior revolving credit facility	(195.7)	–
Amortised cost	(216.8)	(162.1)
Finance lease obligations	(10.5)	(6.7)

All derivatives are categorised as Level 2 under the requirements of IFRS 7 as they are valued using techniques based significantly on observed market data.

The Directors consider that the fair values of each category of the Group's financial instruments are the same as their carrying values in the Group's balance sheet.

23 Financial instruments: risk management

The objectives, policies and processes governing the treasury activities of the Group are reviewed and approved by the Board. The Group's documented treasury policy includes details of authorised counterparties, instrument types and transaction limits and principles for the management of liquidity, interest and foreign exchange risks. As part of its strategy for the management of these risks the Group uses derivative financial instruments. The Group does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

Liquidity risk

The Group manages its cash and borrowing requirements to ensure that it has sufficient liquid resources to meet its obligations as they fall due while making efficient use of the Group's financial resources.

The table below shows the maturity analysis of the undiscounted remaining contractual cash flows (including interest) of the Group's financial liabilities:

	Less than 1 year £m	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Total £m
2018					
Trade and other payables	206.0	–	–	–	206.0
Finance lease liabilities	3.7	3.3	4.3	–	11.3
Senior revolving credit facility	6.0	6.0	209.8	–	221.8
Other liabilities	4.8	3.9	0.6	2.3	11.6
	220.5	13.2	214.7	2.3	450.7
Derivatives: net settled	1.1	0.7	–	–	1.8
<i>Derivatives: gross settled</i>					
Cash in flows	(125.5)	(49.2)	–	–	(174.7)
Cash out flows	120.9	46.6	–	–	167.5
Total cash flows	217.0	11.3	214.7	2.3	445.3

Notes to the consolidated financial statements *continued* at 28 July 2018

23 Financial instruments: risk management *continued*

Liquidity risk *continued*

2017	Less than 1 year £m	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Total £m
Trade and other payables	151.8	–	–	–	151.8
Finance lease liabilities	2.3	1.9	2.9	–	7.1
Senior loan facility	4.6	4.6	203.4	–	212.6
Other liabilities	5.0	3.3	0.6	2.3	11.2
	163.7	9.8	206.9	2.3	382.7
Derivatives: net settled	1.8	1.7	1.2	–	4.7
<i>Derivatives: gross settled</i>					
Cash inflows	(95.4)	–	–	–	(95.4)
Cash out flows	98.2	–	–	–	98.2
Total cash flows	168.3	11.5	208.1	2.3	390.2

Interest rate risk management

The Group's operating profit is affected by the cost of providing interest free credit to its customers. A fall in LIBOR rates would have a positive impact on operating profit and a rise in LIBOR rates would impact operating profit negatively. However, with the current low LIBOR rates any increases or decreases at present would largely be mitigated by the LIBOR 'floor' mechanisms used by the external providers of credit to the Group's customers. Excluding the effect of these floors, an increase in LIBOR of one percentage point would reduce the Group's reported revenue by 0.5%.

The Group is exposed to interest rate risk on its senior revolving credit facility, which bears interest at a floating rate of 3 month GBP LIBOR plus 2.35%. In order to provide some certainty over the future cash flows associated with this debt, the Group has in place four participating interest rate swaps and caps. The effect of these instruments is to fix the interest rate payable on the senior revolving credit facility to a maximum level while allowing the Group to retain some benefit on a proportion of the facility where LIBOR remained below 1.39%. The fair values of the Group's interest rate derivatives are as follows:

	2018 £m	2017 £m
<i>Interest rate swaps</i>		
Derivatives in designated hedging relationships	(1.1)	(3.5)

Foreign exchange risk management

The Group is exposed to the risks of exchange rate fluctuations on the purchase of products denominated in foreign currencies. Currency requirements are assessed by analysis of historic purchasing patterns by month, adjusted as appropriate to take into account current trading expectations. The Group's treasury policy allows for the use of forward foreign exchange contracts to hedge the exchange rate risk arising from these anticipated future purchases up to 18 months in advance. These contracts are designated as cash flow hedges.

