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Annual Report and Accounts 2007

Europe's leading
floorcovering distributor

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COMPANIES HOUSE

Headlam markets, supplies and distributes an extensive range of floorcovering products to independent flooring retailers and contractors throughout the UK, France, Switzerland and the Netherlands.

Our operational strategy is focused on providing our customers with an up to date comprehensive range of competitively priced floorcovering products with the support of a next day delivery.

As part of this strategy, Headlam offers its suppliers the opportunity to achieve wide market penetration backed by cost effective distribution

In implementing this strategy, Headlam has developed a diverse and autonomous structure with 50 businesses in the UK and a further three in Continental Europe

A key factor contributing to the group's success is the individuality of experienced management teams who are responsible for the market presence, development and ultimate profitability of their business

Each business is supported by the commitment to continued investment in people, product, facilities and IT. This commitment has provided the basis for the group's growth and performance enabling it to develop into Europe's leading floorcovering distributor

Financial Highlights

Sales (£m) **+6.8%** Operating Profit (£m) **+2.1m**

Earnings Per Share (p) **+5.7%** Proposed Dividends (p) **+14.6%**

* Not restated for IFRS

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Market Presence

The UK operating structure is based on five business sectors each aimed at maximising market penetration and supporting different aspects of the floorcovering market

Our Regional and National multi-product businesses provide a comprehensive residential and commercial product range and extensive geographical coverage. The Regional commercial businesses focus on strong relationships with suppliers and a high level of localised service for their customers. Our Residential specialist businesses supply medium to premium residential carpet on a national basis and the Commercial specialist businesses, which have a national presence, provide a range of products servicing various aspects of the commercial market

Our business in France operates from two distribution centres and 21 service centres and the businesses in Switzerland and the Netherlands each operate from a single distribution centre. All three businesses on the Continent offer an extensive range of floorcovering products providing full national coverage across their respective countries

Market Presence *continued*

Regional Multi-product Distribution

Distribution Centre

National Multi-product Distribution Network

Distribution Centre
Trans-Shipping Locations

Market Presence *continued*

Regional Commercial Distribution

Distribution Centre
Shared Distribution Centre
Service Centre

National Residential Specialist Products

Distribution Centre

Market Presence *continued*

National Commercial Specialist Products

Distribution Centre

European Multi-product Distribution

Distribution Centre
Service Centre

Chairman's Statement

I am pleased to report that 2007 proved to be another successful year. Each of our five business sectors and eight product categories in the UK performed positively and our businesses in Continental Europe maintained the trend of continued improvement.

Revenue from the group's activities amounted to £544.7 million, an increase of 6.8% on last year, and profit before tax increased by 3.7% to £45.2 million.

Earnings and dividend

Basic earnings per share increased by 5.7% from 35.1p to 37.1p. Adjusted for the amortisation of intangibles, which amounted to £1.5 million in 2007 compared with £0.7 million for the previous year, earnings increased by 7.6% from 35.6 pence to 38.3 pence.

As communicated last year, it is our intention to maintain a progressive dividend increase in order to achieve a payout ratio of approximately 67% by the end of 2009. We gave this commitment since we believe the cumulative effect of increasing dividends is an important method by which we can enhance shareholder returns.

Therefore, your board is recommending a final dividend of 17.75p per share, an increase of 16.0% on last year. This increases the total dividend for the year by 14.6% from 20.15p to 23.10p.

This year's proposal, which represents 16 years of continuous improvement, is equivalent to a payout ratio of 62.3% (2006: 57.4%) compared with basic earnings per share and places us ahead of our timetable.

If approved by shareholders at the forthcoming Annual General Meeting, the final dividend will be paid on 1 July 2008 to shareholders on the register at 6 June 2008.

Strategy

The performance in 2007 has further enhanced our position as the leading distributor of floorcoverings in the UK and Continental Europe. The group's strategy remains unchanged and we will maintain our focus on the development of our floorcovering business. We will continue to invest in the infrastructure of the business to increase capacity and improve material handling techniques where appropriate. In addition, we

Our five business sectors in the UK and three businesses in Continental Europe maintained their continued improvement

will evaluate and make acquisitions of floorcovering businesses where we believe they can contribute to our strategic position and enhance profitability, whether in the UK or Continental Europe

Operations

Fundamental to our ongoing success is the relationship with the leading worldwide flooring manufacturers, who in conjunction with our individual management teams, continue to develop product for our respective markets. This ensures that the independent flooring retailer and contractor are at the forefront of all new floorcovering products.

The group's structure allows the individual management teams of 50 businesses in the UK to operate autonomously and focus on their respective geographical and product areas. Through a combined total of 364 external sales people, we launched 3,715 new products into independent flooring retailers and contractors in conjunction with 794,000 new point of sale displays and sample books.

The management teams in our individual businesses are clearly measured and incentivised on the performance of their specific responsibilities. Whilst encouraging the autonomy of business operations, each team operates to a strategy relevant to their businesses' own market position and complies with consistent operational procedures and financial disciplines.

It is particularly encouraging that our three Continental European businesses in France, Switzerland and the Netherlands have continued the trend of the last three years and further increased revenue and profitability.

The board

Having been a member of our board for nearly nine years serving in his role as the senior independent director and Chairman of the Remuneration Committee, Tom Anderson elected to step down from his responsibilities during May 2007. Our thanks go to Tom for his help and support over the years and we send him our best wishes for his retirement.

I am pleased to report that during October 2007, we appointed David Grove as a non-executive director. David brings a wide range of experience and skills to our board and along with Dick Peters and Mike O'Leary provides us with a non-executive team with a wealth of fresh talent and advice.

Employees

The autonomous nature of our business operations has allowed us to develop a culture of individuality combined with the benefit of wide ranging opportunities derived from a group structure. We have a policy of internal development and promotion, wherever possible, providing our employees with a variety of options to enhance their careers. Over a number of years, this has resulted in many instances where employees have developed into senior sales and management roles.

We wish to thank all our management and employees for their contribution to the group's ongoing success.

Purchase of own shares

During 2007, the board decided to commence a share buy-back programme, to return cash to shareholders and improve balance sheet efficiency. Further to our announcement on 25 May 2007 regarding the introduction of a share buy-back programme, I can report that as at 31 December 2007, the company has acquired 3,838,006 shares at an average price of £5.65 per share.

As at 17 March 2008, a further 550,000 shares have been acquired at an average price of £4.01 per share, bringing the total expenditure on the purchase of own shares since May 2007 to £23.9 million.

Outlook

The group continues to invest in developing the infrastructure, to allow our individual businesses to take advantage of market opportunities. With the management teams of these businesses clearly focused on the objectives before them, we are confident of achieving another year of growth.

Graham Waldron, Chairman

Business Review

During 2007, the combined performance of our 50 UK businesses resulted in an increase in revenue of 4.0% on a like for like basis and in total by 6.8%.

Another positive improvement in Continental Europe resulted in the revenue from our businesses located in France, Switzerland and the Netherlands increasing on a like for like basis by 7.2%.

Challenging market conditions, particularly in the UK, have required additional effort and creativity from our management teams sales representatives and staff to ensure that by working closely with suppliers on product development and launches our customers, principally independent flooring retailers and contractors, retain their market position and subsequent share.

Investment - Facilities

In December 2007 we completed the 20,000 square foot extension to the distribution hub of Mercado in Leeds, increasing their total capacity to 205,000 square feet. We made a further investment in the infrastructure of Mercado with the purchase, in February 2007, of an existing 17,000 square foot building in Bristol to increase trans-shipping capacity. This building was subsequently refurbished and became operational in September. These two investments have increased the capacity and efficiency of Mercado's national operations.

The investment in the Bristol facility also created a service centre for Richards, the regional commercial business, to extend its commercial product offering and customer service in the southwest of England. In December 2007, we purchased a 6,000 square foot building in Southampton in order to establish a service centre to enlarge the Richards commercial presence in the south of England.

During 2007, we entered into leasehold agreements to provide two new service centres for Faithfuls to increase its presence with flooring contractors operating in London. The Dartford 5,000 square foot service centre opened in November followed by the Walthamstow 9,000 square foot service centre opening in January 2008.

We currently have under construction, a new purpose-built freehold 42,000 square foot distribution facility for MCD Wales in Bridgend, which will be operational in the spring of 2008. This will enable MCD Wales to develop further its residential and commercial business in South Wales and the southwest of England.

During July, we acquired the freehold interest in the property occupied by Baileys, our regional multi-product business located in Plymouth. Planning permission has been granted to extend the distribution centre which will be completed by the end of 2008.

It is the group's intention to continue investing in new distribution facilities to increase capacity and efficiency

This will allow Baileys to complement its residential business by increasing significantly its commercial product offering and service to flooring contractors in Devon and Cornwall.

Following the ongoing improvement in our European businesses, we have decided to relocate our Lethem-Vergeer business in the Netherlands to a new purpose-built freehold 65,000 square foot distribution facility for which we are currently awaiting the appropriate planning licence. We anticipate that this facility will be operational in the spring of 2009.

It is the group's intention to continue the investment programme in new purpose-built freehold distribution facilities enabling us to relocate a number of our existing businesses and provide them with increased capacity and more efficient handling techniques.

Investment - Acquisitions

The group has continued to acquire businesses where they can enhance our market position and contribute to increased profitability which has resulted in three acquisitions during 2007.

At the end of March, we acquired 3D Flooring Supplies Limited, a distributor of commercial flooring in South Wales and the southwest of England. 3D will continue to operate from its locations in Cardiff, Swansea and Taunton.

During April, we acquired Florprotec Limited, a leading supplier throughout the UK of floor protection products for the construction industry and refurbishment projects. Florprotec now operates autonomously from the Tamworth distribution centre.

In July, we acquired the trade and assets of Plantation Rug Company, a supplier of rugs to independent retailers throughout the UK. Plantation operates autonomously from our Stockport distribution centre and complements our existing activities in rugs principally through Crucial Trading and National Carpets.

ORDER

PICK

CUT

DELIVER

Customers in the UK,
who are principally
independent flooring
retailers and contractors,
placed 4,624,489 orders
during 2007

Business Review *continued*

The number of active customer accounts increased from 36,225 in 2006 to 39,033 in 2007 illustrating that the independent sector continues to prosper

UK operations

Our 50 businesses in the UK operating from 22 distribution centres and 9 service centres are categorised into five separate sectors. Each sector reflects their relevant geographical or product focus in the UK floorcovering market.

Regional multi-product. The 20 businesses create significant market presence and represent 59% of UK revenue. They continue to offer a comprehensive product range of both residential and commercial floorcovering and increased their revenue by 3.0% during the year.

National multi-product. Mercado with its extensive product offering of residential and commercial floorcovering, increased its revenue by 2.2%. With the benefit of investment and enhancements to the

infrastructure, we are confident of the continued development and growth of the Mercado businesses.

Regional commercial. This sector continues to prosper and now encompasses 15 operations, which are increasing their market presence through organic growth, new service centres and acquisitions growing their revenues collectively by 31.4%. With the recently acquired businesses and new service centres in Bristol, Dartford, Walthamstow and Southampton, we would expect this sector to significantly enlarge its market presence.

Residential specialist. Through product development and continued investment in sales and marketing, our 13 businesses selling principally middle to premium end carpet products were able to increase their revenues by 12.7%. During 2007 we reintroduced the carpet brands Mr Tomkinson and BMK, which historically, are well known with independent retailers. The acquisition of Plantation Rug Company is an opportunity to expand our presence in the UK rug market. Throughout the activities of these 13 specialist businesses we anticipate continued growth in medium to premium products.

Commercial specialist. The original three businesses all performed positively during 2007 and with the additional contribution from Florprotec, this sector increased revenues by 17.2%.

Suppliers

The managers of our 50 businesses in the UK and three businesses in Continental Europe work closely with the leading worldwide manufacturers of floorcovering products, to ensure that our businesses and subsequently our customers are at the forefront of product into their respective markets.

Business Sectors

Regional multi-product (59%)
National multi-product (13%)
Regional commercial (11%)
Residential specialist (12%)
Commercial specialist (5%)

Proportion by Product

Carpet (47%)
Vinyl (12%)
Laminate & Wood (6%)
Underlay (4%)
Commercial (29%)
Rugs (2%)

ORDER

PICK

CUT

DELIVER

Immediate order processing, comprehensive product ranges and high stock levels allow us to respond quickly to customer demand

Business Review *continued*

Products

Each of our product categories showed growth during 2007. Whilst commercial flooring grew at a faster rate than residential market information would suggest that we were able to increase our market share in both residential and commercial flooring.

To assist this growth, the number of products launched and point of sale items placed with customers were consistent with previous years.

Carpet revenues increased by 1.2% through the launch of 2,654 new products which were supported by 604,000 point of sale items. Carpet, which continues to be dominated by plain products in the UK, represents 47% of revenue. The volume of cut lengths was consistent with previous years, with an increase in the number of rolls sold reflecting the activity of our individual sales teams working to create additional demand in a challenging market.

Residential vinyl continues to be enhanced by improved manufacturing techniques, enabling the realistic recreation of various types of natural flooring. With the benefit of 727 new ranges marketed through 142,000 new display items, our revenues increased by 3.3% with independent flooring retailers.

Wood and laminate products enjoyed another positive year, increasing revenue by 26.2% and now represent 6% of UK revenue. This reflected an improving product offer in laminate flooring and an increase in sales of premium products, engineered and solid wood.

Commercial Flooring grew by 17.2% due to positive market demand and investment in new infrastructure and acquisitions. This has continued the increase in our market share in commercial flooring, which now contributes 29% of our UK revenues.

Customers

Our customers in the UK, who are principally independent flooring retailers and contractors, placed 4,624,489 orders during 2007 compared with 4,422,454 in 2006.

The number of active accounts increased from 36,225 in 2006 to 39,033 in 2007, which reflects that independent flooring retailers and contractors continue to prosper.

Average debtor days increased slightly from 41.0 days to 41.9 days due to the increased contribution from the sales of commercial products to flooring contractors. The total cost of doubtful debts as a percentage of revenue reduced from 0.21% to 0.18%.

The increase in active accounts, reduction in doubtful debts and underlying stability in debtor days, demonstrates the performance and strength of independent flooring retailers and contractors.

The group's structure encourages individual businesses to take advantage of market opportunities

Europe

The three businesses in Continental Europe again showed a positive performance, culminating in return on sales increasing from 2.7% to 3.6%.

LMS in France benefited from an improving market and through its infrastructure of two principal distribution centres and 21 service centres, increased revenue by 5.4%.

Belcolor in Switzerland invested in additional sales personnel, primarily focused on commercial flooring and with an increased contribution from Parquet, were able to increase their total revenue by 8.8%.

Lethem-Vergeer in the Netherlands delivered another positive performance, principally in residential flooring and increased their revenue by 10.0%.

Outlook

The group's structure encourages individual businesses to take advantage of market opportunities through the ongoing business development activities of our management teams and sales representatives.

The first ten weeks of 2008 have shown a further positive trend in the UK and Continental Europe and with our strategy of autonomous businesses, we are well placed to achieve our objectives for the year.

Tony Brewer, Group Chief Executive

ORDER

PICK

CUT

DELIVER

Investment in material
processing and handling
equipment enables us to
increase efficiency and
reduce waste

Financial Review

Trading

Revenue

Group revenues increased during the year by 6.8% from £509.9 million to £544.7 million.

In the UK, which accounts for approximately 85% of group revenues like for like revenue increased by 4.0% from £433.5 million to £451.0 million. The incremental benefit from Concept Flooring Supplies, a business acquired during October 2006, combined with the acquisitions completed during 2007, contributed a further £11.8 million.

On the Continent, which accounts for the remaining 15% of group revenues, our three businesses collectively achieved a like for like improvement of 7.2% with revenues increasing from £75.6 million to £81.0 million.

Gross margin

As already highlighted in the Chief Executive's Review in the UK, orders processed for rolls of residential carpet increased during the year compared with the previous year and the rate of growth in our commercial business was considerably ahead of the year on year revenue increases achieved elsewhere in the group.

Since the gross margin achieved on these two product groups is less than the group's overall margin, this change in product mix reduced gross margin by 30 basis points from 31.3% to 31.0%.

Expenses

Distribution and administration expenses collectively represented 22.5% of revenue, down marginally on last year's comparative of 22.6%. In absolute terms, distribution expenses increased year on year by 7.5% mainly due to annual pay awards coupled with an increase in the number of employees.

Administration expenses increased by 3.5% compared with 2006 principally due to the higher level of intangible amortisation in 2007.

Financing costs

The increase during the year from £0.4 million to £0.8 million was attributable to the additional cost associated with funding the group's share buy-back programme. Subject to movements in interest rates and further buy-back activity, we would expect this cost to increase to at least £1.6 million during 2008.

Taxation

The effective rate of taxation remained at 30.0% during the year and is a reflection of the group's current mix of business. For 2008, it is anticipated that the effective tax rate will fall to 28.5%.

Included in the 2007 UK Budget were proposed changes to the capital allowances regime in respect of Industrial Buildings. The stated intention was to reduce the allowances given from 4% straight line to 3% from April 2008, 2% from April 2009, 1% from April 2010 and finally to abolish Industrial Building Allowances entirely from April 2011.

This particular change was not included in Finance Act 2007 and therefore the effect has not been recognised in these financial statements. Should these proposed changes become law, there is a possibility that the group's deferred tax liability in respect of property, plant and equipment will increase by £7.8 million.

This change would also be reflected as part of the group's taxation charge in the 2008 income statement and therefore, based on the number of shares in issue at 31 December 2007, may give rise to an exceptional dilution in basic earnings per share amounting to 9.4 pence.

Property valuation

On transition to IFRS, the group elected to restate the carrying value of its freehold property to depreciated historical cost instead of using the previous basis, which was cost or valuation.

However when we changed the basis we decided to maintain our practice of a triennial review of the portfolio's market value. This was completed as at 31 December 2007 and reveals that the market value determined by reference to existing use exceeds depreciated historical cost by approximately £12.1 million.

This valuation excludes our freehold properties located on the Continent and all UK properties that may be sold in the short term.

Cash flows and net funds

Cash generated from operating activities

Cash flow from operating activities before movement in working capital increased by 6.7% during the year from £49.4 million to £52.7 million.

Investment in net working capital increased during the year by £8.3 million from £1.7 million to £10.0 million. Inventory increased by £1.9 million underpinning our continuing commitment to high service levels through the maintenance of extensive product ranges.

The £6.4 million decrease in cash inflow arising from trade and other payables occurred because of a small reduction in trade credit taken in some of our businesses at the end of 2007 compared with the equivalent position at the end of 2006.

Additional contributions to the defined benefit pension plan during the year amounted to £1.1 million compared with £3.9 million during the previous year.

ORDER

PICK

CUT

DELIVER

Orders, which are received on a daily basis, are processed immediately and subject to customers requirements delivered the following day

Financial Review *continued*

These movements combined with higher interest payments and a small increase in trade and other receivables contributed to net cash from operating activities declining from £30.1 million to £26.5 million.

Cash flows from investing and financing activities

Net cash outflows from investing activities totalled £11.3 million compared with £10.4 million during 2006. Investment in property, plant and equipment amounted to £11.0 million compared with £12.9 million for 2006. Unlike expenditure patterns in previous years where typically a significant proportion of the investment had been devoted to one project this year's investment, as highlighted in the Chief Executive's Review, has been aimed at a larger number of relatively smaller projects.

We are reasonably confident that we will be able to commence development of a new distribution facility for Faithfuls our regional multi-product business located in Hadleigh during the final quarter of 2008. The initiation of this project combined with the completion of the Bridgend facility the extension to Plymouth the relocation of our Dutch business and regular recurring investment will give rise to total expenditure during 2008 amounting to £13.2 million.

During 2008 we are likely to dispose of two properties, the facilities formerly occupied by Wilkes and currently occupied by MCD Wales for a combined total of £3.2 million. These disposals will reduce our net investment in property plant and equipment to £10.0 million.

Expenditure on the three acquisitions completed during the year amounted to £3.2 million.

Net cash out flow from financing activities almost trebled this year increasing from £14.9 million to £39.7 million. The cause and probably the most notable feature of this year's cash flow was the expenditure incurred on the share buy-back programme.

Changes in net funds

Group net funds decreased from £40.6 million to £16.7 million during the year as detailed in the table below.

Employee benefits

During the year, the net deficit relating to the defined benefit pension plans as measured under IAS 19 decreased by £5.9 million from £17.2 million to £11.3 million. Whilst equity values have shown modest improvement during the year, the principal driver contributing to the reduction is the increase in bond yields.