The table below summarises the forward foreign exchange contracts outstanding at the period end:

	2018		2017	
	Notional amount £m	Fair value £m	Notional amount £m	Fair value £m
<i>Derivatives in designated hedging relationships</i>				
US Dollar	167.5	5.2	98.2	(3.5)

The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	Assets		Liabilities	
	2018 £m	2017 £m	2018 £m	2017 £m
US Dollar	8.2	7.3	(7.6)	(5.9)
Euro	4.0	3.5	(1.6)	(1.0)

23 Financial instruments: risk management continued

Foreign currency sensitivity analysis

The Group's primary foreign currency exposures are to US Dollars and the Euro. The table below illustrates the hypothetical sensitivity of the Group's reported profit and closing equity to a 10% weakening of these currencies against Sterling, assuming all other variables were unchanged. The sensitivity rate of 10% represents the Directors' assessment of a reasonably possible change, based on historic volatility.

The analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates. The analysis assumes that exchange rate fluctuations on currency derivatives that form part of an effective cash flow hedge relationship affect the cash flow hedging reserve in equity.

Positive figures represent an increase in profit or equity.

	Income statement		Equity	
	2018 £m	2017 £m	2018 £m	2017 £m
US Dollar	(0.1)	(0.1)	(17.3)	(9.5)
Euro	(0.2)	(0.3)	–	–

A 10% strengthening of the above currencies against the Sterling at the period end would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Financial risk management

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's investment securities.

Investments of cash, borrowings and derivative instruments are transacted only through counterparties meeting the credit rating and investment criteria specified in the Group's treasury policy. The Group's exposure and the credit ratings of its counterparties are regularly reviewed. Concentrations of risk are mitigated through the use of multiple counterparties and by counterparty limits which are reviewed and approved by the Board.

The Group does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics.

Capital management

The capital structure of the Group consists of debt, as analysed in note 26, and equity attributable to the equity holders of the parent Company, comprising issued capital, reserves and retained earnings as shown in the consolidated statement of changes in equity. The Group manages its capital with the objective that all entities within the Group continue as going concerns while maintaining an efficient structure to minimise the cost of capital. The Group is not restricted by any externally imposed capital requirements.

24 Share based payments

The Group has three share based payment schemes in operation:

Long Term Incentive Plan (LTIP)

The LTIP is a discretionary executive reward plan that allows the Group to grant conditional share awards or nil-cost options to selected executives at the discretion of the Remuneration Committee. The scheme is focused on the senior leadership roles in the Group, including Executive Directors. The maximum value of LTIP awards granted to an individual is 150% of base salary, although the Remuneration Committee may in exceptional circumstances increase this to 300%.

LTIP awards vest after a three year performance period (other than those granted shortly after Admission which vested on 31 July 2017) subject to the achievement of performance measures based on earnings per share and total shareholder return targets. Further information on LTIP performance targets and awards made to Directors is given in the Directors' Remuneration Report on pages 58 to 82.

Restricted Share Plan (RSP)

The RSP is also a discretionary reward plan under which conditional share awards or nil-cost options may be granted to individuals in key executive roles in the Group, excluding Executive Directors and other recipients of LTIP awards. Awards may not exceed 50% of an individual's salary for a particular financial year.

RSP awards typically vest after a three year performance period (other than those granted shortly after Admission which vested on 31 July 2017) and are not subject to other performance conditions. During FY18 supplementary RSP awards with a two year vesting period were made to members of the executive management team.

Save as Your Earn (SAYE)

SAYE schemes are currently available to all employees in the UK and Republic of Ireland, with invitations to participate generally issued on an annual basis and subject to HMRC rules. The current maximum monthly savings limit for the schemes is £500. Options are granted at the prevailing market rate less a discount of 20% and vest three years from the date of grant.

Notes to the consolidated financial statements *continued* at 28 July 2018

24 Share based payments *continued*

The movements in outstanding awards under each of the schemes are summarised below. During the year 127,170 RSP awards vested and were exercised and 419,796 LTIP awards reached their vesting date but lapsed as none of the performance conditions for vesting were met. At 28 July 2018 no outstanding awards were exercisable.