The group continues to make additional contributions to the UK plan. During 2007, this amounted to £1.1 million and it is anticipated this will increase to £1.5 million during 2008. However, the UK plan's actuary will undertake a valuation of the scheme as at 31 March 2008 the outcome of which may affect the size of these additional contributions.

Stephen Wilson, Group Finance Director

CHANGES IN NET FUNDS

	At 1 January 2007 £000	Cash flows £000	Acquisitions excluding cash and overdrafts £000	Translation differences £000	At 31 December 2007 £000
Cash at bank and in hand	41,861	(25,313)	–	257	16,805
Bank overdraft	(1,010)	932	–	(25)	(103)
	40,851	(24,381)	–	232	16,702
Debt due within one year	–	246	(246)	–	–
Finance leases and similar hire purchase contracts	(267)	363	(96)	–	–
	40,584	(23,772)	(342)	232	16,702

Directors, Officers and Advisors

Board of Directors

G Waldron :

Chairman

Graham was appointed an executive director in June 1991 becoming Chairman later that year until 31 December 1999. On the resignation of Trevor Larman on 1 June 2006 he was re-appointed Chairman. He has 55 years experience in the floorcovering industry. He is the non-executive Chairman of Tandem Group plc. Age 77

A J Brewer ■

Group Chief Executive

Tony was appointed an executive director in June 1991, becoming Managing Director of the Floorcoverings Division in January 1992 and was appointed Group Chief Executive in November 2000. He has 30 years experience in the floorcovering industry. Age 47

S G Wilson

Group Finance Director

Steve was appointed Group Finance Director in December 1991. He is the non-executive Chairman of Synergy Healthcare plc and is a fellow of the Institute of Chartered Accountants. Age 53

R W Peters ♦♦■

Non-executive Director

Dick was appointed a non executive director in December 2005. He was formerly Senior Partner for the East Midlands practice of Deloitte & Touche in Nottingham. He is a BSc in Mathematics and Statistics and is a fellow of the Institute of Chartered Accountants. He has considerable experience of auditing large companies both UK and overseas, transactional support and project management activities. He is a director and chairman of Headlam Pension Trustees Limited. Age 53

M K O Leary ♦♦■

Senior Independent Director

Mike was appointed a non-executive director in March 2006. He was formerly a director of MISYS plc and chief executive of Marlborough Stirling plc. Mike has worked in domestic and international

markets and brings a wealth of general management experience to the company. He is currently a non-executive director of Psion Teklogix plc, Helphire plc, the Stroud & Swindon Building Society and Digital Healthcare Limited where he is Chairman. Age 55

D L Grove ♦♦■

Non-executive Director

David was appointed a non-executive director in October 2007. He is the Executive Chairman of Hill & Smith Holdings PLC and a shareholder and non-executive director of a number of private manufacturing distribution and investment companies. Age 59

Company Secretary

G M Duggan

Geoff joined the company in April 1998. He is an associate of the Institute of Chartered Secretaries and Administrators and a fellow of the Chartered Institute of Management Accountants. Age 47

Executive Management

A J W Simpson

Managing Director UK Operations

Andrew joined the company in September 1991 and is the Managing Director of UK Operations. Andrew has 35 years experience in the floorcovering industry. Age 55

G B Phillips

Finance Director Operations

Gary joined the company in June 1992 and is the Finance Director of floorcovering operations. He is an associate of the Chartered Institute of Management Accountants. Age 44

A R Judge

Managing Director, Coleshill and Tamworth businesses

Tony joined the company in May 1992 and is Managing Director of all businesses operating from the Coleshill and Tamworth distribution centres. Tony has 27 years experience in the floorcovering industry. Age 43

K R Yates

Managing Director, Mercado

Keith joined Mercado in April 1983 and was subsequently appointed its Managing Director in 1996. Keith has 25 years experience in the floorcovering industry. Age 52

- ♦ Audit committee
- Remuneration committee
- Nomination committee
- ✦ Charities committee

Advisers

Auditors

KPMG Audit Plc
2 Cornwall Street
Birmingham B3 2DL

Taxation Advisers

Deloitte & Touche LLP
Four Brindleyplace
Birmingham B1 2HZ

Principal Bankers

Barclays Bank PLC
PO Box 34
15 Colmore Row
Birmingham B3 2BY

The Royal Bank of Scotland plc
Corporate and Institutional Banking
5th Floor, 2 St Philips Place
Birmingham B3 2RB

Stockbrokers

Arden Partners plc
Arden House
17 Highfield Road Edgbaston
Birmingham B15 3DU

Registrars

Capita Registrars
Northern House
Woodsome Park
Fenay Bridge
Huddersfield HD8 0LA

Financial Calendar

Announcements

Interim Management Statement	15 May 2008
Annual General Meeting	20 June 2008
Interim results announced	1 September 2008
Interim Management Statement	19 November 2008
Full year results announced	March 2009

Dividend Dates

Final dividend for 2007 if approved payable to qualifying shareholders on the register as at 6 June 2008	1 July 2008
Interim dividend for 2008 announced	August 2008
Interim dividend for 2008 payable	January 2009

Directors' Report

The directors present their annual report on the affairs of the group together with the audited Financial Statements and Independent Auditors Report, for the year ended 31 December 2007

Principal activity

The group's activities are wholly aligned to the sales, marketing, supply and distribution of floorcovering products. The principal trading subsidiaries are listed on page 91

Review of the business

A review of the group's activities and future developments, which fulfils the requirements of the Business Review, including the financial performance during the year and key performance indicators is included in the Business Review and the Financial Review on pages 12 to 16 and pages 18 to 20 and Corporate Social Responsibility on pages 41 to 43 which are incorporated into this report by reference. The description of the group's corporate governance arrangements on pages 29 to 34 also forms part of this report. A description of the group's financial risk management objectives and policies and its exposure to price, credit liquidity and cash flow risk is contained in note 22 to the Financial Statements on page 80. Other matters material to the appreciation of the group's position are contained in the Chairman's Statement on pages 10 and 11 and the Business Review on pages 12 to 16

Principal risks and uncertainties

The group's business, results and financial condition are influenced by a range of risks and uncertainties many of which are beyond the control of the board

Whilst the following highlights some of these risks it is not intended to provide an exhaustive analysis of the risks affecting the business. For instance, there are some risks which are as yet not known and others which whilst not presently material could become a significant factor in the future

Market demand

Approximately 94% of the group's sales are to independent retailers and flooring contractors.

The activity levels within this customer base are determined by consumer demand created through residential property refurbishment or moves, new residential housing developments and a wide range of commercial refurbishment and new building projects

Periods of recession, low consumer confidence or changes in trends and preferences have the potential to affect market activity and therefore demand for products supplied by the group. However, market activity is monitored in each individual business and at group level on a daily basis which enables a rapid response to any factors adversely affecting trading

Furthermore, since the group's principal activities are supply and distribution it has the ability to quickly respond to market changes. This, coupled with the development of broad market penetration through the establishment of a range of diverse regional, national and specialist businesses provides the group with a degree of resilience and protection

Competitor risk

The group operates in four different geographical markets which generally share similar trading characteristics. Within each market, the group competes with a variety of regional and national distributors, manufacturers selling directly to our customer base and indirectly with multiple retail chains

The group seeks to sustain its competitive position by maintaining close relationships with its supplier and customer base. Substantial and continued investment in

- management
- an extensive product offering
- a knowledgeable sales resource
- stock availability
- IT
- efficient material handling and
- logistics

removes the need to compete strictly on price and allows the group to enhance its overall market position through its commitment to service

The distribution competition in Continental Europe is diverse and very fragmented. The group has deliberately adopted a cautious acquisition policy in these markets searching for opportunities that provide good growth opportunities but at sensible valuations

Given the number of opportunities it is possible that a competitor following a more aggressive acquisition strategy on the Continent, could challenge the group's position as Europe's leading floorcovering distributor

Credit risk

The group trades with the majority of its customers on credit terms and therefore there is always the risk that customers are unable to pay outstanding balances

The group has standardised credit checking and debt collection procedures at each individual business. Businesses are encouraged to share credit information with other group businesses on a regular basis in order to prevent the escalation of small credit risks. All open accounts are subject to credit limits and businesses must obtain central approval for credit limits in excess of £10,000

Directors' Report *continued*

These procedures, combined with the local knowledge of the credit control teams, not only reduce the risk of default but also in a number of instances, provide opportunities to assist the customer to trade out of their default position

The group does not use credit insurance since the level of default is generally low. Appropriate impairment provisions are made on a regular basis whenever the likelihood of default is high.

Infrastructure

An important element of the group's ability to service its customer base is its network of distribution and service centres. The group's policy of improvement through continued investment in new or extended facilities has been one of the principal drivers behind the group's historic growth rates.

In order to support growth rates in the future, the group will continue to invest in new centres.

There is a risk that future growth will be constrained if these development projects are unduly delayed through either land availability, planning consent or prohibitive building cost.

Systems

The group is highly reliant on its IT systems to deliver its operational objectives and maintain financial control. As a consequence, any prolonged IT failure has the potential to adversely affect business activity.

However, each business has its own dedicated computer system and failure in one will not interrupt another. Furthermore, the group operates well defined back up procedures and has contingency plans in place to enable swift recovery from a failure of this nature.

Transport

The majority of customer orders result in deliveries within twenty-four hours on vehicles operated by the group. Any interruption to this service, for example, major disruption to road networks or the prolonged reduced availability of vehicle fuel could have an adverse effect on activity.

People

The group's ability to deliver continued success is very dependant upon its people.

The group is committed to providing a workplace that is safe and environmentally sound and creating opportunities for individuals to progress their careers. Recruitment, training and development are aimed at ensuring that the group has suitably skilled and qualified people to meet the operational needs of the business.

Pension

The cost of funding the group's defined benefit plans may increase due to a decline in investment returns, movement in interest rates and longer life expectancy. As a result of the triennial actuarial valuation of the UK plan, undertaken at 31 March 2005, the group agreed to make an additional payment of approximately £1.5 million every year until 2016.

The results of future scheme valuations, the next being 31 March 2008, could result in this commitment increasing.

Government legislation

The group's operations are regulated by a variety of laws, which relate, amongst others, to health and safety, the environment, employment, commercial, corporate, financial and tax.

The group is committed to complying with these requirements in each of the markets in which it operates and achieves this by managing its obligations at the group level and within individual businesses. Where appropriate, the group engages the services of competent third party advisers.

Changes in regulations are incorporated into the group's policies and procedures on a timely basis.

Results

The results for the year are shown in the Consolidated Income Statement on page 46.

Dividends

An interim dividend of 5.35p per share (2006: 4.85p) was paid on 2 January 2008 and your board is recommending a final dividend of 17.75p per share (2006: 15.30p), making a total dividend of 23.10p per share for the year (2006: 20.15p). The final dividend, if approved by shareholders at the Annual General Meeting ("AGM"), will be payable on 1 July 2008 to shareholders whose names appear on the register at the close of business on 6 June 2008.

AGM

This year's AGM will be held at the group's distribution facility in Coleshill, Birmingham on 20 June 2008 at 10.00am. The notice convening this meeting together with explanatory notes for the special business are set out in a shareholder circular which will be posted with the annual report and accounts and proxy voting papers. At the meeting resolutions will be proposed to renew the authority to issue shares without applying statutory pre-emption rights and to authorise the company to make market purchases of its own shares. Resolutions will also be proposed to introduce new long term executive incentive schemes and plans. Full details of these resolutions are provided in the Notice of Meeting.

Directors' Report *continued*

Share capital

The company's issued share capital comprised a single class of share capital which is divided into ordinary shares of 5p each. Details of the company's share capital are given in note 21 to the Financial Statements. During the year 40,700 new ordinary shares were issued under employee share schemes. The rights and obligations attaching to the company's ordinary shares are set out in the company's articles of association, copies of which can be obtained from Companies House in the UK or by writing to the Company Secretary. Subject to applicable statutes, shares may be issued with such rights and restrictions as the company may by ordinary resolution decide or, if there is no such resolution or so far as it does not make specific provision as the board may decide. Holders of ordinary shares are entitled to receive the company's Annual Report and Accounts to attend and speak at general meetings of the company to appoint proxies and to exercise voting rights. Holders of ordinary shares may receive a dividend and on a liquidation may share in the assets of the company. Subject to meeting certain thresholds, holders of ordinary shares may requisition a general meeting of the company or propose resolutions at AGM's. Voting rights for ordinary shares held in treasury are suspended and the treasury shares carry no rights to receive dividends or other distributions of assets.

There are no restrictions on the transfer of ordinary shares in the company other than:

- Certain restrictions as may from time to time be imposed by laws and regulations (for example insider trading laws), and
- Pursuant to the company's share dealing code whereby the directors and certain employees of the company require approval to deal in the company's shares.

None of the ordinary shares carry any special rights with regard to control of the company. The only restrictions on voting rights are those that apply to the ordinary shares held in treasury, as described above. Electronic and paper proxy appointments and voting instructions must be received by the company's registrars not later than 48 hours before a general meeting, or any adjournment thereof.

The company is not aware of any arrangements between shareholders that may result in restrictions on the transfer of ordinary shares or on voting rights. At the AGM of the company held on 25 May 2007, shareholders approved a resolution to permit directors to undertake market purchases of its own shares up to a maximum number of 13,066,500 ordinary shares of 5 pence each. The resolution remains valid until the conclusion of this year's AGM. It is the directors' intention only to exercise the authority to purchase the company's shares where it would continue to improve balance sheet efficiency. This power will only be used if the directors consider that to do so would be in the best interests of shareholders generally. The purchase of shares would be dependent on market conditions and

would also take into account the cash generated in the business and other investment opportunities that might arise over time. During the year ended 31 December 2007, the company made market purchases of 3,838,006 of its own shares of 5p for a total consideration of £21.69 million. Of these 1,756,478, 2% of the issued share capital with a nominal value of £87,824 were cancelled and 2,081,528, 2% of the issued share capital with a nominal value of £104,076 were held as treasury shares, of which 2,575 have been utilised to satisfy the exercise of SAYE share option awards. At 31 December 2007 2,078,953 were held as treasury shares, that being the maximum held during the year.

Substantial shareholdings

As at the last date prior to posting the Annual Report and Accounts, the company had been notified of the following holdings of voting rights attaching to the company's shares in accordance with the Disclosure and Transparency Rules:

	Ordinary shares of 5p each	% of share capital directly owned	% of share capital indirectly owned
Aberforth Partners LLP	4,163,928	0.00%	5.02%
Aegon UK			
Group of Companies	4,347,020	4.62%	0.37%
Aviva plc	4,343,469	3.35%	3.04%
AXA S.A.	7,003,815	0.10%	7.94%
Credit Suisse Asset Management Limited	6,605,674	7.91%	0.00%
Legal & General Investment Management Limited	4,201,896	4.41%	0.60%
Lloyds TSB Group Plc	5,017,503	0.00%	6.02%
Schroders plc	8,289,262	0.00%	9.52%

Directors and their interests

The names of the directors of the company at the date of this report and biographical details are given on page 22. A complete list of directors who served during the year is shown within the Remuneration Report on page 38. No other person has acted as a director of the company during the financial year ended 31 December 2007. The company's articles require that one third of the directors retire by rotation each year. Accordingly, Tony Brewer and Dick Peters retire by rotation and being eligible, offer themselves for re-election at the forthcoming AGM. In proposing their re-election, the board confirms to shareholders that following a formal performance evaluation each of these individuals' performance continues to be effective and they have expressed a willingness to continue in their roles.

David Grove was appointed to the board on 19 October 2007 and, in accordance with the company's articles of association, offers himself for election at the forthcoming AGM. He is also a member of the Audit, Remuneration and Nomination committees.

Directors' Report *continued*

David is the Executive Chairman of Hill & Smith Holdings PLC and Chairman of Grove Industries Limited. He has held a number of senior management posts in a variety of businesses and the board believes that his business knowledge and financial and management expertise will be a positive contribution as the group continues to develop. In accordance with the recommendations of the Combined Code relating to non-executive directors, the board believes that David Grove should be elected and makes such a recommendation to shareholders.

Details of directors remuneration and service contracts are set out on pages 37 and 38. The beneficial interests of the directors and their immediate families in the company's shares and their interests in share options are detailed on page 39. No director had, at any time during the period under review, a material interest in any contract with the company or any of its subsidiaries.

Directors' insurance

The company continues to maintain directors and officers liability insurance.

Political and charitable donations

The group's Charities Committee considers requests for charitable donations within set criteria. During 2007, in addition to donations made to overseas charities, the group contributed charitable donations to UK charitable organisations, principally to local organisations serving the communities in which we operate, of £19,174 (2006: £54,661) during the year. The board has maintained its policy of not making political donations.

Supplier payment policy

The group's policy with regard to the payment of suppliers is to agree the terms of payment as part of the conditions of supply of goods and services. The group seeks to strictly comply with these payment terms whenever it is satisfied that the supplier has provided the goods and services in accordance with the agreed terms and conditions. The payment policy has been and will continue to be developed to meet the group's specific requirements and is not based on any particular code or standard relating to payment practice. The number of creditor days of the company at 31 December 2007 was 43 days (2006: 40 days).

Employment, training and development

The board values two-way communication between senior management and employees on all matters affecting the welfare of the business, including regular management visits to operating units and through the intranet.

The group's annual report is made available to staff which provides employees with a greater awareness of the group's performance as well as the financial and economic factors that affect it. In addition, those employees who are eligible are also encouraged to become involved in the group's performance through participation in share schemes.

The group remains committed to providing a workplace that is safe and environmentally sound and which complies with applicable laws and regulations. The group expects employees to respect confidential information and company time and assets and believes in open and honest communication, fair treatment and equal opportunities. The group supports the fundamental principles of good governance.

It is the group's policy that employment opportunities, training, career development and promotion should be available to all, irrespective of age, gender, ethnic origin, religion or disability. Due consideration is given to applications for employment, having regard to the particular aptitudes and abilities of the applicants. Any employee who develops a disability during employment is given the opportunity to retrain for alternative employment where practicable, given the nature of the group's activities.

The group's human resources policies are available to all staff and include guidance on employment matters, ethics, equal opportunities, staff benefits and training and development.

It is the group's continued practice to maintain employee participation and involvement in matters which affect their interests. The group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the group. This is achieved through formal and informal meetings and through the annual and interim financial statements. Employee representatives are consulted regularly on a wide range of matters affecting their current and future interests.

Employee turnover remains low and as a result the employee base remains stable. The group is firmly committed to developing the potential of its people and regularly reviews its succession planning processes. Recruitment, training and development is designed to ensure the group has suitably skilled and qualified employees to meet the operational needs of the business and offer the opportunity for employees to develop and grow. Training is delivered primarily through internal resources with assistance from external providers on specialist subjects as and when required.

The group considers it important that its employees provide for their retirement and accordingly provides opportunities for them to participate in retirement plans.

Health, safety and environmental

The group provides and maintains a safe environment for all employees, customers and other visitors to its premises and the wider workplace. The group complies with the relevant health and safety legislation in the jurisdictions in which it operates. The group monitors its health and safety processes and seeks to make continual improvements. Guidance and solutions are provided to the operating businesses on all aspects of health and safety and serves to strengthen further the health and safety culture within the group. The system sets and closely monitors the achievement of standards for health and safety on all sites and during

Directors' Report *continued*

the year the average performance exceeded the benchmark standard set by the group. The board is committed to ensuring that the group's activities are carried out in accordance with relevant statutory provisions and all reasonable and appropriate measures are taken to avoid risk to employees or others who may be affected. Whilst management is committed to providing a safe working environment with the appropriate working practices and training this can only be achieved if employees equally give their commitment to a rigorous health and safety culture. During the year there were thirteen reportable accidents made to the Health and Safety Executive, none of which resulted in serious injury. There were no prosecutions for breaches of health and safety in the year. The group's health and safety policy and performance is regularly reviewed by the board. Further details are included on page 42 of the Corporate and Social Responsibility report.

Statement of Directors' Responsibilities

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 IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

The group and parent company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the group and the parent company and the performance for that period. The Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

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 judgments and estimates that are reasonable and prudent
- state whether they have been prepared in accordance with IFRSs as adopted by the EU and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that 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 1985. They 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 Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply 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.

Going concern

The group continues to place considerable emphasis on its budgeting and forecasting procedures and each month produces a forecast of trading and cash flow for the accounting period. Accordingly, the group continues to have in place all the procedures and information appropriate to the going concern assessment required by the Combined Code on Corporate Governance. Having reviewed the group's resources and a range of likely trading out-turns, the directors believe that they have reasonable grounds for stating that the group has adequate resources to continue in operational existence for the foreseeable future and that it is therefore appropriate to adopt the going concern basis in preparing its financial statements.

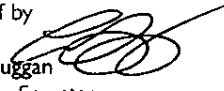
Disclosure of information to the auditor

In accordance with the provisions of section 234 ZA of the Companies Act 1985 the directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditor is unaware, and each of the directors has taken all steps that he ought to have taken as a director to make himself aware of any relevant audit information as defined and to establish that the company's auditor is aware of that information.

Auditor

KPMG Audit Plc has expressed its willingness to continue in office as auditor of the company and in accordance with the provisions of section 385 of the Companies Act 1985 a resolution for its re-appointment and to authorise the directors to agree its remuneration will be proposed at the forthcoming AGM. Auditor remuneration and fees paid during the year to 31 December 2007 are set out in note 3 to the Financial Statements.

This directors report has been approved by the board and signed on its behalf by


Geoff Duggan
Company Secretary
17 March 2008

Corporate Governance

The company is committed to the highest standards of corporate governance and save as set out on page 34, throughout the year ended 31 December 2007 the company complied with the principles set out in section 1 of the Combined Code on Corporate Governance adopted in July 2003 and as amended in 2006 ('the Code')

This statement explains our governance policies and practices and describes how the company has applied the principles and provisions of the Code

Directors' and board effectiveness

The board is collectively responsible for the success of the group. Its role is to provide entrepreneurial leadership within a framework of prudent and effective controls which enables risk to be assessed and managed, to set strategic aims ensure that the necessary financial and human resources are in place to meet its objectives and review management performance, to set the group's values and standards; and to ensure that its obligations to its shareholders and others are understood and met.

To help ensure the effective control of the group, the board has a number of items reserved for its sole consideration

- setting group strategy and approving an annual budget and medium term projections.
- reviewing operational and financial performance
- approving acquisitions, divestments and capital expenditure
- reviewing the group's systems of financial control and risk management.
- ensuring that appropriate management development and succession plans are in place
- reviewing the health and safety and environmental performance of the group
- approving appointments to the board and to the position of Company Secretary, and approving policies relating to directors' remuneration and the severance of directors' service contracts.
- ensuring that a satisfactory dialogue takes place with shareholders.
- approval of results announcements and the annual report and accounts
- setting and agreeing dividend policy
- approving and reviewing the group's treasury policy
- reviewing the group's approach to corporate governance and ensuring compliance with the listing requirements
- setting the group's policy with regards to corporate social responsibility

Further details of the board's role in relation to the group's systems of internal control and risk management are given on pages 33 and 34. A description of the specific responsibilities delegated to the principal board committees is given on pages 31 to 33.

As of 31 December 2007 the board comprised Graham Waldron Chairman, Tony Brewer, Group Chief Executive, Steve Wilson Group

Finance Director and three independent non-executive directors, Dick Peters, Mike O'Leary and David Grove. Mike O'Leary was the Senior Independent Director throughout the year. Biographical details of the current directors are given on page 22.

The board usually meets eight or nine times a year and normally includes at least one meeting at an operating business. During the year there are sufficient opportunities for the Chairman to meet with the non-executive directors without the executive directors being present should this be deemed appropriate.

Board balance and independence

For the majority of the year the board complied with the Code requirement that at least half the board excluding the Chairman, comprise non-executive directors determined by the board to be independent. The board did not comply during the period 25 May 2007 to 19 October 2007 following the resignation of Tom Anderson and prior to the appointment of David Grove. All of the non-executive directors are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. Each non-executive director possesses a wide range of skills and experience. The board will keep under review the size and structure of the board to ensure it is appropriate for the ongoing business.

Chairman and Group Chief Executive

The roles and responsibilities of the Chairman and Group Chief Executive are clearly divided, set out in writing and periodically reviewed by the board. Whilst collectively they are responsible for the leadership of the group, the Chairman's primary responsibility is for leading the board and ensuring its effectiveness and the Group Chief Executive is responsible for implementing strategy, running the businesses in accordance with the objectives and policies agreed by the board and for the executive management of the group.

The other significant current commitments of the Chairman are listed in his biography on page 22 and the board is satisfied that his existing commitments do not unduly restrict his availability to the group.

Board information, induction, training and professional development

The board has a forward rolling business agenda which is regularly updated to include specific topics that directors have requested for review at future meetings. The board reviews the key activities of the business receiving papers and presentations from senior management and external advisers to enable it to do so effectively. The board receives regular reports from the executive management covering a broad range of issues including health safety and environmental matters, finance and operational performance, risk management, business development initiatives, special projects, legal and regulatory developments, governance and best practice guidelines that affect the group. The Company Secretary is responsible to the board and is available to individual directors in respect of board procedures. In conjunction with the

Corporate Governance *continued*

Chairman the Company Secretary ensures that information distributed to the board is sufficient, clear and accurate that it is circulated in a timely manner and is appropriate to enable the board to discharge its duties. Comprehensive briefing papers are generally provided to all directors one week before board meetings.

On joining the board a director receives a comprehensive induction pack which includes background information about the group and its directors details of board meeting procedures, directors responsibilities, procedures for dealing in company shares and a number of other governance-related issues. The director meets with the Group Chief Executive to be briefed on the general group strategy encompassing visits to group businesses. External training, particularly on matters relating to the role of a director and the role and responsibilities of board committees, is arranged as appropriate. Ongoing training is provided as and when necessary and may be identified in annual performance reviews or on an ad hoc basis. The suitability of external courses is kept under review by the Company Secretary. Training and development of directors in the year took various forms including visits to group businesses, with the Group Chief Executive, attendance by certain directors at courses run by professional bodies and solicitors attendance at external training sessions and seminars on matters relevant to members of the audit and remuneration committees and workshops run by external bodies on various commercial and regulatory matters. Directors receive regular updates appropriate to the business throughout the year and the company provides resources for directors to develop and refresh their knowledge and capabilities as required. All directors are suitably qualified, trained and experienced so as to be able to participate fully in the work of the board.

To assist with the independent conduct of their function, the non-executive directors are able to obtain professional advice at the company's expense, if required in connection with their duties, and a process is in place to facilitate this. In addition all directors have access to the services of the Company Secretary. The group maintains appropriate directors' and officers' liability insurance cover.

Board appointments and performance evaluation

There is a formal and transparent procedure for the appointment of new directors to the board. This is described in the section on the Nominations committee below. The non-executive directors are initially appointed for a three-year term and, subject to review and re-election, can serve up to a maximum of three such terms. During the year using an in-house process, the board conducted a formal evaluation of its own performance and that of its committees and individual directors, including the Chairman involving the completion of a questionnaire. No actions were considered necessary as a result of the evaluations. The board intends to conduct a further evaluation of its performance during 2008 with the aim of continually improving processes, procedures and performance.

The schedule of matters reserved for the board, statements outlining the roles of the Chairman and Group Chief Executive, the terms of reference of the committees and other policy statements are periodically reviewed as part of the evaluation process.

The Chairman communicates frequently with the non-executive and executive directors. Directors are also encouraged to discuss any issues or concerns with the Chairman at any time throughout the year and ensure that any unresolved issues are formally minuted.

Director re-election

All directors are subject to election by shareholders at the first AGM following their appointment by the board. Under the articles of association of the company each of the directors is required to retire by rotation at least once every three years. Details of the directors retiring and seeking re-election at an AGM are given to shareholders in the Notice of Meeting.

Accountability and audit

The statement of the responsibility of directors for the preparation of the Directors' Report and the accounts under adopted IFRS is set out on page 28. The directors' confirmation that they consider it appropriate to prepare the accounts for 2007 on a going concern basis is given on page 28.

Communication with shareholders

In its reporting to shareholders, the board aims to present a balanced and understandable assessment of the group's financial position and prospects and this is outlined in the Business Review. The company reports formally to shareholders twice a year when its half year and full year results are announced and an interim and a full year report is issued to shareholders. There are regular institutional, analyst and media presentations which cover strategy, trading and market conditions. The company seeks to present an accurate and objective view in a manner appropriate for the intended audience. Contact with the major shareholders is principally maintained by the Group Chief Executive and Group Finance Director. The Chairman ensures that the views of shareholders are communicated to the board as a whole. The board is provided with a summary of the feedback from broker and shareholder meetings on a six-monthly basis. The Group Chief Executive and Group Finance Director have met with the company's brokers during the year to ensure they are aware of the current views of major shareholders and of any material issues they may have. These reports include summaries prepared by the company's brokers on the market's reaction to results announcements and the subsequent meetings between management and investors. External brokers' reports on the company are circulated to all directors. The Senior Independent Director and the other non-executive directors are invited to attend presentations to analysts and shareholders in particular the annual and interim results presentations. No specific meetings were requested by shareholders with the non-executive directors during the year.

Corporate Governance *continued*

All directors normally attend the AGM and shareholders are invited to ask questions during the meeting and to meet with directors after the formal proceedings have ended. The group seeks to present an accurate, objective and balanced picture in its annual and interim reports, trading statements, results presentations and city announcements in a style and format which is appropriate to the intended audience. Copies of annual and interim reports are available on its website. The notice of the meeting and related papers are sent to shareholders at least twenty-one clear days before the meeting, and separate resolutions are proposed on each substantial issue. Shareholders at the meeting are advised as to the level of proxy votes received, including the percentage for and against each resolution together with the level of abstentions following each vote on a show of hands. The company issues a market announcement after the conclusion of the AGM setting out the voting results of the various resolutions and details are made available on the company's website.

Details of the 2008 AGM are set out in the Notice of Meeting in a separate circular issued to shareholders, along with details of the facilities available for proxy votes to be cast electronically. The company offers shareholders the right to withhold their vote, if they so wish, in line with best practice.

Board committees

The terms of reference of the following board committees are available upon request.

Audit committee

At 31 December 2007, membership of the Audit committee comprised Dick Peters (Chairman), Mike O'Leary and David Grove. Each of these directors is non-executive and regarded by the board as independent. The board has determined that Dick Peters has recent and relevant financial experience. Only members of the committee are entitled to be present at meetings; however the auditor, Chairman, Group Chief Executive and Group Finance Director attend meetings by invitation. The company does not have a formal internal audit function, considering that one is not appropriate; however the Finance Director for Operations reports to the Group Finance Director and has access to the Chairman of the committee. The committee members, all other directors and senior management have direct access to the external auditor throughout the year to seek advice or raise any issues or concerns.

The committee monitors the integrity of the company's financial statements and the effectiveness of the external audit process. It is responsible for ensuring that an appropriate relationship between the company and the external auditor is maintained, including reviewing non-audit services and fees and makes recommendations to the board on the appointment, re-appointment or dismissal of the external auditor. It also reviews the group's systems of internal control and the processes for monitoring and evaluating the risks facing the group on an ongoing basis. The committee periodically reviews its terms of reference and its effectiveness and recommends to the board any changes required as a result of such review.

The committee has an agenda linked to events in the group's financial calendar, normally meeting at least twice a year, including meetings before the annual and interim results announcements. The committee met three times in the year, members' attendance record being given on page 33. All of the committee members attended the meetings that they were eligible to attend. The committee has authority to investigate any matters within its terms of reference, to access resources, to call for information and to obtain external professional advice at the cost of the company.

At each meeting there is an opportunity for the external auditor to discuss matters with the committee without any executive management being present. The committee has independent access to the external auditor who has direct access to the Chairman of the committee outside formal committee meetings. The Audit committee has the specific task of keeping under review the nature and extent of non-audit services provided by the external auditor in order to ensure that objectivity and independence are maintained. The external auditor has in place processes to ensure its independence is maintained, including safeguards to ensure that, where it does provide non-audit services, its independence is not compromised. It has written to the audit committee confirming that, in its opinion, it is independent.

During the 2007 financial period the Audit committee discharged its responsibilities by:

- reviewing the group's draft 2006 preliminary annual results announcement and financial statements and 2007 interim results statement prior to board approval, including consideration of the significant accounting judgments contained therein and reviewing the external auditors' detailed reports thereon
- reviewing the group's trading update announcement prior to release at the AGM
- reviewing the consistency of and any changes to the group's accounting policies, the application of appropriate accounting standards and methods used to account for significant or unusual transactions
- reviewing regularly the potential impact on the group's financial statements of certain matters such as impairment of asset values and employee benefits
- reviewing the effectiveness of the 2006 external audit process and recommending to the board, after due consideration, the reappointment of the incumbent external auditor at the AGM
- reviewing the application of the board's policy on non-audit work performed by the group's external auditor together with the non-audit fees payable to the external auditor in 2006
- reviewing the external auditors' plan for the audit of the group's 2007 accounts, which included key areas of focus, key risks on the accounts, confirmations of auditor independence and the proposed audit fee and approving the terms of engagement for the audit.

Corporate Governance *continued*

- reviewing reports from the external auditor on the group's systems of internal control in advance of the announcement of the group's results for 2006 (the internal report included a summary of and commentary on the business risks and internal control processes) and reporting to the board on the results of this review and reviewing interim updates prior to the interim results.
- receiving regular updates from management on key financial control matters arising in the group
- considering the appropriateness of an internal audit function

During the year the committee reviewed the scope and programme of work to be undertaken by the external auditor; considered the independence and objectivity of services provided and reviewed the level of fees paid for those services. Whilst KPMG have been an external auditor to the group since 1991, there is a procedure in place for the audit partner to change every five years, so maintaining objectivity and independence without the need to change firms. The last such a change took place during 2007.

Resolution 6 set out in the Notice of AGM recommends that shareholders re-appoint KPMG Audit Plc as the group's auditor and resolution 7 authorises the directors to determine their remuneration.

When appointing advisers for non-audit work, the group considers the value for money, experience and objectivity required and in this respect it has used Deloitte & Touche to conduct non-audit tax work. The committee recognises that there are occasions when it is advantageous to use the external auditor to undertake non-audit services, when they are best placed to do so. The committee operates under a formal policy approved by the board to help ensure the independence and objectivity of the external auditor is not compromised. The policy states that non-audit fees paid to the principal external auditor should not exceed 250% of the audit fee except in the case of significant events. The Chairman of the committee is required to authorise non-audit work above a pre-agreed threshold. Note 3 to the group accounts provides a breakdown of 2006 and 2007 audit and non-audit fees. In 2007 the non-audit services provided by the external auditor was well below the pre-agreed threshold, being predominantly in respect of the winding up or liquidation of non-trading subsidiary companies.

Remuneration committee

Details of the Remuneration committee, including membership are set out in the Remuneration Report on pages 35 to 40, which should be read in conjunction with this report.

Nominations committee

During the year the Nominations committee consisted of the non-executive directors and the Group Chief Executive under the Chairmanship of Mike O'Leary. Appointments to the committee are made by the board. The committee leads the process for identifying and makes recommendations to the board on candidates for appointment

as directors of the company and as Company Secretary, giving full consideration to succession planning and the leadership needs of the group. It also makes recommendations to the board on the composition and chairmanship of the Audit and Remuneration committees. It keeps under review the structure, size and composition of the board, including the balance of skills, knowledge and experience and the independence of the non-executive directors, and makes recommendations to the board with regard to any changes. The committee meets periodically when required. Members' attendance record at meetings of the committee in 2007 is given below. Only members of the committee are entitled to be present at meetings but others may be invited by the committee to attend. The board has agreed the procedures to be followed by the Nominations committee in making appointments to the various positions on the board and as Company Secretary. The committee has access to such information and advice both from within the group and externally, at the cost of the company, as it deems necessary. This may include the appointment of external executive search consultants, where appropriate. The procedures referred to above were used in the appointment during 2007 of David Grove as a non-executive director. This included an assessment of the time commitment expected from the director. Independent executive search consultants were not used in connection with the appointment. No director is involved in any decisions regarding their appointment. The committee performed the above activities as necessary in 2007.

All non executive directors are appointed for an initial three year term pursuant to a standard letter of appointment, which is available for viewing at the company's registered office during normal business hours or at the AGM.

The committee ensures that newly appointed directors receive a full induction and when considering the re-appointment of directors ensures that the board has an appropriate balance of skills, knowledge and experience. Items discussed by the committee during the year to enable it to discharge its duties in accordance with its terms of reference included:

- the size, structure, composition and skills of the board membership
- the consideration of potential candidates submitted by members of the board regarding the appointment of an independent non-executive director
- the proposal to re-elect Tony Brewer and Dick Peters under the retirement by rotation provisions
- the board and board committee evaluation process.

The committee in conjunction with the board receives updates from the Group Chief Executive on succession and development planning for senior positions within the group. Changes to directors' commitments are reported to the committee as they arise and are considered on their individual merits. There were no significant changes to any of the directors' external commitments during the year.

Corporate Governance *continued*

Directors' attendance record

The attendance of directors at relevant meetings of the board and of the Remuneration, Audit and Nominations committees held during 2007 was as follows.

	Board meetings	Remuneration	Committee meetings Audit	Nominations
Number of meetings in the year	8	2	3	4
Number attended by each member				
Graham Waldron	8	*	*	*
Tony Brewer	8	*	*	4
Stephen Wilson	8	*	*	*
Tom Anderson (resigned 25 May 2007)	3	1	1	2
Dick Peters	8	2	3	4
Mike O'Leary	8	2	3	4
David Grove (appointed 19 October 2007)	2	1	1	—

*Executive directors do not attend these meetings unless invited to do so by the committee Chairman

Risk management and internal controls

The board is ultimately responsible for establishing and maintaining the group's systems of internal control and for reviewing their effectiveness.

The board confirms that it has established procedures necessary to comply with the Code to implement the guidance on internal control issued by the Turnbull Committee and is reporting in accordance with that guidance

The board is responsible for ensuring that the group maintains systems of internal controls, including internal financial control, operational and compliance controls and risk management systems and for monitoring the effectiveness of these controls. Meetings of the board and the Audit committee ensure that risk management and internal control are considered on a regular basis throughout the year and are subject to continuous review and development. This includes consideration of corporate social responsibility matters.

The systems are designed to meet the group's particular needs and to manage, rather than eliminate, the risks to which the businesses are exposed. By their nature, they provide only reasonable and not absolute assurance against material misstatement or loss. The board considers that the measures taken, including physical controls, segregation of duties and reviews by management, provide sufficient and objective assurance.

During the year the board maintained its process of hierarchical reporting and review in order to evaluate the effectiveness of the group's systems of financial and non-financial controls. The group has developed a comprehensive series of operating and financial control

procedures which are applied at all businesses and the group finance team performs annual reviews to verify that the businesses are complying with the prescribed operating and financial control procedures. In addition, the board reviews the group's high level internal controls and risk management arrangements. Furthermore, the Audit committee receives reports from the external auditor on matters identified in the course of its statutory audit work.

These procedures provide a documented and auditable trail of accountability, the results of which are periodically reviewed by management for completeness and accuracy. These procedures allow for successive assurances to be given at increasingly higher levels of management through to the board. Planned corrective actions are monitored for timely completion. Having reviewed its effectiveness, the directors are not aware of anything in the group's systems of control during the period covered by this report and accounts which could render them ineffective. There were no changes in the group's internal controls or financial reporting that have materially affected, or are reasonably likely to affect, the group's systems of internal control.

The group operates a comprehensive planning system including detailed reviews at all subsidiary undertakings, together with formal reviews and approval of annual plans by the board. Actual performance is reported on a monthly basis measured against plan and prior year, including a detailed explanation of major variances. The company and its subsidiary undertakings have implemented control procedures designed to ensure complete and accurate accounting for financial transactions and to limit the potential exposure to fraud. The group has clearly defined guidelines for capital expenditure and investment appraisal. These include annual

Corporate Governance *continued*

plans, detailed appraisal and review procedures, levels of authority and due diligence requirements when businesses are acquired. Any acquisition or disposal of a business needs formal board approval. The board reports that full procedures are in place to achieve compliance with the internal control aspects of the Code for the next financial period.

The output of these reviews form an important element of management reporting and a process is in place for monitoring the achievement of action plans together with the identification of new and emerging risks. An ongoing process of risk management and internal control in accordance with the Code has been in place for the financial year under review and up to the date of this report. The group views the careful management of risk as a key managerial activity in delivering business opportunities. The ethos of the group, delegation of responsibility and other control procedures together with accounting policies and procedures are communicated through the group and laid out in the group procedures manual which is periodically updated.

The objective of the group's risk management processes is to ensure sustainable development throughout the conduct of its business in a way which

- satisfies its customers
- maintains proper relationships with suppliers and contractors
- protects against losses from unforeseen causes
- provides a safe and healthy workplace
- develops environmentally friendly processes
- minimises the cost and consumption of increasingly scarce resources
- prevents pollution and waste
- maintains a positive relationship with the communities in which it does business

A high standard of health and safety management is promoted at all levels within the group. The group's health and safety approach is supported by training programmes at operating businesses, group health and safety rules and monitoring and auditing to promote a high level of awareness and commitment. Individual businesses are assessed on a periodic basis, and remedial solutions implemented where necessary. Line management retain the responsibility for completion of action plans with progress being monitored and reported.