	LTIP No.	RSP No.	SAYE No.
Outstanding at the beginning of the year	1,468,870	1,536,797	2,773,856
Granted	826,761	1,816,599	1,527,079
Forfeited	(19,706)	(124,032)	(63,095)
Lapsed	(419,796)	–	–
Exercised	–	(127,197)	(3,532)
Cancelled	–	–	(1,560,501)
Outstanding at the end of the year	1,856,129	3,102,167	2,673,807
Weighted average remaining contractual life (months)	18.5	20.6	22.7

Fair value calculations

The LTIP, RSP and SAYE awards are all accounted for as equity-settled under IFRS 2. The fair value of LTIP awards which are subject to a market based performance condition (total shareholder return) is calculated using a stochastic (Monte Carlo) option pricing model. RSP awards, SAYE awards and LTIP awards subject to a non-market based performance condition (earnings per share) are valued using a Black-Scholes option pricing model. The inputs to these models for awards granted during the financial period are detailed below:

	LTIP	RSP	RSP	SAYE
Grant date	16 November 2017	16 November 2017	16 November 2017	6 December 2017
Share price at date of grant	£1.90	£1.90	£1.90	£2.01
Exercise price	Nil	Nil	Nil	£1.61
Volatility	31.0%	— ²	— ²	24.0%
Expected life	3 years	2 years	3 years	3.1 years
Risk free rate	0.5%	— ²	— ²	0.5%
Dividend yield	— ¹	5.9%	5.9%	5.9%
Fair value per share				
Market-based performance conditions	£0.70/£0.74	–	–	–
Non-market based or no performance condition	£1.90	£1.68	£1.59	£0.32

1. LTIP participants are entitled to receive dividend equivalents on unvested awards therefore dividend yield does not impact the fair value calculation

2. Volatility and risk free rates do not impact the fair value calculation for awards with no exercise price or market based performance condition

As the Company had only limited share price history at the date of grant, expected volatility was based on a proxy volatility determined from the median volatility of a group of appropriate comparator companies within the FTSE All Share index. Expected life has been assumed to equate to the vesting period of the awards.

The total share based payment expense included in administration costs in respect of the above schemes was £2.8m (2017: £2.0m).

25 Operating leases

Non-cancellable operating lease rentals are payable as follows:

	2018 £m	2017 £m
Less than one year	84.1	64.6
Between one and five years	315.0	247.5
More than five years	342.8	333.9
	741.9	646.0

The Group has entered into operating leases in respect of stores, warehouses and equipment. These non-cancellable leases have remaining terms of between 3 months and 17 years. The majority of the Group's operating leases provide for their renewal by mutual agreement at the expiry of the lease term.

During the year £74.2m was recognised as an expense in the income statement in respect of operating leases (2017: £61.6m). At 28 July 2018, future rentals receivable under non-cancellable leases where the Group is the lessor were £8.7m (2017: £11.8m).

26 Net debt

	2017 £m	Cash flow £m	Acquisitions £m	Other non-cash changes £m	2018 £m
Cash in hand, at bank	61.0	(19.7)	5.9	–	47.2
Cash and cash equivalents	61.0	(19.7)	5.9	–	47.2
Senior loan facility	(198.8)	200.0	–	(1.2)	–
Senior revolving credit facility	–	(197.0)	–	1.3	(195.7)
Finance lease liabilities	(6.7)	3.1	(1.8)	(5.1)	(10.5)
Total net debt	(144.5)	(13.6)	4.1	(5.0)	(159.0)

27 Related parties

Key management personnel

At 28 July 2018, Directors of the Company held 0.8% of its issued ordinary share capital (2017: 0.8%), and a further 0.2% (2017: 0.2%) was held by other key management personnel.