The Audit committee meets at least twice a year and in accordance with its terms of reference, reviews the effectiveness of the group's systems of internal control. In accordance with the Code the board has undertaken an assessment of the need for a group internal audit function. The board considers that the control systems and procedures undertaken by the group are adequately performed by management and therefore does not currently propose to introduce a group internal audit function but will keep the matter under review.

The integrity and competence of personnel is assessed during the recruitment process and monitored throughout employment. Ethical standards expected of personnel are laid out in the group procedures manual.

The system for monitoring risks is continuous and an ongoing process throughout the year. Principal risks and uncertainties are set out on pages 24 to 25 of the Directors Report.

This process has identified a number of risks where action plans have been developed to eliminate, minimise or mitigate these risks (including the use of insurance where appropriate). The board has not identified or been advised of any significant failings or weaknesses where action has not been taken which might have a material impact on the business.

Compliance with the Combined Code

The group was in compliance with the relevant provisions of the Code throughout 2007, except with regard to the following aspects:

The Code provision A3.2 states that except for smaller companies, at least half of the board, excluding the Chairman, should comprise non-executive directors determined by the board to be independent. The Code provisions B2.1 and C3.1 state that the board should establish both an Audit and a Remuneration committee of at least three, or in the case of smaller companies, two members who should all be independent non-executive directors. The group complied with these provisions up until the resignation of Tom Anderson on 25 May 2007 and again from the appointment of David Grove on 19 October 2007. The Code provision D1.1 states that the Senior Independent Director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders. Whilst the opportunities exist, such meetings do not currently take place. However the executive directors are fully aware of the issues and concerns of the major shareholders and share these with the board twice a year following the announcement of interim and full year results.

This directors report has been approved by the board and signed on its behalf by


Geoff Duggan
Company Secretary
17 March 2008

Remuneration Report

Introduction

This report, which will be submitted to the forthcoming AGM for approval describes the group's remuneration policy as it applies to directors and senior executives and provides detailed disclosures in relation to directors' remuneration. It explains how the company has applied the principles of the Combined Code on Corporate Governance that relate to directors' remuneration during the period and has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 which require that part of the information set out in this report on pages 38 to 40 are subject to audit.

No director is involved in the determination of, or votes on any matter relating to their own remuneration.

Composition and role of the Remuneration committee

The board of directors is responsible for executive remuneration policy. It has established a Remuneration committee which is chaired by Mike O'Leary and is comprised of the non-executive directors. Mike O'Leary and Dick Peters were members of the committee throughout 2007, Tom Anderson until May 2007 when he resigned from the board and David Grove became a member when he joined the board in October 2007. The non-executive directors have no personal financial interest, other than as shareholders, in matters to be decided, no potential conflicts of interest and, as independent non-executive directors, no day to day involvement in running the business. The biographical details for each of the committee members are shown on page 22. Details of members' attendance at the meetings of this committee are shown in the report on Corporate Governance on page 33 and directors' shareholdings are shown later in this report on page 39. The remuneration of the non-executive directors is the responsibility of the other board members.

The committee has written terms of conditions that set out its responsibilities. These include the following:

- recommending to and agreeing with the board the policy and framework for executive remuneration
- agreeing the terms and conditions of employment for the executive directors including their individual annual remuneration and pension arrangements
- agreeing the targets for any performance related bonus and share schemes
- agreeing the remuneration of the Chairman of the board (which is done in his absence)
- ensuring that on termination, contractual terms and payments are fair both to the company and to the individual so that failure is not rewarded and that the duty to mitigate loss is recognised and
- agreeing the terms of reference of any remuneration consultants it may appoint.

The committee has access to advice provided by the Group Chief Executive, Company Secretary and external consultants. During 2007 the committee sought information from a wide variety of published sources, and members attended seminars on the subject, to assist in the formulation of the committee's recommendations and in respect of retirement benefits and non-executive directors' fees. The committee did not however make any specific appointments in sourcing such information.

Remuneration policy

Framework and policy on executive directors' remuneration

The group's remuneration policy is designed to provide competitive reward for its executive directors and other senior executives. The policy takes into account the company's performance, the markets in which the group operates and pay and conditions elsewhere in the group with the objective of providing remuneration packages that whilst challenging and competitive in both commercial and human terms, will retain and continue to motivate talented people in the business and enable the recruitment of appropriately skilled and experienced individuals.

The committee aims to achieve a balance between fixed and variable elements for each executive director. Remuneration packages for each executive director are reviewed annually. A significant proportion of the potential remuneration is dependent on the attainment of performance objectives, both through the annual bonus scheme and through participation in share incentive schemes. Participation in share incentive schemes are designed to align the interests of executive directors and other senior executives with the longer term interests of shareholders by rewarding them for delivering increased shareholder value.

The Remuneration committee, through the executive directors and Company Secretary, seeks the views of the company's principal shareholders as necessary. In determining the level of base salaries and the annual performance related bonus scheme, the committee takes into consideration the potential maximum remuneration that executives could receive.

During the year the committee reviewed the executive remuneration policy. When considering executive remuneration for 2008, the committee took account of the forthcoming expiry of the company's ten year authority to operate the existing executive approved and unapproved share option schemes. The directors are seeking authority at the AGM in June 2008 for the adoption of a new HMRC approved discretionary share option scheme and a new non-HMRC approved discretionary share option scheme which are intended to replace the existing schemes. The directors will additionally be seeking shareholders' authority to adopt a performance share plan.

Remuneration Report *continued*

and a co-investment plan, further detail in respect of which is given below. A circular is attached to the Annual Report and Accounts providing an explanation of how it is proposed that the schemes will operate and a summary of the principle terms of the schemes together with a description of their intended application with regard to executive directors' remuneration benefits in 2008.

With regard to the other components of executive directors' remuneration, only minor changes are proposed in 2008 and these are covered in that section of this report.

The total emoluments of the executive directors are disclosed on page 38.

Components of remuneration

Basic salary

The committee seeks to establish a basic salary for each executive director and other senior executives determined by individual performance and having regard to market salary levels for similar positions in comparable companies by reference to independent sources. Basic salary, which is the only element of remuneration that is pensionable, is reviewed annually on 1 January.

Annual performance bonus

The committee reviews the bonus scheme at the beginning of each year to ensure that it remains competitive in the marketplace, continues to incentivise the executive directors and other senior executives. The scheme focuses on annual objectives and links individual performance with business targets. The financial targets are calculated by reference to the extent to which the group's profit before taxation exceeds the planned target. The Remuneration committee establishes the objectives that must be attained each financial year if a bonus is to be paid. If the performance target is not achieved, the bonus is not normally payable. However, the Remuneration committee has discretion to award part payment if circumstances are considered appropriate. The committee takes account of the relative success of the group's performance for which the executive directors are responsible and the extent to which strategic objectives are being attained. A maximum bonus of 150% of basic salary is payable for achievement of performance related targets including over performance. The performance related components of remuneration for executive directors and executive management are paid in March following the completion of the annual audit. Details of the payments to directors are included in the directors' emoluments for the year on page 38.

Executive share option schemes (ESOS) and Long term incentive scheme (LTIS)

As stated above, the company's ten year authority to operate the existing executive approved and unapproved share option schemes is due to expire in 2008. No new options were granted in 2007, the most recent grant of options made under these schemes being in 2005, details of options granted to executive directors being shown on page 39. Subject to the extent that performance conditions are satisfied, options granted under the existing ESOS become exercisable three years after the date of grant and remain so until the tenth anniversary of grant in respect of the approved scheme and the seventh anniversary of grant in respect of the unapproved scheme. Performance conditions are based on the extent to which growth in the group's earnings per share (EPS) exceeds growth in the Retail Prices Index (RPI) over a three-year performance period. EPS is calculated as fully diluted earnings per share. The committee believes that this method of calculating EPS provides an objective, independent and verifiable measure of the group's performance. In respect of each grant of options under the approved scheme, the committee has determined that, for the option to be exercisable, EPS growth must exceed RPI growth by 3% pa or more over the three year performance period. In respect of each grant of options under the unapproved scheme, the committee has determined that, for options up to one times eligible earnings to be exercisable, EPS growth must exceed RPI growth by 3% pa or more over the three year performance period and by 5% or more over the three year performance period for options granted of between one times and two times eligible earnings. Options granted prior to 2004 under the ESOS permitted the group's EPS to be measured annually for a further two years from the date of grant of the options with the performance conditions increasing proportionately. Having reviewed market practice regarding the retesting of performance measures, the committee removed this element in respect of all option grants from January 2004. The committee continues to believe that, in relation to the ESOS, EPS growth in excess of RPI growth is the most appropriate measure for determining the increase in value delivered to shareholders by the company's executive directors and other senior executives. The committee reviews the appropriateness of the performance measure and the specific targets set when considering each new grant of options. The committee has agreed that no further grants of options will be made under the existing ESOS.

With the forthcoming expiry of the existing schemes the committee has undertaken a review of the share incentive arrangements. As a result of this review, the directors are seeking shareholder authority

Remuneration Report *continued*

to replace the existing schemes and to adopt a performance share plan and a co-investment plan. Summaries of the main terms of the new schemes and plans are contained in an appendix to the circular that is to accompany the Annual Report and Accounts sent to shareholders.

Pension

Details regarding the executive directors' participation in a non-contributory final salary pension plan are given on page 40.

Other employment benefits

In common with other senior management, executive directors are entitled to a range of benefits including a company car, private fuel, life assurance cover and private medical insurance. They are also eligible to participate in the company's Inland Revenue-approved sharesave scheme which is open to all eligible employees on the same basis, providing a long-term savings and investment opportunity.

Service contracts

It is the company's policy for the notice period in executive directors' service contracts not to exceed one year. The executive directors' service contracts have no fixed term but provide that either the director or the company may terminate the employment by giving one year's written notice and that the company may pay compensation in lieu of notice. The company recognises however that it may be necessary in the case of new executive appointments to offer an initial longer notice period, which would subsequently reduce to one year after the expiry of that period. All future appointments to the board will comply with this requirement.

The Chairman does not hold a service contract and does not participate in the company's executive share schemes, incentive plans or pension schemes. Additionally, he is not a member of the various committees of the board.

External appointments of executive directors

The board believes that experience of other companies' practices and challenges is valuable both for the personal development of its executive directors and for the company. It is therefore the company's policy to allow each executive director to accept one non-executive directorship of another company, although the board retains the discretion to vary this policy. Fees received in respect of external appointments are retained by the individual director. Fees received in 2007 in respect of non-executive appointments by Graham Waldron and Steve Wilson were £50,000 and £44,000 respectively.

Non-executive directors

The board determines the fee paid to non-executive directors. The fees are set in line with prevailing market conditions and at a level which will attract individuals with the necessary experience and ability to make a significant contribution to the group's affairs. The fees were reviewed during the year taking into account not only the need to attract individuals of the right calibre and experience, but also their increased responsibilities and time commitment, as envisaged in the Combined Code. As part of the review, the board received survey and other information from a variety of sources. With effect from 1 January, annual fees were increased from £33,500 to £35,000, with an additional £5,000 being paid to the respective chairmen of the Audit and Remuneration committees. Non-executive directors are not involved in any discussion or decision about their own remuneration. The aggregate limit for fees paid to non-executive directors is laid down in the articles of association. The non-executive directors do not participate in any of the company's share schemes, incentive plans or pension schemes, nor do they have service agreements. They are appointed for an initial period of three years by letter of appointment which is terminable by either party subject to one month's notice for which no compensation is payable. At the end of the initial period, the company discusses with the non-executive director whether they wish to renew their appointment and whether it is in the best interests of the company for their appointment to be renewed. Such renewal would normally be for a further period of three years (subject to termination as aforesaid). Non-executive directors are typically expected to serve two three-year terms, although the board may invite them to serve for an additional period.

Non-executive directors' appointment dates are shown on page 38.

Remuneration Report *continued*

The remuneration report from page 35 to page 37 up to this statement, has not been audited. With the exception of directors' interests in shares on page 39, from this point until the end of the report on page 40 the disclosures have been audited by the company's auditor KPMG.

Performance graph

The above graph has been included to meet the requirements of Schedule 7a of the Companies Act 1985. It shows the group's performance for the five year period to 31 December 2007 measured by total shareholder return ('TSR'), compared with the performance of the FTSE 250 index also measured by TSR, which is defined as share price growth, plus re-invested dividends. The FTSE 250 index has been chosen because it provides a basis for comparison against companies in a relevant broad based equity index in which the group is a constituent member.

Directors' emoluments

Details of directors' emoluments for the year ended 31 December 2007 are set out below:

	Salary and fees		Benefits		Performance related pay		Total	
	2007 £000	2006 £000	2007 £000	2006 £000	2007 £000	2006 £000	2007 £000	2006 £000
Executive								
Tony Brewer	495	450	31	26	659	644	1,185	1,120
Steve Wilson	358	325	46	46	487	476	891	847
Graham Waldron	110	100	20	21	—	—	130	121
Non-executive								
Tom Anderson (i)	16	37	—	—	—	—	16	37
Roger Dickens (ii)	—	3	—	—	—	—	—	3
David Grove (iii)	7	—	—	—	—	—	7	—
Trevor Larman (iv)	—	31	—	—	—	—	—	31
Mike O'Leary (v)	37	26	—	—	—	—	37	26
Dick Peters	39	37	—	—	—	—	39	37
	1,062	1,009	97	93	1,146	1,120	2,305	2,222

(i) Tom Anderson resigned from the board and retired on 25 May 2007.

(ii) Roger Dickens resigned from the board on 29 January 2006.

(iii) David Grove was appointed on 19 October 2007.

(iv) Trevor Larman resigned from the board and retired on 1 June 2006.

(v) Mike O'Leary was appointed on 1 March 2006.

Remuneration Report *continued*

Benefits are in respect of all taxable benefits arising from employment by the company including the provision of a company car, private fuel, life assurance cover and private medical insurance. Pension benefits and gains made by executive directors in respect of share options are excluded from the table above. The aggregate amount of gains made by executive directors on the exercise of share options was £nil (2006 £11,714).

Directors' interests in shares

The following tables below show the beneficial interests of the directors, and their connected persons who held office at the end of the year in the ordinary shares of the company and the interests in the company's share schemes.

	Shareholdings at 31 December 2007	Shareholdings at 31 December 2006
Executive Directors		
Graham Waldron	310,638	481,463
Tony Brewer	443,874	443,874
Steve Wilson	336,433	336,433
Non-executive Directors		
Dick Peters	5,000	5,000
Tom Anderson	—	4,000
David Grove	10,000	—

At 17 March 2008 the interests in shares of the directors were unchanged from those at 31 December 2007.

Directors' interests in share option schemes

Executive schemes

During 2006 an option held under the 2002 savings related share option scheme was exercised details of which are shown in note 5 to the Financial Statements.

Details of options held by executive directors are set out below a description of which is given on page 36.

	Options held at 1 January 2007	Options granted during the year	Options exercised during the year	Options held at 31 December 2007	Exercise price (pence)	Date from which exercisable	Expiry date
Tony Brewer							
1998 USOS (i)	342,858	—	—	342,858	420.00	Aug 2008	Aug 2012
1998 ESOS (ii)	7,142	—	—	7,142	420.00	Aug 2008	Aug 2015
Sharesave (iii)	8,337	—	—	8,337	197.00	Jan 2008	Jun 2008
Steve Wilson							
1998 USOS (ii)	242,858	—	—	242,858	420.00	Aug 2008	Aug 2012
1998 ESOS (ii)	7,142	—	—	7,142	420.00	Aug 2008	Aug 2015
Sharesave (iii)	8,337	—	—	8,337	197.00	Jan 2008	Jun 2008
Graham Waldron							
Sharesave (iii)	2,331	—	—	2,331	401.00	July 2009	Jan 2010

(i) Headlam Group Unapproved Executive share option scheme 1998 (1998 USOS)
Details of the operation of the scheme are provided on page 36.

(ii) Headlam Group Approved Executive share option scheme 1998 (1998 ESOS)
Details of the operation of the scheme are provided on page 36.

(iii) Headlam Group Sharesave scheme 2002 (Sharesave)

The company operates an Inland Revenue approved all-employee savings-related share option scheme in the UK. The scheme is designed to provide a long term savings and investment opportunity for employees and is described on page 36.

The closing price of a Headlam Group plc ordinary share on the last trading day of 2007 (31 December) was 432.00 pence. The range during the year was 634.00 pence (high) and 430.00 pence (low).

Remuneration Report *continued*

Pension benefits

Tony Brewer and Steve Wilson participate in the group's defined benefit pension scheme which provides benefits at a normal retirement age of fifty five based upon pensionable service and basic pay bonus being excluded. The maximum pension payable under the scheme is two-thirds of final pensionable pay subject to Inland Revenue limits. There are lump sum death-in-service benefits and pension provisions for members dependents.

Details of executive directors' pension benefits for the year ended 31 December 2007 are shown below.

	Increase in accrued pension during the year £000pa	Transfer value of increase £000	Accumulated accrued pension at 31 December 2007 £000pa	Change in accrued pension over the year £000pa	Accumulated accrued pension at 31 December 2006 £000pa
Tony Brewer	5	82	55	6	49
Steve Wilson	4	86	70	6	64

The increase in accrued pension entitlement is the difference between the accrued benefit at the year end and that at the previous year end. Transfer values have been calculated on the basis of actuarial advice consistent with Actuarial Guidance Note GN11. The increase in the transfer value is the increase in the value of accrued benefits during the year. The transfer value of the increase in accrued benefits, required by the listing rules, discloses the current value of the increase in accrued benefits that the director has earned in the period, whereas the change in the transfer value, required by the companies act, discloses the absolute increase or decrease in the transfer value and includes the change in value of the accrued benefits that result from market volatility affecting the transfer value at the beginning of the year, as well as the additional value earned in the year.

	Transfer value of accrued pension at 31 December 2007 £000	Change in transfer value over the year £000pa	Transfer value of accrued pension at 31 December 2006 £000
Tony Brewer	933	150	783
Steve Wilson	1,555	205	1,350

This report has been approved by the Remuneration committee and signed on its behalf by



Geoff Duggan
Company Secretary
17 March 2008

Corporate and social responsibility

Introduction

Our commitment to Corporate Social Responsibility ('CSR') is included within our group procedures manual which sets out our undertaking to act ethically and responsibly in all of our business dealings with stakeholders and includes our ethics, fraud and whistle-blowing policies which are communicated to employees. We do not permit bribery, anti competition or corrupt practices in any dealings. We are committed to continuous improvements in all aspects of CSR – our policies, our systems, our performance and our reporting. Our management structure allows the consideration of social and environmental factors by both individual businesses within the group and also at a group level. Our links with external stakeholders continue to grow including improved customer liaison and community involvement. We aim to manage our relationships with our stakeholders and communicate with them professionally and responsibly. The board has identified its principal stakeholders as shareholders, customers, employees, suppliers and local communities and also recognises its responsibility to the environment. Responsibility to the board for relations with all our stakeholders lies with the Group Chief Executive and the board as a whole reviews key CSR elements.

We monitor our performance against objectives with the aim of continual improvement. In addition to improvements in respect of environmental and social responsibility performance we have continued to make positive moves in waste and energy management, supply chain accountability, sustainable development, health and safety and staff development and welfare.

Our policy

Our policy sets out the framework for the development and implementation of CSR activities across the group. We will conduct all our business activities in a fair and balanced manner respecting and responding to legal, social and ethical issues arising from our commercial activities. We are committed across the group to continued progress in the following areas:

- improving the quality of our products, processes and services
- becoming an employer of choice
- improving our health and safety performance
- working with the local communities around our businesses
- protecting the environment and achieving sustained growth and profitability

These areas reflect our main responsibilities as the leading European floorcovering distributor. They will inevitably be widened to encompass other stakeholders as our CSR programme develops.

Improving the quality of our products, processes and services

We aim to increase awareness and communication of the environmental strategy and commitments through a programme of employee training.

We work with our main suppliers to improve working practices and the environmental management of our supply chain, although we recognise that many of our main suppliers already work to exacting standards. We seek to improve in these areas and would comment on our commitment as follows:

- increase the use of environmental specification
- increase the volume of certified sustainable natural products
- reduce the amount of CO₂ emissions
- reduce fuel consumption and vehicle emissions
- reduce the amount of waste sent to landfill
- increase recycling rates
- reduce the amount of packaging
- increase the use of green energy
- reduce water consumption
- encourage the use of whole life cost assessments
- encourage pollution prevention initiatives

We seek to reduce energy and water consumption through the development of an awareness programme communicated to employees, the introduction on repair, renewal or installation of energy or water efficient techniques and equipment.

We continue to invest in new facilities for our businesses which incorporate modern construction techniques and products. The group has a policy to replace the commercial and motor vehicles it operates every five and three years respectively so improving operational efficiencies and reducing operating costs and vehicle emissions. Obligations placed on manufacturers have resulted in the production of more efficient and less polluting vehicles. Progressive replacement of Euro 2 compliant commercial vehicles with new Euro 4 compliant models, according to manufacturers statistics, has resulted in significant savings in all regulated exhaust emissions: a 62.5% reduction in carbon monoxide, a 58.8% reduction in hydrocarbons, a 50% reduction in nitrous oxides and a 86.6% reduction in particulate matter or soot. Efficiencies achieved in motor vehicles have been less notable with CO₂ emissions for the majority of the motor vehicles operated reducing from 159g to 157g following the introduction of Euro 4 compliant models.

Our operations predominantly create waste materials in the form of protective plastic wrapping, cardboard and wooden pallets. Increasingly we collect the plastic and cardboard in discreet types and

Corporate and social responsibility *continued*

with the use of baler units that we have invested in over the last few years, dispatch these to specialist re-processing agents

Wooden pallets are re-cycled where possible or sent to specialist re-processors. In addition we recycle the cardboard poles that are used in the centre of rolls of carpet and vinyl until they are no longer capable of being re-used. In these ways we have reduced the amount of waste that is sent to landfill sites. Guidance on waste management is issued to the managers of the individual businesses to increase awareness of the need to control waste.

We continue to work with our suppliers to improve the re-cycling content of packaging materials and consequently reduce our packaging waste.

Higher risk parts of the facilities, such as fuel and lubrication stores and fork lift truck battery charging areas, have containment and inspection regimes which meet legislative requirements.

In order to support our customers and develop relationships, we travel to their sites when necessary. We attempt to minimise this impact by the use of audio conferencing, however face to face contact is essential to the business. The choice of airline routing and number of travellers is generally based on cost and timetable availability. Direct flights and modern aircraft being preferred.

Good relationships are maintained with national and local regulatory organisations such as the Environment Agency and Environmental Health Departments in the UK. Processes are in place to keep up to date on regulatory issues and are the subject of regular review. The amount of environmental legislation is growing, resulting in increasing training and compliance costs. Staff training in health, safety and environmental matters is important and is reviewed annually as part of normal appraisal processes.

Becoming an employer of choice

At the heart of the group are our people who seek to deliver their best for the business, which combined with a fair and responsive way of doing business, generates a common ambition to add significant value. Our policy towards employees is set out in the Directors Report in the section on employment, training and development.

Improving our health and safety performance

The group attaches great significance to the management of the health, safety and welfare of both its employees and others. To this end we have adopted a policy that is available for inspection at all operating locations and which is reviewed on a regular basis.

The board has put in place policies that seek to ensure that group operations are carried out at all times in such a manner as to ensure so far as it is reasonably practicable, the health and safety at work of employees and all persons likely to be affected, including other contractors, customers, staff and members of the public where appropriate.

The value of employee participation in delivering this commitment is recognised and management teams are encouraged to create a supportive culture. To achieve this we endeavour to ensure that we

- continue to improve health and safety systems, procedures and guidance
- make personnel aware of this policy
- maintain high standards of health and safety
- maintain a consistent reporting structure
- provide adequate resources

Investment in automated dispatch sortation equipment has significantly reduced manual handling in those businesses where they have been installed which will in turn reduce the number and frequency of reported manual handling accidents.

Training in health and safety awareness, impending changes in relevant legislation and other specialist subjects is fully supported. Health and safety activities are verified by regular site audits and inspections. During the year the group health and safety policy was introduced into recently acquired businesses. This coordinated approach, with a common policy approach throughout the group, improves our governance and shows additional commitment to being an employer of choice. Good relationships are maintained with regulators in the areas in which we operate.

During the year we have improved policies on work related driving and stress where new approaches have been launched. Feedback from health and safety committees has also been used to develop health and safety improvements. Whilst we aim for lower levels, the low level of accidents reflects the success of our health and safety policies.

Further details are given in the Directors Report in the section on health and safety.

Working with the local communities around our businesses

We recognise that our business should be conducted in a socially as well as environmentally responsible way. Listening to and learning from what our customers, employees, suppliers and other stakeholders tell us about what is important to them is a feature of how we work. It has helped us keep in touch with what is happening

Corporate and social responsibility *continued*

in the markets in which we operate. We are committed to managing the social responsibilities connected with our business in an open and honest way. We try to make a positive contribution to all the communities in which we operate. We support local community activity and give charitable donations. Where suitable opportunities are presented, the focus is on creating links that are sustainable, and on improving the image and understanding of the business in the community. Examples include the provision of work experience placements for local schools, the use of facilities, employees acting as school governors and engaging with local organisations.

Protecting the environment

The board is committed to keeping the environmental impact of the group's facilities and activities to a minimum. We have a structure in place that facilitates the pooling of information and resources to ensure best practice is shared across the group. In recognising our responsibility to protect the environment we have adopted an environmental policy which is reviewed periodically. Our policy seeks to cover the various aspects that affect our businesses, including the following:

- maintaining a management framework for implementing the environmental policy objectives into business decision making, alongside commercial, safety and other factors
- complying with applicable environment legislation, regulations and standards
- developing operational procedures designed to minimise pollution risks and to deal effectively with any incidents which occur
- taking positive action to minimise waste and to encourage recycling wherever practical
- improving efficiency in the use of facilities, energy, water and raw materials
- working with our advisors, suppliers and sub-contractors to ensure effective environmental supply chain management, alongside quality, price and other purchasing criteria
- reducing the environmental impact of our products through improved design and specification
- training employees to enhance their awareness of and commitment to maximising environmental performance
- reviewing the group's environmental policy periodically to take account of organisational, legislative and fiscal changes

The group seeks to improve its environmental performance and to minimise the impact of its operations.

Achieving sustained growth and profitability

Whilst achieving the group's goal of sustained growth and profitability in future years, there are a number of key areas which will assist in attaining the financial objectives at the same time as meeting our corporate social responsibility obligations.

Through improving our understanding and control of our supply chain, we shall continue to investigate the benefits from using green specification guides and modify our strategy accordingly. We shall continue to work with suppliers to ensure products are supplied from renewable sources and that their manufacturing processes fairly reward employees and do not seek to exploit. We shall continue to work with our suppliers to investigate the potential for improvements in product design. Where choice of suppliers is possible, various procurement methods are used depending on the type of product or service being procured. Local suppliers for service functions to our businesses are used where commercially practical. There are no significant supply contracts which are essential to the business of the group.

We place great importance on effectively managing our operations to minimise the likelihood of adverse impact. We proactively manage our facilities to minimise energy consumption utilising energy efficient lighting and heating. Our new sites are subjected to an environmental assessment prior to any construction taking place. This allows solutions to any identified environmental issues to be incorporated into the planning process. Recognising that development can be potentially damaging, we seek to minimise energy consumption during the construction of new premises and the effects on the environment. Wherever possible, subject to the operating constraints of the business, existing trees and vegetation are retained and augmented as necessary. Existing sites are maintained in a tidy condition to minimise ecological impact.

As part of our commitment to sustainable development we work with transport consultants to formulate green travel plans incorporating car sharing schemes and provision for bicycles when designing new facilities.

We recognise that our business operations will be around for many years, having an impact on future generations, and to this end we work with local authorities to design new properties which not only comply with guidelines but seek to blend in with their surroundings through the careful use of quality materials, landscaping and design features. We support the desire to see development take place in sustainable locations.

This report is not subject to audit by KPMG.

Independent Auditor's Report

to the Members of Headlam Group plc

We have audited the group and parent company financial statements (the "financial statements") of Headlam Group plc for the year ended 31 December 2007 which comprise the Group Income Statement the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statements of Recognised Income and Expenses, and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 28.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that information presented in the Chairman's Statement, Business Review and Financial Review that is cross referred from the Review of the Business section of the Directors' Report.

In addition we report to you if in our opinion the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Independent Auditor's Report

to the Members of Headlam Group plc - *continued*

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion

- the group financial statements give a true and fair view in accordance with IFRSs as adopted by the EU, of the state of the group's affairs as at 31 December 2007 and of its profit for the year then ended,
- the parent company financial statements give a true and fair view in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2007
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and as regards the group financial statements, Article 4 of the IAS Regulation and
- the information given in the Directors' Report is consistent with the financial statements

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor

2 Cornwall Street
Birmingham
B3 2DL

17 March 2008

Consolidated Income Statement

for the year ended 31 December 2007

	Note	2007 £000	2006 £000
Revenue	2	544,718	509,899
Cost of sales		(375,990)	(350,506)
Gross profit		168,728	159,393
Distribution expenses		(87,711)	(81,623)
Administrative expenses		(35,004)	(33,829)
Operating profit	2	46,013	43,941
Financial income	6	6,321	4,926
Financial expenses	6	(7,162)	(5,309)
Net financing costs		(841)	(383)
Profit before tax	3	45,172	43,558
Taxation	7	(13,534)	(13,067)
Profit for the year attributable to the equity shareholders		31,638	30,491
Dividend paid per share	21	20.15p	18.00p
Earnings per share			
Basic	9	37.1p	35.1p
Diluted	9	36.8p	34.8p

All group operations during the financial years were continuing operations

Statements of Recognised Income and Expense

for the year ended 31 December 2007

	Note	Group		Company	
		2007 £000	2006 £000	2007 £000	2006 £000
Foreign exchange translation differences arising on translation of overseas operations		1,090	(419)	–	–
Actuarial gains and losses on defined benefit pension plans		5,000	(173)	5,302	(261)
Tax recognised on income and expenses recognised directly in equity		(1,660)	1,057	(1,712)	383
Net income recognised directly in equity		4,430	465	3,590	122
Profit for the year		31,638	30,491	35,300	32,237
Total recognised income and expense attributable to the equity shareholders	21	36,068	30,956	38,890	32,359

Balance Sheets

at 31 December 2007

		Group		Company	
	Note	2007 £000	2006 £000	2007 £000	2006 £000
Non-current assets					
Property plant and equipment	10	92,097	85,032	73,596	66,773
Investments in subsidiary undertakings	12	—	—	85,781	84,247
Intangible assets	11	13,210	13,210	—	—
Deferred tax assets	13	5,942	9,182	4,290	6,480
		111,249	107,424	163,667	157,500
Current assets					
Inventories	14	101,491	94,217	—	—
Trade and other receivables	15	100,830	91,284	20,466	21,899
Cash and cash equivalents	16	16,805	41,861	30,135	40,221
		219,126	227,362	50,601	62,120
Total assets		330,375	334,786	214,268	219,620
Current liabilities					
Bank overdraft	16	(103)	(1,010)	—	—
Other interest-bearing loans and borrowings	17	—	(267)	—	(267)
Trade and other payables	18	(154,320)	(149,422)	(38,271)	(40,663)
Employee benefits	19	(1,491)	(1,102)	(1,491)	(1,102)
Income tax payable	8	(10,747)	(10,184)	(5,306)	(2,324)
		(166,661)	(161,985)	(45,068)	(44,356)
Non-current liabilities					
Employee benefits	19	(9,837)	(16,124)	(9,364)	(15,930)
Deferred tax liabilities	13	(3,836)	(3,665)	(2,858)	(2,627)
		(13,673)	(19,789)	(12,222)	(18,557)
Total liabilities		(180,334)	(181,774)	(57,290)	(62,913)
Net assets		150,041	153,012	156,978	156,707
Equity attributable to equity holders of the parent					
Share capital	21	4,268	4,354	4,268	4,354
Share premium	21	53,512	53,428	53,512	53,428
Other reserves	21	(11,042)	(616)	9,062	20,578
Retained earnings	21	103,303	95,846	90,136	78,347
Total equity		150,041	153,012	156,978	156,707

These Financial Statements were approved by the board of directors on 17 March 2008 and were signed on its behalf by

Tony Brewer
Director



Stephen Wilson
Director



Cash Flow Statements

for the year ended 31 December 2007

		Group		Company	
	Note	2007 £000	2006 £000	2007 £000	2006 £000
Cash flows from operating activities					
Profit/(loss) before tax for the year		45,172	43,558	2,700	(1,684)
Adjustments for:					
Depreciation, amortisation and impairment		6,227	4,974	1,162	1,066
Financial income		(6,321)	(4,926)	(7,197)	(5,825)
Financial expense		7,162	5,309	4,941	4,452
(Profit)/loss on sale of property, plant and equipment		(18)	10	—	17
Equity settled share-based payment expenses		501	472	194	196
Operating profit/(loss) before changes in working capital and provisions		52,723	49,397	1,800	(1,778)
(Increase)/decrease in trade and other receivables		(6,849)	(6,810)	1,120	(460)
Increase in inventories		(4,781)	(2,930)	—	—
Increase/(decrease) in trade and other payables		1,587	7,987	(798)	(1,423)
Cash generated from the operations		42,680	47,644	2,122	(3,661)
Interest paid		(3,325)	(2,023)	(486)	(133)
Tax (paid)/received		(11,729)	(11,622)	2,563	1,885
Additional contributions to defined benefit pension plans		(1,098)	(3,927)	(790)	(2,080)
Net cash from operating activities		26,528	30,072	3,409	(3,989)
Cash flows from investing activities					
Proceeds from sale of property, plant and equipment		159	1,816	—	1,729
Interest received		2,757	2,001	2,572	1,878
Dividends received		—	—	33,629	34,775
Acquisition of subsidiaries, net of cash acquired		(3,190)	(1,369)	(2,698)	(1,747)
Additional investment in subsidiary		—	—	—	(1,336)
Acquisition of property, plant and equipment		(10,980)	(12,884)	(7,685)	(7,447)
Net cash from investing activities		(11,254)	(10,436)	25,818	27,852
Cash flows from financing activities					
Proceeds from the issue of share capital		86	1,176	86	1,176
Proceeds from the issue of treasury shares		10	—	10	—
Payment to acquire own shares		(21,687)	—	(21,687)	—
Repayment of borrowings		(246)	—	—	—
Payment of finance lease liabilities		(363)	(497)	(267)	(471)
Dividends paid		(17,455)	(15,612)	(17,455)	(15,612)
Net cash from financing activities		(39,655)	(14,933)	(39,313)	(14,907)
Net (decrease)/increase in cash and cash equivalents		(24,381)	4,703	(10,086)	8,956
Cash and cash equivalents at 1 January		40,851	36,193	40,221	31,265
Effect of exchange rate fluctuations of cash held		232	(45)	—	—
Cash and cash equivalents at 31 December	16	16,702	40,851	30,135	40,221

The company's profit before tax excludes dividends received from subsidiaries

Notes to the Financial Statements

1 ACCOUNTING POLICIES

Headlam Group plc (the "company") is a company incorporated in the UK.

The group Financial Statements consolidate those of the company and its subsidiaries which together are referred to as the group. The company's financial statements present information about the company as a separate entity and not about its group.

Both the company's Financial Statements and the group's Financial Statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards as adopted by the EU ("adopted IFRS"). On publishing the parent company Financial Statements here together with the group Financial Statements the company is taking advantage of the exemption in s230 of the Companies Act 1985 not to present its individual income statement and related notes that form a part of these approved Financial Statements.

The principal accounting policies applied in the preparation of the Financial Statements of the group and the Financial Statements of the company are set out below. These policies have been applied consistently to all years presented unless otherwise stated. The principal exception is that the directors have changed the accounting policies in respect of the following matters:

- Amendment to IAS 1 Capital Disclosures
- IFRS 7 Financial Instruments Disclosures

The implementation of the changes noted above has not had an effect on either the profit or the net assets of the group and the company for the period commencing 1 January 2007.

The most notable effect of the changes implemented above is the additional disclosure presented in the Financial Statements regarding credit and market risk under IFRS 7.

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 below.

IFRS not yet applied

The following IFRS is available for early application but have not been applied for by the company or group in these Financial Statements:

IFRS 8 'Operating Segments Disclosure' applicable for years commencing on or after 1 January 2009. This will require the disclosure of segment information based on the internal reports regularly reviewed by the group's chief operating decision maker in order to assess each segment's performance and to allocate resources to them. The group plans to adopt it during 2009.

Measurement convention

The company and group Financial Statements are prepared on the historical cost basis. Non-current assets held for sale are stated at the lower of previous carrying amount and fair value less costs to sell.

Basis of consolidation

Subsidiaries are entities controlled by the group. Control exists when the group has the power, directly or indirectly to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the group.

Inter-company transactions, balances and unrealised gains and losses on transactions between group companies are eliminated.

Accounting estimates and judgements

Management discussed the development, selection and disclosure of the group's critical accounting policies and estimates and the application of these policies and estimates with the Audit committee. In applying the accounting policies, appropriate estimates have been made in a number of areas and the actual outcome may differ from the position described in the company's and group's Balance Sheet at 31 December 2007. The key sources of estimation uncertainty at the balance sheet date that may give rise to a material adjustment to the carrying value of assets and liabilities within the next financial year are as follows:

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment losses. The group is committed to investing in new facilities where existing facilities fail to provide satisfactory customer service in a cost effective manner. When construction on a new facility is initiated, the existing facility is marketed for sale and this action can on occasions give rise to an adverse difference between cost and fair value. It has been assumed that at the balance sheet date, cost equates to fair value.

Goodwill impairment

The impairment test for goodwill is dependent on the forecasts of the cash flows of the cash-generating units and the assumptions relating to growth rate. No impairment resulted from the annual impairment test for 2007.

Notes to the Financial Statements *continued*

Deferred tax assets

Deferred tax assets are recognised at the balance sheet date based on the assumption that there is a high expectation that the asset will be realised in due course. This assumption is dependent on the group's ability to generate sufficient future taxable profits.

Employee benefits

The deficit relating to the group's defined benefit plans is assessed annually in accordance with IAS 19 and after taking independent actuarial advice. The amount of the deficit is dependent on plan asset and liability values and the actuarial assumptions used to determine the deficit. Assumptions include asset growth rates, pension and salary increases, price inflation, discount rate used to measure actuarial liabilities and mortality rates.

Foreign currency

Transactions in foreign currencies are translated 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 translated at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

The assets and liabilities of foreign subsidiaries, including goodwill and fair value adjustments arising on consolidation, are translated at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign subsidiaries are translated at an average rate for the period where this rate approximates to the foreign exchange rates ruling at the dates of the transactions.

Exchange differences arising from this translation of foreign subsidiaries are taken directly to the translation reserve. They are released into the income statement upon disposal.

Classification of financial instruments issued by the group

Financial instruments issued by the group are treated as equity, i.e. forming part of shareholders' funds, only to the extent that they meet the following two conditions:

- (a) they include no contractual obligations upon the company or group as the case may be to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the company or group, and
- (b) where the instrument will or may be settled in the company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the company's own equity instruments or is a derivative that will be settled by the company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the company's own shares, the amounts presented in these Financial Statements for called up share capital and share premium account exclude amounts in relation to those shares.

Finance payments associated with financial liabilities are dealt with as part of financial expenses. Finance payments associated with financial instruments that are classified in equity are dividends and are recorded directly in equity.

Investments in debt and equity securities

Investments in subsidiaries are carried at cost less impairment.

Where the consideration for the acquisition of a subsidiary undertaking includes shares in the company to which the provisions of Section 131 of the Companies Act 1985 apply, cost represents the nominal value of shares issued together with the fair value of any additional consideration given and costs. In the Consolidated Financial Statements the excess of the fair value of the consideration of shares issued over the nominal value is credited to the special reserve.

Derivative financial instruments and hedging

Following initial adoption, the group has decided not to apply the hedge accounting requirements of IAS 39. Consequently, all movements in the fair value of the hedge are recognised immediately in the income statement, within net financing costs.

Derivative financial instruments

Derivative transactions relate to forward foreign currency contracts used to hedge the group's exposure to currency risks arising from selling and buying activities. In accordance with its treasury policy the group does not hold or issue derivative financial instruments for trading purposes. However derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the income statement.

The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and 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 company and the group assume substantially all the risks and rewards of ownership of the leased asset are classified

Notes to the Financial Statements *continued*

as finance leases. 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 impairment losses. Lease payments are accounted for as described below.

Depreciation is charged to the income statement on a straight-line basis over their estimated useful lives. Land is not depreciated. The annual rates applicable are:

Freehold and long leasehold properties	- 2%
Short leasehold properties	- period of lease
Motor vehicles	- 25%
Office and computer equipment	- 10% - 33.3%
Warehouse and production equipment	- 10% - 20%

Goodwill and other intangible assets

Goodwill represents amounts arising on acquisition of subsidiaries prior to 1 January 2004. In respect of business acquisitions that have occurred since 1 January 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired. Identifiable intangibles are those which can be sold separately or which arise from legal rights regardless of whether those rights are separable.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortised but, tested annually for impairment.