The compensation of key management personnel (including the Directors) is as follows:

	2018 £m	2017 £m
Emoluments	2.7	2.6
Company contributions to money purchase schemes	0.1	0.1
	2.8	2.7

Company balance sheet

at 28 July 2018

	Note	2018 £m	2017 £m
Fixed assets			
Investments	29	241.5	238.7
Current assets			
Amounts due from Group companies	30	293.0	198.0
Current liabilities			
Amounts due to Group companies	31	(71.2)	(47.5)
Net assets		463.3	389.2
Capital and reserves			
Called up share capital	32	319.5	319.5
Share premium	32	40.4	40.4
Merger reserve	32	18.6	18.6
Treasury shares	32	(3.3)	(3.7)
Retained earnings		88.1	14.4
Equity shareholders' funds		463.3	389.2

These financial statements were approved by the Board of Directors on 3 October 2018 and were signed on its behalf by:

Ian Filby
Chief Executive Officer

Nicola Bancroft
Chief Financial Officer

Company statement of changes in equity

at 28 July 2018

	Share capital £m	Share premium £m	Merger reserve £m	Treasury shares £m	Retained earnings £m	Total equity £m
Balance at 30 July 2016	319.5	40.4	18.6	(3.7)	56.2	431.0
Profit for the year	–	–	–	–	–	–
Other comprehensive income/(expense)	–	–	–	–	–	–
Total comprehensive expense for the year	–	–	–	–	–	–
Dividends	–	–	–	–	(43.8)	(43.8)
Share based payments	–	–	–	–	2.0	2.0
Balance at 29 July 2017	319.5	40.4	18.6	(3.7)	14.4	389.2
Profit for the year	–	–	–	–	95.0	95.0
Other comprehensive income/(expense)	–	–	–	–	–	–
Total comprehensive income/(expense) for the year	–	–	–	–	95.0	95.0
Dividends	–	–	–	–	(23.7)	(23.7)
Treasury shares issued	–	–	–	0.4	(0.4)	–
Share based payments	–	–	–	–	2.8	2.8
Balance at 28 July 2018	319.5	40.4	18.6	(3.3)	88.1	463.3

Notes to the company financial statements

at 28 July 2018

28 Accounting policies

Basis of preparation

The financial statements are prepared in accordance with Financial Reporting Standard 101 *Reduced Disclosure Framework* ("FRS 101").

In these financial statements the Company has applied the exemption available under FRS101 in respect of the following disclosures:

- a cash flow statement and related notes
- comparative period reconciliations
- disclosures in respect of transactions with wholly owned subsidiaries
- disclosures in respect of capital management
- the impact of new but not yet effective IFRSs

As the consolidated accounts of the Company include the equivalent disclosures, the Company has also taken the exemption available under FRS 101 in respect of IFRS 2 *Share Based Payments* disclosures of group settled share based payments. Under Section 408 of the Companies Act 2006, the Company is not required to present its own profit and loss account. The Company's profit for the period was £95.0m (2017: £nil).

The Company proposes to continue to adopt the reduced disclosure framework of FRS 101 in its next financial statements.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Going concern

The Company heads a Group which is highly cash generative, with sufficient medium and long term facilities in place to enable it to meet its obligations as they fall due. The directors are therefore satisfied that the Company will be able to continue in operational existence, as detailed in the Group's Viability Statement on page 17, and have therefore continued to prepare the Company's financial statements on the going concern basis.

Investments

Investments are stated at cost, less provision for any impairment.

Amounts due from and to Group companies

Amounts receivable from or payable to other companies within the Company's Group are recognised initially at fair value and subsequently measured at amortised cost less any provision for impairment.

Taxation

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to a business combination, or items recognised directly in equity or other comprehensive income. Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Share based payments

Awards (options or conditional shares) granted by the Company over its own shares to the employees of subsidiary companies are recognised in the Company's own financial statements as an increase in the cost of investment in subsidiaries. The amount recognised is equivalent to the equity-settled share based payment charge recognised in the consolidated financial statements. The corresponding credit is recognised directly in equity.

Treasury shares

Where the Company purchases the Company's equity share capital into treasury (treasury shares), the consideration paid, including any directly attributable incremental costs is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of.