In respect of acquisitions prior to 1 January 2004, goodwill is included on the basis of its deemed cost, which represents the amount recorded under UK GAAP which was broadly comparable save that only separable intangibles were recognised and goodwill was amortised. This is in accordance with IFRS 1.

Negative goodwill arising on an acquisition is recognised in the income statement.

Expenditure on research activities 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 impairment losses. 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. The estimated useful lives of customer order books are deemed to be between 1 – 24 months.

Trade and other receivables

Trade and other receivables are stated at their nominal amount, discounted if material less impairment losses. Debts are provided for on specific receivables in full as soon as they are known to be 'bad' or it becomes apparent that payment is 'doubtful'.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Inventory provisions are determined by reference to each individual product and are calculated by assessing the age, condition and quantity of each individual product.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of cash management of both the company and group are included as a component of cash and cash equivalents for the purpose only of the Cash Flow Statements.

Impairment

The carrying amounts of the group's assets other than inventories and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets recoverable amount is estimated.

For goodwill and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash-generating units and then to reduce the carrying amount of the other assets in the unit on a pro-rata basis. A cash generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Calculation of recoverable amount

The recoverable amount of the group's receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate, i.e., the effective interest rate computed at initial recognition of these financial assets. Receivables with a short duration are not discounted.

Notes to the Financial Statements *continued*

The recoverable amount of other assets is the greater of their fair value less cost to sell and value in use. In assessing value in use the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Reversals of impairment

An impairment loss in respect of a receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of goodwill is not reversed.

In respect of other assets an impairment loss is reversed when there is an indication that the impairment loss may no longer exist and there had been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the assets 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.

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 with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

Employee benefits

The company and the group operate both defined benefit and defined contribution plans, the assets of which are held in independent trustee administered funds. The pension cost is assessed in accordance with the advice of a qualified actuary.

Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

Defined benefit plans

The group's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value, and the fair value of any plan assets, at bid price, is deducted. The liability discount rate is the yield at the balance sheet date using AA rated corporate bonds that have maturity dates approximating to

the terms of the group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately the expense is recognised immediately in the income statement.

All actuarial gains and losses that arise in calculating the group's obligation in respect of a scheme are recognised immediately in reserves and reported in the Statement of Recognised Income and Expense (SORIE).

Where the calculation results in a benefit to the group, the asset recognised is limited to the present value of any future refunds from the plan or reductions in future contributions to the plan.

The group operates a UK defined benefit pension plan and a defined benefit plan in Switzerland. In the UK there is no contractual agreement or stated group policy for allocating the net defined benefit liability between the participating subsidiaries and as such the full deficit is recognised by the company which is the sponsoring employer. The participating subsidiary companies have recognised a cost equal to contributions payable for the period as advised by a professionally qualified actuary.

Share-based payment transactions

The company and group operate various equity settled share option schemes under the approved and unapproved executive schemes and savings related schemes.

For executive share option schemes the option price may not be less than the mid market value of the group's shares at the time when the options were granted or the nominal value.

Approved

These share option awards are subject to the movement of the group's earnings per share exceeding RPI over the relevant period.

Unapproved

These share option awards subject to the movement of the group earnings per share exceeding RPI between by 3% and 5% per annum.

The performance is assessed by reference to the group's published results.

The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using an option valuation

Notes to the Financial Statements *continued*

model taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is due only to share prices not achieving the threshold for vesting.

When options are granted to employees of subsidiaries of the company the fair value of options granted is recognised as an employee expense in the financial statements of the subsidiary undertaking together with the capital contribution received. In the financial statements of the company the options granted are recognised as an investment in subsidiary undertakings with a corresponding increase in equity.

Repurchase of share capital

When share capital recognised as equity is repurchased the amount of the consideration paid, net of any tax effects is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity.

When treasury shares are sold or reissued subsequently the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to or from retained earnings.

Revenue

Revenue from the sale of goods is measured at the fair value of the consideration, net of trade discounts and excludes intra-group sales and value added and similar taxes. Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods are transferred to the buyer the amount of revenue can be reliably measured and it is probable that the economic benefits associated with the transaction will flow to the group.

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.

Net financing costs

Net financing costs comprise interest payable, finance charges on shares classified as liabilities, finance leases, interest receivable on funds invested, foreign exchange gains and losses and gains and losses on hedging instruments as outlined in the accounting policy relating to derivative financial instruments and hedging described above.

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

The expected return on assets of funded defined benefits pension plans less administration expenses of pension plans are recognised in financial income. The interest accruing on defined benefit pension plan liabilities are recognised in financial expenses.

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 items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income 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. Deferred tax is not recognised for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill.

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.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Non-current assets held for sale

A non-current asset is classified as held for sale if its carrying amount will be recovered principally through the sale rather than through continuing use, it is available for immediate sale and is highly probable within one year.

On initial classification as held for sale, non-current assets and disposal groups are measured at the lower of previous carrying amount and fair value less costs to sell with any adjustments taken to profit or loss. The same applies to gains and losses on subsequent remeasurement.

Notes to the Financial Statements *continued*

2 SEGMENT REPORTING

The group's activities are wholly aligned to the sales, marketing, supply and distribution of floorcovering products. These activities are carried out from business centres located in both the UK and Continental Europe. The group's internal management structure and financial reporting systems treat the UK and Continental Europe as two separate segments because of the difference in reward arising from these two markets and this forms the basis for the geographical presentation of the primary segment information given below.

	UK		Continental Europe		Total	
	2007 £000	2006 £000	2007 £000	2006 £000	2007 £000	2006 £000
Revenue						
External sales	463,671	434,321	81,047	75,578	544,718	509,899
Result						
Segment result	46,092	43,670	2,916	2,044	49,008	45,714
Unallocated corporate expenses					(2,995)	(1,773)
Operating profit					46,013	43,941
Financial income					6,321	4,926
Financial expense					(7,162)	(5,309)
Taxation					(13,534)	(13,067)
Profit for the year					31,638	30,491
Other information						
Segment assets	287,552	293,280	36,881	32,324	324,433	325,604
Unallocated assets					5,942	9,182
Consolidated total assets					330,375	334,786
Segment liabilities	(135,868)	(133,493)	(18,555)	(17,206)	(154,423)	(150,699)
Unallocated liabilities					(25,911)	(31,075)
Consolidated total liabilities					(180,334)	(181,774)
Capital expenditure	10,617	10,882	663	2,002	11,280	12,884
Depreciation	4,044	3,610	666	674	4,710	4,284
Amortisation	1,517	690	—	—	1,517	690

Each segment is a continuing operation.

Unallocated assets comprise deferred tax assets. Unallocated liabilities comprise income tax, deferred tax liabilities and employee benefits.

Management has access to information that provides details on sales and gross margin by principal product group and across the five principal business sectors which comprise Regional multi-product, National multi-product, Commercial regional Residential specialist and Commercial specialist. However, this information is not provided as a secondary segment since the group's operations are not managed by reference to these sub-classifications and the presentation would require an arbitrary allocation of overheads, assets and liabilities undermining the presentations validity and usefulness.

Notes to the Financial Statements *continued*

3 PROFIT BEFORE TAX

The following are included in profit before tax

	2007 £000	2006 £000
Depreciation on property, plant and equipment	4,710	4,284
Amortisation of intangible assets	1,517	690
(Profit)/loss on sale of property plant and equipment	(18)	10
Equity settled share-based payment expenses	501	472
Operating lease rentals		
Plant and machinery	8,237	7,926
Land and buildings	2,021	1,831
Auditor's remuneration		
	2007 £000	2006 £000
Audit of these financial statements	57	54
Amounts received by the auditor and their associates in respect of		
Audit of financial statements of subsidiaries pursuant to legislation	124	121
All other services	40	8
	221	183

Amounts paid to the company's auditor in respect of services to the company, other than the audit of the company's Financial Statements, have not been disclosed as the information is required instead to be disclosed on a consolidated basis

Notes to the Financial Statements *continued*

4 STAFF NUMBERS AND COSTS

The average number of people employed, including directors during the year analysed by category, was as follows

	Number of employees Group		Number of employees Company	
	2007	2006	2007	2006
By sector				
Floorcoverings	2,129	2,053	—	—
Central operations	9	9	9	9
	2,138	2,062	9	9
By function				
Sales and distribution	1,960	1,891	—	—
Administration	178	171	9	9
	2,138	2,062	9	9

The aggregate payroll costs were as follows

	£000	£000	£000	£000
Wages and salaries	56,561	53,089	2,595	2,496
Equity settled transactions	501	472	194	196
Social security costs	7,067	6,632	325	312
Contributions to defined contribution plans	1,361	1,307	93	15
Increase in liability for defined benefit plans	1,803	1,768	256	590
	67,293	63,268	3,463	3,609

5 DIRECTORS' EMOLUMENTS

	2007 £000	2006 £000
Directors' emoluments	2,305	2,222
Gains made on share options	—	12

Further details of directors' emoluments, share options and pension entitlement are given in the Remuneration Report on pages 35 to 40

Notes to the Financial Statements *continued*

6 FINANCE INCOME AND EXPENSE

	2007 £000	2006 £000
Interest income		
Bank interest	2,641	1,823
Other	46	124
Return on defined benefit plan assets	3,634	2,979
Financial income	6,321	4,926
Interest expense		
Bank loans, overdrafts and other financial expenses	(3,328)	(1,862)
Interest on defined benefit plan obligation	(3,827)	(3,342)
Finance leases and similar hire purchase contracts	(3)	(36)
Other	(4)	(69)
Financial expenses	(7,162)	(5,309)

7 TAXATION

Recognised in the income statement

	2007 £000	2006 £000
Current tax expense		
Current year	13,333	13,302
Adjustments for prior years	(1,130)	(826)
	12,203	12,476
Deferred tax expense		
Origination and reversal of temporary differences	1,276	(40)
Effect of change in UK tax law	(178)	—
Adjustments for prior years	233	631
	1,331	591
Total tax in income statement	13,534	13,067

	2007 £000	2006 £000
Tax relating to items (charged)/credited to equity		
Current tax:		
Current tax on income and expenses recognised directly in equity	(74)	1,938
Deferred tax:		
Deferred tax on share options	(494)	193
Deferred tax on income and expenses recognised directly in equity	(1,586)	(881)
Total tax reported directly in reserves	(2,154)	1,250

Notes to the Financial Statements *continued*

7 TAXATION - CONTINUED

Reconciliation of effective tax rate

	2007		2006	
	%	£000	%	£000
Profit before tax		45,172		43,558
Tax using the UK corporation tax rate	30%	13,552	30%	13,067
Effect of change in UK tax law	(0.4%)	(178)	–	–
Non-deductible expenses	3.1%	1,392	0.4%	186
Effect of tax rates in foreign jurisdictions	(0.7%)	(335)	0.0%	9
Over provided in prior years	(2.0%)	(897)	(0.4%)	(195)
Total tax in income statement	30%	13,534	30%	13,067

8 CURRENT TAX LIABILITIES

The group current tax liability of £10,747,000 (2006 £10,184,000) represents the amount of income payable in respect of current and prior year periods which exceed any amounts recoverable. The company current tax liability of £5,306,000 (2006 £2,324,000) represents the amount of income tax payable in respect of current and prior year periods which exceed any amounts recoverable.

9 EARNINGS PER SHARE

	2007 £000	2006 £000
Earnings		
Earnings for the purposes of basic earnings per share being profit attributable to equity holders of the parent	31,638	30,491
Number of shares		
Issued ordinary shares at 1 January	87,079,521	86,512,854
Effect of share movement during the period	(1,709,414)	416,237
Weighted average number of ordinary shares for the purposes of basic earnings per share	85,370,107	86,929,091
Effect of diluted potential ordinary shares		
Weighted average number of ordinary shares at 31 December	85,370,107	86,929,091
Share options	2,114,930	2,046,461
Number of shares that would have been issued at fair value	(1,471,286)	(1,422,270)
Weighted average number of ordinary shares for the purposes of diluted earnings per share	86,013,751	87,553,282

During the year the company purchased 2,078,953 shares which are held in treasury and these are excluded from the calculation of earnings per share.

Notes to the Financial Statements *continued*

10 PROPERTY, PLANT AND EQUIPMENT – GROUP AND COMPANY

Group	Land & buildings £000	Plant & equipment £000	Under construction £000	Total £000
Cost				
Balance at 1 January 2006	65 086	18 814	2 001	85 901
Acquisition	248	92	–	340
Additions	2 005	3 866	7 013	12 884
Transfer from non-current assets held for sale	1 890	–	–	1,890
Disposals	–	(1,583)	–	(1,583)
Effect of movements in foreign exchange	(254)	(119)	–	(373)
Reclassification	8 292	–	(8 292)	–
Balance at 31 December 2006	77 267	21 070	722	99 059
Balance at 1 January 2007	77,267	21,070	722	99,059
Acquisition	27	239	–	266
Additions	6,487	3 265	1 528	11,280
Disposals	(246)	(1,162)	–	(1,408)
Effect of movements in foreign exchange	437	375	–	812
Reclassification	(52)	52	–	–
Balance at 31 December 2007	83 920	23 839	2 250	110 009
Depreciation				
Balance at 1 January 2006	5 397	5 864	–	11 261
Depreciation charge for the year	1,335	2,949	–	4 284
Transfer from non-current assets held for sale	120	–	–	120
Disposals	–	(1,457)	–	(1,457)
Effect of movements in foreign exchange	(95)	(86)	–	(181)
Balance at 31 December 2006	6,757	7,270	–	14 027
Balance at 1 January 2007	6,757	7,270	–	14,027
Depreciation charge for the year	1,433	3,277	–	4,710
Disposals	(211)	(1,057)	–	(1,268)
Effect of movements in foreign exchange	160	283	–	443
Reclassification	(7)	7	–	–
Balance at 31 December 2007	8,132	9 780	–	17,912
Net book value				
At 1 January 2006	59 689	12,950	2 001	74,640
At 31 December 2006 and 1 January 2007	70,510	13 800	722	85,032
At 31 December 2007	75,788	14,059	2,250	92,097

Notes to the Financial Statements *continued*

10 PROPERTY, PLANT AND EQUIPMENT – GROUP AND COMPANY - CONTINUED

Company	Land & buildings £000	Plant & equipment £000	Under construction £000	Total £000
Cost				
Balance at 1 January 2006	60,155	558	2,001	62,714
Additions	138	52	7,013	7,203
Transfer from non-current assets held for sale	1,890	–	–	1,890
Disposals	–	(51)	–	(51)
Transfer from group companies	245	–	–	245
Reclassification	8,292	–	(8,292)	–
Balance at 31 December 2006	70,720	559	722	72,001
Balance at 1 January 2007	70,720	559	722	72,001
Additions	6,462	–	1,523	7,985
Disposals	(197)	–	–	(197)
Balance at 31 December 2007	76,985	559	2,245	79,789
Depreciation				
Balance at 1 January 2006	3,600	449	–	4,049
Depreciation charge for the year	1,036	30	–	1,066
Transfer from non-current assets held for sale	120	–	–	120
Disposals	–	(7)	–	(7)
Balance at 31 December 2006	4,756	472	–	5,228
Balance at 1 January 2007	4,756	472	–	5,228
Depreciation charge for the year	1,133	29	–	1,162
Disposals	(197)	–	–	(197)
Balance at 31 December 2007	5,692	501	–	6,193
Net book value				
At 1 January 2006	56,555	109	2,001	58,665
At 31 December 2006 and 1 January 2007	65,964	87	722	66,773
At 31 December 2007	71,293	58	2,245	73,596

Property, plant and equipment under construction

During the year ended 31 December 2006 the group acquired land in Bridgend, South Wales with the intention of building a new warehouse and distribution facility on the site. The costs incurred by 31 December 2007 on this new facility were £2,012,000. During the year ended 31 December 2007 the group undertook various property projects which included extensions and re-modifications. The costs of these projects in the course of construction were £238,000 bringing the group's total cost of projects under construction to £2,250,000.

Assets held under finance leases

The carrying value of assets held under finance leases amounts to £nil (2006 £1,936,000).

Fair value of UK freehold and long leasehold land and buildings

A full independent valuation of UK freehold and long leasehold land and buildings was carried out as at 31 December 2007 by Lambert Smith Hampton a firm of chartered surveyors and valuers, in accordance with the General Principles and Practice Statements contained within the Appraisal and Valuation Standards produced by the Royal Institution of Chartered Surveyors. Properties were valued on an existing use basis which is consistent with the basis used for previous valuations. The valuation revealed a surplus of £12,100,000. However, following the adoption of IFRS, the revaluation is not reflected in the balance sheets of the group or the company.

Notes to the Financial Statements *continued*

11 INTANGIBLE ASSETS – GROUP

	Goodwill £000	Customer lists £000	Total £000
Cost			
Balance at 1 January 2006	13,210	1,672	14,882
Addition (note 23)	–	690	690
Balance at 31 December 2006	13,210	2,362	15,572
Balance at 1 January 2007	13,210	2,362	15,572
Additions (note 23)	–	1,517	1,517
Balance at 31 December 2007	13,210	3,879	17,089
Amortisation			
Balance at 1 January 2006	–	1,672	1,672
Amortisation for the year	–	690	690
Balance at 31 December 2006	–	2,362	2,362
Balance at 1 January 2007	–	2,362	2,362
Amortisation for the year	–	1,517	1,517
Balance at 31 December 2007	–	3,879	3,879
Net book value			
At 1 January 2006	13,210	–	13,210
At 31 December 2006 and 1 January 2007	13,210	–	13,210
At 31 December 2007	13,210	–	13,210

Amortisation

The amortisation charge is recognised in administration expenses in the income statement.

Impairment tests for cash-generating units containing goodwill

The following cash-generating units have significant carrying amounts of goodwill

	2007 £000	2006 £000
UK	6,671	6,671
Continental Europe	6,539	6,539
	13,210	13,210

On acquisition, each cash-generating unit is fully integrated into the group's business model and benefits from shared purchasing, common IT systems and other shared support services including warehousing and logistics. Accordingly, it is not possible to separately test each individual cash-generating unit for goodwill impairment.

Goodwill by geographical segments has been separately identified and measured for impairment. The recoverable amount of each cash-generating unit has been assessed on a value in use basis using the operating profit of each geographical segment for 2007 and extrapolating forward assuming forecast inflationary growth rates of 3% for the territories in which the cash-generating units are located. The group has applied a discount rate of 9.2% when measuring for impairment.

Notes to the Financial Statements *continued*

12 INVESTMENTS IN SUBSIDIARIES

Summary information on investments in subsidiary undertakings is as follows

	£000
Cost	
Balance at 1 January 2006	146,705
Share options granted to employees of subsidiary undertakings	276
Additions during the period	3,083
Disposals during the period	(65,127)
Balance at 31 December 2006	84,937
Balance at 1 January 2007	84,937
Share options granted to employees of subsidiary undertakings	306
Additions during the period	2,698
Balance at 31 December 2007	87,941
Provisions	
Balance at 1 January 2006	51,870
Disposals during the period	(51,870)
Impairment during the period	690
Balance at 31 December 2006	690
Balance at 1 January 2007	690
Impairment during the period	1,470
Balance at 31 December 2007	2,160
Carrying value	
At 1 January 2006	94,835
At 31 December 2006 and 1 January 2007	84,247
At 31 December 2007	85,781

The principal trading subsidiaries are listed on page 91

Notes to the Financial Statements *continued*

13 DEFERRED TAX ASSETS AND LIABILITIES - GROUP

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following

	Assets		Liabilities		Net	
	2007	2006	2007	2006	2007	2006
	£000	£000	£000	£000	£000	£000
Property, plant and equipment	—	—	(3,836)	(3,665)	(3,836)	(3,665)
Intangible assets	496	551	—	—	496	551
Employee benefits	4,155	6,640	—	—	4,155	6,640
Provisions	841	1,265	—	—	841	1,265
Other items	450	726	—	—	450	726
Tax assets/(liabilities)	5,942	9,182	(3,836)	(3,665)	2,106	5,517

Movement in deferred tax during the year

	1 January 2007 £000	Recognised in income £000	Recognised in equity £000	31 December 2007 £000
Property, plant and equipment	(3,665)	(171)	—	(3,836)
Intangible assets	551	(55)	—	496
Employee benefits	6,640	(405)	(2,080)	4,155
Provisions	1,265	(424)	—	841
Other	726	(276)	—	450
	5,517	(1,331)	(2,080)	2,106

Movement in deferred tax during the prior year

	1 January 2006 £000	Recognised in income £000	Recognised in equity £000	31 December 2006 £000
Property, plant and equipment	(1,403)	(2,262)	—	(3,665)
Intangible assets	539	12	—	551
Employee benefits	7,047	281	(688)	6,640
Provisions	377	888	—	1,265
Other	236	490	—	726
	6,796	(591)	(688)	5,517

Unrecognised deferred tax assets and liabilities

At the balance sheet date the group has unused capital losses of £9,804,000 (2006 £9,555,000) available for offset against future chargeable gains. No deferred tax asset has been recognised in respect of this amount as the group does not anticipate incurring significant chargeable gains in the foreseeable future.

Notes to the Financial Statements *continued*

13 DEFERRED TAX ASSETS AND LIABILITIES - COMPANY

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following

	Assets		Liabilities		Net	
	2007	2006	2007	2006	2007	2006
	£000	£000	£000	£000	£000	£000
Property, plant and equipment	–	–	(2,858)	(2,627)	(2,858)	(2,627)
Employee benefits	3,614	5,898	–	–	3,614	5,898
Provisions	676	582	–	–	676	582
Tax assets/(liabilities)	4,290	6,480	(2,858)	(2,627)	1,432	3,853

Movement in deferred tax during the year

	1 January 2007 £000	Recognised in income £000	Recognised in equity £000	31 December 2007 £000
Property, plant and equipment	(2,627)	(231)	–	(2,858)
Employee benefits	5,898	(569)	(1,715)	3,614
Provisions	582	94	–	676
	3,853	(706)	(1,715)	1,432

Movement in deferred tax during the prior year

	1 January 2006 £000	Recognised in income £000	Recognised in equity £000	31 December 2006 £000
Property, plant and equipment	(1,616)	(893)	(118)	(2,627)
Employee benefits	6,480	(303)	(279)	5,898
Provisions	149	433	–	582
	5,013	(763)	(397)	3,853

Unrecognised deferred tax assets and liabilities

At the balance sheet date the company has unused capital losses of £9,804,000 (2006 £9,555,000) available for offset against future chargeable gains. No deferred tax asset has been recognised in respect of this amount as the company does not anticipate incurring significant chargeable gains in the foreseeable future.

Notes to the Financial Statements *continued*

14 INVENTORIES

	Group		Company	
	2007	2006	2007	2006
	£000	£000	£000	£000
Finished goods and goods held for resale	101,491	94,217	–	–

Cost of sales consists of the following

	Group		Company	
	2007	2006	2007	2006
	£000	£000	£000	£000
Material cost	368,672	343,603	–	–
Processing cost	4,666	4,282	–	–
Other	2,652	2,621	–	–
	375,990	350,506	–	–

15 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2007	2006	2007	2006
	£000	£000	£000	£000
Trade receivables	77,468	71,505	1	22
Prepayments and accrued income	3,613	3,858	123	55
Other receivables	19,749	15,921	433	1,983
Amounts due from subsidiary undertakings	–	–	19,909	19,839
	100,830	91,284	20,466	21,899

£1,088,000 (2006 £1 298 000) was recognised as an impairment loss in the Consolidated Income Statement in respect of trade receivables

16 CASH, CASH EQUIVALENTS AND BANK OVERDRAFTS

	Group		Company	
	2007	2006	2007	2006
	£000	£000	£000	£000
Cash and cash equivalents per balance sheet	16,805	41,861	30,135	40,221
Bank overdrafts	(103)	(1,010)	–	–
Cash and cash equivalents per cash flow statements	16,702	40,851	30,135	40,221

Notes to the Financial Statements *continued*

17 OTHER INTEREST-BEARING LOANS AND BORROWINGS

This note provides information about the contractual terms of the groups and company's interest-bearing loans and borrowings. For more information about the group's and company's exposure to interest rate and foreign currency risk, see note 22.

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Current liabilities				
Finance lease liabilities	–	267	–	267
	–	267	–	267

The group has undrawn borrowing facilities expiring in one year or less which, at 31 December 2007, amounted to £51,877,000 (2006 £50,536,000) and undrawn borrowing facilities expiring in 2012 of £30,000,000 (2006 £nil) which has a five year term. The facility conditions for drawdown had been met during the period. The borrowing is unsecured and there is a cross guarantee in place between the company and its UK subsidiaries. There is a downstream guarantee from the company in relation to its borrowing facility in the Netherlands.

The undrawn borrowing facilities are as follows:

	Interest rate %	2007 £000	Interest rate %	2006 £000
UK	6.2	76,000	6.0	46,000
Netherlands	5.3	367	4.7	337
France	4.3	3,203	4.1	2,022
Switzerland	3.7	2,307	3.2	2,177
		81,877		50,536

All the borrowing facilities above bear interest at floating rates. The Swiss facility may be drawn as an overdraft or fixed rate loan with different terms depending on length of time and amount.

Finance lease liabilities

The group and company have no finance lease liabilities payable at 31 December 2007. The minimum lease liability of £267,000 which was outstanding at 31 December 2006 and payable in less than one year was paid during 2007.

18 TRADE AND OTHER PAYABLES

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Current				
Trade payables	117,316	114,555	159	281
Taxation and social security	10,941	10,857	749	1,326
Non-trade payables and accrued expenses	26,063	24,010	5,078	6,886
Amounts due to subsidiary undertakings	–	–	32,285	32,170
	154,320	149,422	38,271	40,663

Notes to the Financial Statements *continued*

19 EMPLOYEE BENEFITS

Pension plans

During the year, the group operated a UK and Swiss defined benefit plan and defined contribution plans in the UK France and the Netherlands. The Headlam Group plc Staff Retirement Benefits Scheme is the principal defined benefit plan which provides benefits to group employees that have been admitted into the scheme. The scheme is self-administered and its assets are held independently of the company's finances. The scheme is funded partly by contributions from members and partly by contributions from the company at rates advised by professionally qualified actuaries. The latest actuarial valuation was carried out as at 31 March 2005 using the projected unit method. The main annual rate assumptions used by the actuary were, increase in salaries 4.5%, increase of pensions in payment 2.5% discount rate before retirement 6.7% discount rate after retirement 4.7% and inflation 2.5%. Assets were taken at their audited market value at the valuation date.

The total group cost of operating the plans during the year was £3,164,000 (2006 £3,075,000) and at 31 December 2007 there was an amount of £423,000 (2006 £319,000) owed to the plans, being employer and employee contributions due for December 2007 but not received by 31 December 2007.

Included within the total group cost are costs relating to the group's defined contribution plans. The pension cost for the year represents contributions payable by the group to the plans and amounted to £1,361,000 (2006 £1,307,000). Contributions amounting to £95,000 (2006 £88,000) were payable to the scheme at 31 December 2007.

In the UK there is no contractual agreement or stated group policy for allocating the net defined benefit liability between the participating subsidiaries and as such the full deficit is recognised by the company, which is the sponsoring employer. The participating subsidiary companies have recognised a cost equal to contributions payable for the period as advised by a professionally qualified actuary. The company recognises a cost equal to its contributions payable for the period net of amounts recharged in relation to the group deficit to the participating subsidiary companies.

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Present value of funded defined benefit obligations	(71,350)	(73,160)	(66,953)	(69,736)
Fair value of plan assets	60,308	56,220	56,098	52,704
Net obligations	(11,042)	(16,940)	(10,855)	(17,032)
Recognised liability for defined benefit obligations	(11,042)	(16,940)	(10,855)	(17,032)
Other long term employee benefits (note 20)	(286)	(286)	—	—
Total employee benefits	(11,328)	(17,226)	(10,855)	(17,032)
Split:				
Current liabilities	(1,491)	(1,102)	(1,491)	(1,102)
Non-current liabilities	(9,837)	(16,124)	(9,364)	(15,930)
Total employee benefits	(11,328)	(17,226)	(10,855)	(17,032)

Notes to the Financial Statements *continued*

19 EMPLOYEE BENEFITS - CONTINUED

Pension plans - continued

The employee benefits recognised as a current liability represent committed additional group and company contributions to be payable during the year ended 31 December 2008

The group and company expect to contribute approximately £2,845,000 (2006 £2,415,000) to defined benefit plans in the next financial year

Movements in present value of defined benefit obligation

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
At 1 January	73,160	64,750	69,736	64,750
Reclassification of Swiss defined benefit plan	–	3,470	–	–
Current service cost	1,610	1,405	1,477	1,226
Interest cost	3,827	3,342	3,725	3,240
Actuarial (gains)/losses	(4,493)	1,689	(4,989)	1,664
Benefits paid	(3,315)	(1,653)	(3,252)	(1,394)
Contributions by members	334	347	256	250
Effect of movements in foreign exchange	227	(190)	–	–
At 31 December	71,350	73,160	66,953	69,736

Movements in fair value of plan assets

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
At 1 January	56,220	44,524	52,704	44,524
Reclassification of Swiss defined benefit plan	–	3,446	–	–
Expected return on plan assets	3,634	2,979	3,494	2,844
Actuarial gains	507	1,516	313	1,403
Contributions by employer	2,699	5,249	2,583	5,077
Contributions by members	334	347	256	250
Benefits paid	(3,315)	(1,653)	(3,252)	(1,394)
Effect of movements in foreign exchange	229	(188)	–	–
At 31 December	60,308	56,220	56,098	52,704

Following advice from a professionally qualified actuary the Swiss plan was reclassified as a defined benefit plan in 2006

Notes to the Financial Statements *continued*

19 EMPLOYEE BENEFITS - CONTINUED

Pension plans - continued

Expense recognised in the Consolidated Income Statement

	Group	
	2007	2006
	£000	£000
Current service cost	1,610	1,405
Interest on defined benefit plan obligation	3,827	3,342
Expected return on defined benefit plan assets	(3,634)	(2,979)
Total	1,803	1,768

The expense is recognised in the following line items in the Consolidated Income Statement

	Group	
	2007	2006
	£000	£000
Administrative expenses	1,610	1,405
Net financing costs	193	363
Total	1,803	1,768

Cumulative actuarial gains and losses reported in the Statement of Recognised Income and Expenses since 1 January 2004, the transition date to IFRS, are £1,498,000 (2006: £6,498,000). Cumulative actuarial gains and losses reported in the company's Statement of Recognised Income and Expense are £1,284,000 (2006: £6,586,000).

The fair value of the plan assets and the return on those assets were as follows

	Group		Company	
	2007	2006	2007	2006
	£000	£000	£000	£000
Equities	36,052	37,784	35,269	35,263
Government debt	14,689	14,311	14,689	14,311
Corporate bonds	4,771	–	2,670	–
Annuities	3,327	3,122	3,327	3,122
Other	1,469	1,003	143	8
Total	60,308	56,220	56,098	52,704
Actual return on plan assets	4,150	4,556	3,807	4,247

The expected rates of return on plan assets are determined by reference to relevant indices. The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the plan's investment portfolio.

Notes to the Financial Statements *continued*

19 EMPLOYEE BENEFITS - CONTINUED

Pension plans - continued

Principal actuarial assumptions, expressed as weighted averages, are as follows.

	Group		Company	
	2007 %	2006 %	2007 %	2006 %
Discount rate	5.7	5.3	5.9	5.4
Future salary increases	5.2	5.1	5.4	5.3
Future pension increases	3.2	3.1	3.4	3.3
Inflation rate	3.3	3.2	3.4	3.3
Expected rate of return on plan assets	6.4	6.6	6.6	6.7
Mortality table assumptions				
UK pre-retirement	A92 (Ultimate) table	A92 (Ultimate) table	A92 (Ultimate) table	A92 (Ultimate) table
UK post-retirement – future-pensioners	PA92 C=2020	PA92 C=2020	PA92 C=2020	PA92 C=2020
UK post-retirement – current pensioners	PA92 C=2010	PA92 C=2010	PA92 C=2010	PA92 C=2010
Swiss scheme	EVK 2000	EVK 2000	–	–

The mortality assumption implies the expected future lifetime from age 65 is as follows

	Group		Company	
	2007 years	2006 years	2007 years	2006 years
Non-pensioner male	19.9	19.9	19.9	19.9
Pensioner male	19.0	19.0	19.0	19.0
Non-pensioner female	22.8	22.8	22.8	22.8
Pensioner female	22.0	22.0	22.0	22.0

Notes to the Financial Statements *continued*

19 EMPLOYEE BENEFITS – CONTINUED

Pension plans – continued

History of plans

The history of the plans for the current and prior periods is as follows

Balance sheet

	2007 £000	2006 £000	2005 £000	2004 £000
Group				
Present value of defined benefit obligation	(71,350)	(73,160)	(64,750)	(54,729)
Fair value of plan assets	60,308	56,220	44,524	36,815
Deficit	(11,042)	(16,940)	(20,226)	(17,914)

	2007 £000	2006 £000	2005 £000	2004 £000
Company				
Present value of defined benefit obligation	(66,953)	(69,736)	(64,750)	(54,729)
Fair value of plan assets	56,098	52,704	44,524	36,815
Deficit	(10,855)	(17,032)	(20,226)	(17,914)

Experience adjustments

	2007 £000	2006 £000	2005 £000	2004 £000
Group				
On plan liabilities	(4,493)	1,688	6,711	4,786
On plan assets	507	1,518	4,134	1,030
As a percentage of plan liabilities	(6.3%)	2.3%	10.4%	8.7%
As a percentage of plan assets	0.8%	2.7%	9.3%	2.8%
Company				
On plan liabilities	(4,989)	1,664	6,711	4,786
On plan assets	313	1,403	4,134	1,030
As a percentage of plan liabilities	(7.5%)	2.4%	10.4%	8.7%
As a percentage of plan assets	0.6%	2.7%	9.3%	2.8%

Notes to the Financial Statements *continued*

19 EMPLOYEE BENEFITS – CONTINUED

Share-based payments – group and company

Executive directors and executive management currently participate in executive share option schemes. The option price may not be less than the greater of the mid-market value of the group's shares at the time when the options were granted or the nominal value. Options granted under the 1998 Inland Revenue approved scheme are normally exercisable between the third and tenth anniversaries of their date of grant, subject to the movement of the group's basic earnings per share exceeding RPI over the relevant period.

Options granted under the 1998 unapproved scheme are normally exercisable between the third and seventh anniversaries of their date of grant. Awards are subject to the movement of the group's basic earnings per share exceeding RPI between 3% and 5% per annum over the relevant period.

Additionally the group operates a savings related share option scheme ("sharesave scheme") which is open to employees subject to eligibility criteria determined by the directors prior to each option grant. The first grant under the current scheme was made on 28 October 2002 where employees with over one year's service were invited to participate. As this sharesave scheme was granted before 7 November 2002 the recognition and measurement principles in IFRS 2 have not been applied in accordance with the transitional provisions in IFRS 1 and IFRS 2. The most recent grant was on 25 May 2006 when employees with over one month's service were invited to participate. This sharesave scheme has been accounted for under IFRS 2.

Notes to the Financial Statements *continued*

19 EMPLOYEE BENEFITS – CONTINUED

Share-based payments – group and company – continued

The terms and conditions of the grants are as follows whereby all options are settled by physical delivery of shares

Grant date/employees entitled	Number of instruments outstanding		Vesting Conditions	Contractual life of options
	2007	2006		
Approved 1998 scheme grant to key management 10 January 2001	10,000	10,000	Movement of the group's basic earnings per share exceeding RPI over the relevant period	10/01/04 – 10/01/11
Five year sharesave scheme granted to other employees 28 October 2002	374,308	395,849	Continuous service	01/01/08 – 30/06/08
Approved 1998 scheme grant to key management 14 April 2003	46,404	70,357	Movement of the group's basic earnings per share exceeding RPI over the relevant period	14/04/06 – 14/04/13
Unapproved 1998 scheme grant to key management 14 April 2003	12,596	22,596	Movement of the group's basic earnings per share exceeding RPI over the relevant period	14/04/06 – 14/04/10
Unapproved 1998 scheme grant to key management 22 August 2005	1,242,864	1,242,864	Movement of the group's basic earnings per share exceeding RPI by 3%-5% pa over the relevant period	22/08/08 – 22/08/12
Approved 1998 scheme granted to key management 22 August 2005	57,136	57,136	Movement of the group's basic earnings per share exceeding RPI by 3% pa over the relevant period	22/08/08 – 22/08/15
Three year sharesave scheme granted to other employees 25 May 2006	217,059	231,365	Continuous service	01/07/09 – 01/01/10
Five year sharesave scheme granted to other employees 25 May 2006	154,563	179,524	Continuous service	01/07/11 – 01/01/12
Total share options	2,114,930	2,209,691		

Notes to the Financial Statements *continued*

19 EMPLOYEE BENEFITS – CONTINUED

Share-based payments – group and company – continued

The movement and weighted average exercise prices of share options during the year are as follows

	Weighted average exercise price 2007	Number of options 2007	Weighted average exercise price 2006	Number of options 2006
Outstanding at the beginning of the year	366.6	2,209,691	319.9	2,407,331
Exercised during the year	223.3	(43,275)	207.5	(566,667)
Granted during the year	–	–	401.0	419,436
Lapsed during the year	342.4	(51,486)	211.9	(50,409)
Outstanding at the end of the year	370.1	2,114,930	366.6	2,209,691
Exercisable at the end of the year	202.4	69,000	206.5	102,953

Options were exercised on a regular basis during the year. The average share price during the year was 589.4p (2006: 489.4p).

Of the options exercised during the year 40,700 were new share issues and 2,575 were issues from treasury.

The options outstanding at the year end have an exercise price in the range of 128.0p to 420.0p and a weighted average contractual life of 5.4 years.

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured using the Black-Scholes option pricing model.

It is expected that the options will be exercised as soon as they reach maturity.

There are no market conditions associated with the share option grants.

The expected volatility is based on historic volatility calculated over the weighted average remaining life of the share options.

There were no share options granted during the year ended 31 December 2007. Details of the fair value of share options granted during 2006 are shown below:

	3 year options	5 year options
2006		
Fair value at measurement date	97.4p	105.2p
Share price at 31 December	615p	615p
Exercise price	401p	401p
Expected volatility (expressed as weighted average volatility used in the modelling under the Black-Scholes model)	36.8	32.1
Option life (expressed as weighted average life used in the modelling under the Black-Scholes model)	3 years	5 years
Expected dividends	3.1%	3.1%
Risk-free interest rate (based on UK Gilts)	4.6%	4.6%

Notes to the Financial Statements *continued*

19 EMPLOYEE BENEFITS – CONTINUED

Share-based payments – group and company – continued

The total expenses recognised for the year arising from share based payments are as follows

	Group		Company		Subsidiaries	
	2007 £000	2006 £000	2007 £000	2006 £000	2007 £000	2006 £000
Share options granted in 2003 under the approved 1998 scheme	–	14	–	–	–	14
Share options granted in 2003 under the unapproved 1998 scheme	–	3	–	2	–	1
Share options granted in 2005 under the approved 1998 scheme	17	17	6	6	11	11
Share options granted in 2005 under the unapproved 1998 scheme	369	369	187	187	182	182
Share options granted in 2006 under the SAYE 3 year scheme	77	46	1	1	76	45
Share options granted in 2006 under the SAYE 5 year scheme	38	23	–	–	38	23
Total expense recognised	501	472	194	196	307	276

20 OTHER LONG TERM EMPLOYEE BENEFITS – GROUP

During the year, the group operated an employment indemnity scheme in connection with a foreign subsidiary undertaking to provide for lump sum cash payments due to employees retiring on their normal retirement date. The present retirement indemnity obligation at 31 December 2007 is £286,000 (2006: £286,000).