29 Investments

	Shares in subsidiary undertakings	
	2018 £m	2017 £m
Cost and net book value		
At the start of the financial period	238.7	236.7
Additions	2.8	2.0
At the end of the financial period	241.5	238.7

Details of the Company's investments are given in note 10. Additions in the current and prior year relate to capital contributions made in respect of share based payments schemes for the Group's employees.

30 Debtors

	2018 £m	2017 £m
Amounts due from subsidiary undertakings	293.0	198.0

31 Creditors: amounts due in less than one year

	2018 £m	2017 £m
Amounts due to subsidiary undertakings	71.2	47.5

32 Capital and reserves

Share capital

	Number of shares '000	Ordinary shares £m
<i>Allotted, called up and fully paid</i>		
Amounts due to subsidiary undertakings	213,030	319.5

Share premium

The share premium account represents the surplus of consideration received for issued ordinary share capital over its nominal value. This arose on the issue ordinary shares on 11 March 2015.

Merger reserve

The merger reserve arose on the issue of shares in the Company in exchange for minority interests in the issued share capital of a subsidiary company on 10 March 2015.

Treasury shares

Where the Company purchases the Company's equity share capital into treasury (treasury shares), the consideration paid, including any directly attributable incremental costs is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of.

During the period ending 30 July 2016 the Company purchased 1,500,000 of its own ordinary shares at a total cost of £3.7m for the purpose of satisfying employee share based payment awards. During the year 130,729 of these shares (2017: 858) were used to satisfy employee share based payment awards.

Financial history

		FY18 ¹	FY17	FY16	FY15 ²
Gross sales	£m	1,125.6	990.8	980.4	913.1
Revenue	£m	870.5	762.7	756.0	706.1
Underlying EBITDA	£m	76.1	82.4	94.4	89.2
Profit before tax	£m	25.8	50.1	64.5	10.7
Basic earnings per share	p	8.9	18.7	28.3	4.3
Ordinary dividends per share	p	11.2	11.2	11.0	9.3
Special dividends per share	p	–	9.5	–	–
Purchase of own shares	£m	–	–	3.7	–
Total shareholder return	%	+1.9	+6.5	–21.5	+11.8

Notes

1. Sofology acquired 30 November 2017
2. IPO 10 March 2015

Shareholder information

Contacts

Chief Executive Officer

Ian Filby

Chief Financial Officer

Nicola Bancroft

Group Company Secretary

Elizabeth McDonald

Investor relations

Mike Schmidt

Corporate website

www.dfscorporate.co.uk

Registered office

DFS Furniture plc
1 Rockingham Way
Redhouse Interchange
Adwick-le-Street
Doncaster
DN6 7NA

Corporate advisers:

Auditor

KPMG LLP
1 Sovereign Square
Sovereign Street
Leeds
LS1 4DA

Remuneration adviser

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Embankment Place London
WC2N 6RH

Brokers

UBS Limited & Jefferies International Limited

Shareholder enquiries

The Company's registrar is Equiniti. They will be pleased to deal with any questions regarding your shareholding or dividends. Please notify them of your change of address or other personal information. Their address details are:

Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

Equiniti is a trading name of Equiniti Limited.

Equiniti helpline: 0371 384 2030.
Overseas holders should contact +44 (0)121 415 7047.

Lines are open 8.30am to 5.30pm, Monday to Friday
(excluding public holidays).

Shareholders are able to manage their shareholding online and facilities include electronic communications, account enquiries, amendment of address and dividend mandate instructions.

For institutional investor enquiries, please contact:

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200 Aldersgate
Aldersgate Street London
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Annual General Meeting 2018

This year's AGM will be held at 2.30pm on 30 November 2018 at DFS Head Office, 1 Rockingham Way, Redhouse Interchange, Adwick-le-Street, Doncaster, DN6 7NA

Financial calendar

FY18 full year results	4 October 2018
Annual General Meeting	30 November 2018
Record date for FY18 final dividend	8 December 2018
Payment date for FY18 final dividend	27 December 2018
FY19 half year results	March 2019
Payment date for FY19 interim dividend	June 2019

Notes





DFS Furniture plc

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Report and Accounts

Registered number 7236769
28 July 2018