Notes to the Financial Statements *continued*

21 CAPITAL AND RESERVES

Reconciliation of movement in capital and reserves – group

	Share capital £000	Share premium £000	Capital redemption reserve £000	Translation reserve £000	Treasury reserve £000	Retained earnings £000	Total equity £000
Balance at 1 January 2006	4,326	52,280	–	(577)	–	79,798	135,827
Transfer between reserves	–	–	–	380	–	(380)	–
Total recognised income and expense	–	–	–	(419)	–	31,375	30,956
Equity-settled share based payment transactions	–	–	–	–	–	472	472
Share options exercised by employees	28	1,148	–	–	–	–	1,176
Deferred tax on Schedule 23 share options (pre November 2002)	–	–	–	–	–	193	193
Dividends	–	–	–	–	–	(15,612)	(15,612)
Balance at 31 December 2006	4,354	53,428	–	(616)	–	95,846	153,012
Balance at 1 January 2007	4,354	53,428	–	(616)	–	95,846	153,012
Total recognised income and expense	–	–	–	1,090	–	34,978	36,068
Equity-settled share based payment transactions	–	–	–	–	–	501	501
Cancellation of own shares	(88)	–	88	–	–	(10,073)	(10,073)
Consideration for purchase of own shares	–	–	–	–	(11,614)	–	(11,614)
Share options exercised by employees	2	84	–	–	10	–	96
Deferred tax on Schedule 23 share options (pre November 2002)	–	–	–	–	–	(494)	(494)
Dividends	–	–	–	–	–	(17,455)	(17,455)
Balance at 31 December 2007	4,268	53,512	88	474	(11,604)	103,303	150,041

Notes to the Financial Statements *continued*

21 CAPITAL AND RESERVES - CONTINUED

Reconciliation of movement in capital and reserves – company

	Share capital £000	Share premium £000	Capital redemption reserve £000	Translation reserve £000	Special reserve £000	Treasury reserve £000	Retained earnings £000	Total equity £000
Balance at 1 January 2006	4,326	52,280	–	(1,759)	20,578	–	62,833	138,258
Transfer between reserves	–	–	–	1,759	–	–	(1,759)	–
Total recognised income and expense	–	–	–	–	–	–	32,359	32,359
Equity-settled share based payment transactions	–	–	–	–	–	–	472	472
Share options exercised by employees	28	1,148	–	–	–	–	–	1,176
Deferred tax on Schedule 23 share options (pre November 2002)	–	–	–	–	–	–	54	54
Dividends	–	–	–	–	–	–	(15,612)	(15,612)
Balance at 31 December 2006	4,354	53,428	–	–	20,578	–	78,347	156,707
Balance at 1 January 2007	4,354	53,428	–	–	20,578	–	78,347	156,707
Total recognised income and expense	–	–	–	–	–	–	38,890	38,890
Equity-settled share based payment transactions	–	–	–	–	–	–	501	501
Cancellation of own shares	(88)	–	88	–	–	–	(10,073)	(10,073)
Consideration for purchase of own shares	–	–	–	–	–	(11,614)	–	(11,614)
Share options exercised by employees	2	84	–	–	–	10	–	96
Deferred tax on Schedule 23 share options (pre November 2002)	–	–	–	–	–	–	(74)	(74)
Dividends	–	–	–	–	–	–	(17,455)	(17,455)
Balance at 31 December 2007	4,268	53,512	88	–	20,578	(11,604)	90,136	156,978

Notes to the Financial Statements *continued*

21 CAPITAL AND RESERVES - CONTINUED

Share capital

	Ordinary shares	
	2007	2006
Number of Shares		
On issue at 1 January	87,079,521	86,512,854
Allotted under share option scheme	40,700	566,667
Cancelled shares	(1,756,478)	—
On issue at 31 December – fully paid	85,363,743	87,079,521
	2007	2006
	£000	£000
Authorised		
Ordinary shares of 5p each	5,392	5,392
5.6% cumulative preference shares of £1 each	50	50
	5,442	5,442
Allotted, called up and fully paid		
Ordinary shares of 5p each	4,268	4,354
5.6% cumulative preference shares of £1 each	—	—
	4,268	4,354
Shares classified as liabilities	—	—
Shares classified in shareholders funds	4,268	4,354
	4,268	4,354

During the year the company purchased 1,756,478 shares for cancellation with a nominal value of £87,824 representing 2% of the issued share capital amounting to £10,073,000.

The company also purchased 2,081,528 shares to be held in treasury with a nominal value of £104,076, representing 2% of the issued share capital amounting to £11,614,000. At 31 December 2007, there were 2,078,953 shares held in treasury, 2,575 shares being utilised to satisfy the exercise of SAYE share option awards. Dividends are not payable on these shares and they are excluded from the calculation of earnings per share.

In the period from 31 December 2007 to 17 March 2008 a further 550,000 shares have been purchased for consideration amounting to £2,203,992.

Ordinary shares

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the company.

Notes to the Financial Statements *continued*

21 CAPITAL AND RESERVES - CONTINUED

Preference shares

The preference shares carry a fixed cumulative preferential dividend at the rate of 5.6% per annum. On a winding up they entitle the holders to repayment of the capital paid up on the shares, together with a premium of 7.50p per share and a sum equal to any arrears of the fixed dividend thereon.

The dividend will be calculated to the date of the return of capital and will be payable irrespective of whether such dividend has been declared or earned or not in priority to any payment to the holders of any other shares. The preference shares do not entitle the holders to any further participation in the profits or assets of the company. The preference shares have no voting rights unless the fixed cumulative preference dividend is in arrears for a period of six months or a resolution is to be proposed to alter the provisions of the Memorandum of Association of the company with respect to its objects or varying or abrogating any of the special rights or privilege attached to preference shares or for winding up the company.

Capital redemption reserve

The capital redemption reserve represents the nominal value of shares repurchased and cancelled during 2007.

Translation reserve

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign subsidiaries.

Treasury reserve

The treasury reserve comprises the cost of the company's shares held by the group. At 31 December 2007, the group held 2,078,953 of the company's shares (2006 Nil).

Special reserve

The special reserve arose on the issuance of ordinary shares in connection with acquisitions made by the company in earlier years.

Dividends

	2007 £000	2006 £000
Interim dividend for 2006 of 4.85p paid 3 January 2007	4,218	—
Final dividend for 2006 of 15.30p paid 3 July 2007	13,237	—
Interim dividend for 2005 of 4.40p paid 3 January 2006	—	3,789
Final dividend for 2005 of 13.60p paid 3 July 2006	—	11,823
	17,455	15,612

The final proposed dividend of 17.75p per share (2006 15.30p per share) will not be provided for until authorised by shareholders at the forthcoming AGM.

Interim dividends of 5.35p per share (2006 4.85p per share) are provided for when the dividend is paid.

The total value of dividends proposed but not recognised at 31 December 2007 is £19,219,000 (2006 £17,455,000).

22 FINANCIAL INSTRUMENTS

The main financial risks arising in the normal course of the group's business are credit risk, liquidity risk, interest rate risk and foreign currency risk. Derivative transactions relate to forward currency contracts used to manage the currency risks from the group's selling and buying activities.

Credit risk

The group and company have a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all new customers requiring credit cover over £1,000 and these are frequently reviewed by management to limit exposure. Businesses must obtain central approval for credit limits in excess of £10,000. The group does not require collateral in respect of financial assets.

Notes to the Financial Statements *continued*

22 FINANCIAL INSTRUMENTS - CONTINUED

Credit risk - *continued*

At the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

The carrying amount of financial assets at the balance sheet date was

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Trade and other receivables (note 15)	100,830	91,284	20,466	21,899
Cash and cash equivalents (note 16)	16,805	41,861	30,135	40,221
	117,635	133,145	50,601	62,120

The maximum exposure to credit risk for trade receivables at the balance sheet date by geographic region was

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
UK	63,352	57,933	1	22
Continental Europe	14,116	31,572	–	–
	77,468	71,505	1	22

The ageing of trade receivables at the balance sheet date was

	Gross £000	2007 Impairment £000	Gross £000	2006 Impairment £000
Not past due	75,046	–	69,194	–
Past due 0-30 days	2,186	–	2,311	–
Past due 31-120 days	2,109	(1,873)	1,859	(1,859)
	79,341	(1,873)	73,364	(1,859)

The company had trade receivables of £1,000 (2006 £22,000) all of which are not past due.

The movement in the allowance for impairment in respect of trade receivables during the year was as follows

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Balance at 1 January	1,859	1,814	–	–
Movement in year	14	45	–	–
Balance at 31 December	1,873	1,859	–	–

The movement in impairment loss during the year consists of an impairment loss recognised in the Consolidated Income Statement, net of the utilisation of the credit loss allowance and foreign exchange movements.

Notes to the Financial Statements *continued*

22 FINANCIAL INSTRUMENTS - CONTINUED

Credit risk - continued

Based on historic default rates, the group believes that no general impairment allowance is necessary in respect of trade receivables however the group provides fully for specific debts when required. During the year the group's impairment loss as a percentage of revenue amounted to 0.20% (2006 0.25%).

Liquidity risk

Liquidity risk is the risk that the group will not be able to meet its financial obligations as they fall due. The group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due.

The following are the contractual maturities of financial liabilities all of which are due within one year:

Group	2007		2006	
	Carrying amount £000	Contractual Cash flows £000	Carrying amount £000	Contractual Cash flows £000
Trade and other payables (note 18)	154,320	154,320	149,422	149,422
Bank overdrafts (note 16)	103	103	1,010	1,010
Other interest-bearing loans and borrowings (note 17)	—	—	267	267
	154,423	154,423	150,699	150,699

Company	2007		2006	
	Carrying amount £000	Contractual Cash flows £000	Carrying amount £000	Contractual Cash flows £000
Trade and other payables (note 18)	38,271	38,271	40,663	40,663
Other interest-bearing loans and borrowings (note 17)	—	—	267	267
	38,271	38,271	40,930	40,930

Interest rate risk

The group and company are exposed to interest rate fluctuations on borrowings and cash deposits. Borrowings are principally in sterling, euros and Swiss francs at both fixed and floating rates; deposits in sterling, euros and Swiss francs at floating rates. During the year, the group maintained its policy of borrowing at floating rates.

At the reporting date the interest rate profile of the group's interest-bearing financial instruments was:

	Group		Company	
	2007 Carrying amount £000	2006 Carrying amount £000	2007 Carrying amount £000	2006 Carrying amount £000
Variable rate instruments				
Financial assets	16,805	41,861	30,135	40,221
Financial liabilities	(103)	(1,277)	—	(267)
	16,702	40,584	30,135	39,954

There were no fixed rate instruments held by the group at 31 December 2007 (2006 £nil).

Notes to the Financial Statements *continued*

22 FINANCIAL INSTRUMENTS - CONTINUED

Sensitivity analysis

A change of 100 basis points in the interest rates at the reporting date would have increased/(decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis is performed on the same basis for 2006.

	Group				Company			
	Profit or loss		Equity		Profit or loss		Equity	
	100bp increase £000	100bp decrease £000	100bp increase £000	100bp decrease £000	100bp increase £000	100bp decrease £000	100bp increase £000	100bp decrease £000
31 December 2007								
Variable rate instruments	167	(167)	–	–	301	(301)	–	–
31 December 2006								
Variable rate instruments	406	(406)	–	–	400	(400)	–	–

Foreign currency risk

The group and company are exposed to movements in currency exchange rates arising from transaction currency cash flows and the translation of the results and net assets of overseas subsidiary operations. These exposures, however, have not had a significant effect on the results and financial position of the group overall. The currencies giving rise to this risk are primarily the euro and Swiss franc.

The group and company use forward exchange contracts to hedge their foreign currency transactional risk. A future foreign currency contract would be entered into where there was a known requirement for the currency due to planned imports that are not invoiced in sterling. These forward exchange contracts would have a maturity of less than one year after the balance sheet date. The group also enters into foreign currency contracts at spot rate where the amounts are not frequent or material. Gains and losses on currency contracts recognised as a liability as at 31 December 2007 amounted to £23 000 (2006: £62 000).

For the twelve month period to 31 December 2007, 6.3% (2006: 4.7%) of the group's operating profit was derived from overseas subsidiaries and at 31 December 2007, 10.8% (2006: 8.6%) of the group's operating assets related to overseas subsidiary operations. Hedge accounting, following the adoption of IFRS, has not been applied to these operations given their relative size and because of the onerous level of compliance required under IAS 39.

The group and company do not use derivatives other than as described above.

In managing interest rate and currency risks the group and company aim to reduce the impact of short-term fluctuations on company and group's earnings. In the short term, income statement and net asset volatility arising from these exposures is not considered significant. Over the longer-term, however, permanent changes in interest rates and foreign exchange have the potential to impact the Consolidated Income Statement and carrying value of net assets.

Notes to the Financial Statements *continued*

22 FINANCIAL INSTRUMENTS - CONTINUED

Foreign currency risk - continued

The group's exposure to foreign currency risk based on notional amounts was as follows

2007	Euro amount £000	Group Other amount £000	Total £000	Euro amount £000	Company Other amount £000	Total £000
Trade and other receivables	–	–	–	86	19	105
Cash and cash equivalents	586	26	612	417	1	418
Trade and other payables	(1,304)	(185)	(1,489)	–	–	–
	(718)	(159)	(877)	503	20	523

2006	Euro amount £000	Group Other amount £000	Total £000	Euro amount £000	Company Other amount £000	Total £000
Trade and other receivables	–	–	–	74	16	90
Cash and cash equivalents	1,074	–	1,074	442	–	442
Trade and other payables	(1,568)	(182)	(1,750)	–	–	–
	(494)	(182)	(676)	516	16	532

Sensitivity analysis

A 10 percent strengthening of sterling against the following currencies at 31 December would have increased/(decreased) profit or loss by the amounts shown below there is no equity effect. This analysis assumes that all other variables, in particular interest rates remain constant. The analysis is performed on the same basis for 2006

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Euro	(72)	(49)	50	52
Other	(16)	–	2	2

A 10 percent weakening of sterling against the above currencies at 31 December 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.

Notes to the Financial Statements *continued*

22 FINANCIAL INSTRUMENTS - CONTINUED

Fair values

The carrying amounts shown in the balance sheet for financial instruments are a reasonable approximation to fair value

Trade receivables, trade payables and cash and cash equivalents – Fair values are assumed to approximate to cost due to the short term maturity of the instrument

Borrowings, other financial assets and other financial liabilities – Where available, market values have been used to determine fair values. Where market values are not available, fair values have been estimated by discounting expected future cash flows using prevailing interest rate curves. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date.

Capital management

The board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The board closely monitors the shareholder base, dividend yield and earnings per share.

The group has commenced a share buy-back programme, to return cash to shareholders and improve balance sheet efficiency.

There were no changes to the group's approach to capital management in the year.

Notes to the Financial Statements *continued*

23 ACQUISITIONS OF SUBSIDIARIES

On 30 March 2007, the company acquired 100% of the ordinary share capital of 3D Flooring Supplies Limited, a regional commercial floorcovering distributor located in South Wales and south west England, for a cash consideration of £1,377,500. On 27 April 2007, the company acquired 100% of the ordinary share capital of Florprotec Limited for a cash consideration of £1,249,600. Florprotec is a leading national supplier of floor protection products for the construction industry and refurbishment projects. On 27 July 2007, a group subsidiary company acquired the trade and assets of Plantation Rug Company for a cash consideration of £490,700. Plantation Rug Company is a supplier of rugs to independent retailers throughout the UK. Since their acquisition the businesses have contributed profit of £287,000 to the consolidated profit for the year attributable to the equity shareholders. If the acquisitions had occurred on 1 January 2007 group revenue would have been an estimated £548,535,000 and profit would have been an estimated £31,971,000.

	Acquiree's book value £000	Fair value adjustments £000	Acquisition amounts £000
Acquiree's net assets at the acquisition date			
Intangible assets	–	1 517	1 517
Property, plant and equipment	293	(27)	266
Inventories	1,682	(8)	1 674
Trade and other receivables	1,756	–	1,756
Cash and cash equivalents	9	–	9
Short-term funding	(246)	–	(246)
Trade and other payables	(1,706)	–	(1,706)
Income tax payable	(67)	–	(67)
Deferred tax liabilities	(4)	–	(4)
Net identifiable assets and liabilities	1,717	1,482	3 199
Goodwill on acquisition			–
Consideration paid			(3 199)
Satisfied by:			
Cash			3 118
Acquisition costs capitalised			81
			3,199
Analysis of cash flows			
On completion			(3 118)
Costs of acquisition			(81)
Cash and cash equivalents			9
			(3,190)

No goodwill has arisen on the acquisition of 3D Flooring Supplies Limited, Florprotec Limited or on the acquisition of the trade and assets of Plantation Rug Company. The intangible assets on acquisition are attributable to customer order books.

Following acquisition it is the group's normal practice to implement its operational and financial procedures and IT systems.

Furthermore, acquired businesses gain access to the group's extensive product ranges and benefit from enhanced sales and marketing investment. These changes typically enable acquired businesses to enhance the service provided to their customers and ultimately develop and grow.

Notes to the Financial Statements *continued*

23 ACQUISITIONS OF SUBSIDIARIES - CONTINUED

Whilst acquired customer order books are a key component at the point of acquisition this position quickly dissipates during the post acquisition period. The dynamic and renewable nature of this class of asset is the reason the group typically elects to amortise it over a period of between one and twenty four months the precise period being dependant upon the size of the acquired business.

During 2007, the intangible assets amounting to £1,517,000 were amortised in full.

On 6 October 2006, the company acquired Concept (Midlands) Limited, a distributor of commercial flooring located in West Bromwich, supplying flooring contractors throughout the Midlands. Total consideration paid was £1,747,150 satisfied in cash. In the three months to 31 December 2006, the business contributed profit of £67,000 to the consolidated profit for the year attributable to the equity shareholders. If the acquisition had occurred on 1 January 2006 group revenue would have been an estimated £512,168,000 and profit would have been an estimated £30,764,000.

	Acquiree's book value £000	Fair value adjustments £000	Acquisition amounts £000
Acquiree's net assets at the acquisition date			
Intangible assets	–	690	690
Property, plant and equipment	341	–	341
Inventories	387	–	387
Trade and other receivables	629	–	629
Cash and cash equivalents	378	–	378
Trade and other payables	(678)	–	(678)
Net identifiable assets and liabilities	1,057	690	1,747
Goodwill on acquisition			–
Consideration paid			(1,747)
Satisfied by			
Cash			1,722
Acquisition costs capitalised			25
			1,747
Analysis of cash flows			
On completion			(1,722)
Costs of acquisition			(25)
Cash and cash equivalents			378
			(1,369)

No goodwill has arisen on the acquisition of Concept (Midlands) Limited and the intangible asset on acquisition was attributed to the customer order book. The intangible asset was amortised in full during 2006.

Notes to the Financial Statements *continued*

24 OPERATING LEASES

The aggregate payments, for which there are commitments under non-cancellable operating leases as at the end of the year fall due as follows

Group	Land and buildings £000	2007 Plant and machinery £000	Total £000	Land and buildings £000	2006 Plant and machinery £000	Total £000
Less than one year	1,630	7,947	9,577	730	6,142	6,872
Between one and five years	4,965	9,833	14,798	2,920	13,560	16,480
More than five years	3,061	–	3,061	2,747	515	3,262
	9,656	17,780	27,436	6,397	20,217	26,614

Company	Land and buildings £000	2007 Plant and machinery £000	Total £000	Land and buildings £000	2006 Plant and machinery £000	Total £000
Less than one year	16	15	31	16	15	31
Between one and five years	65	1	66	65	16	81
More than five years	1,276	–	1,276	1,292	–	1,292
	1,357	16	1,373	1,373	31	1,404

The group leases the majority of its motor and commercial vehicles on terms that range between three and five years

During the year ended 31 December 2007 £10,258,000 was recognised as an expense in the Consolidated Income Statement in respect of operating leases (2006 £9,757,000)

25 CAPITAL COMMITMENTS

Group

During the year ended 31 December 2007, the group entered into contracts to purchase property, plant and equipment for £1,906,000 (2006 £251,000). These commitments are expected to be settled in the following financial year.

Company

During the year ended 31 December 2007, the company entered into contracts to purchase property, plant and equipment for £1,541,000 (2006 £80,000). These commitments are expected to be settled in the following financial year.

Notes to the Financial Statements *continued*

26 RELATED PARTIES

Group

Identity of related parties

The group has a related party relationship with its subsidiaries and with its directors and executive officers

Transactions with key management personnel

As at 31 December 2007 directors of the company and their immediate relatives controlled 13 per cent of the voting shares of the company (2006 15 per cent)

The remuneration of the board of directors who are the key managing personnel of the group, is set out below in aggregate for each of the categories specified in IAS 24 'Related Party Disclosures'

	2007 £000	2006 £000
Short-term employee benefits	2,305	2,222
Share based payment	179	178
	2,484	2,400

Details of the directors remuneration is disclosed within the Remuneration Report on page 38

Company

Identity of related parties

The company has a related party relationship with its subsidiaries and with its directors and executive officers

Transactions with key management personnel

As at 31 December 2007, directors of the company and their immediate relatives control 13 per cent of the voting shares of the company (2006 15 per cent)

The remuneration of the directors of the company is set out below in aggregate for each of the categories specified in IAS 24 'Related Party Disclosures'

	2007 £000	2006 £000
Short-term employee benefits	2,305	2,222
Share based payment	179	178
	2,484	2,400

The directors and their remuneration is fully disclosed within the Remuneration Report on page 38

Notes to the Financial Statements *continued*

26 RELATED PARTIES - CONTINUED

Transactions with other group companies

	Highest during the year £000	Balance at 31 December 2007 £000	Highest during the year £000	Balance at 31 December 2006 £000
Amounts due from subsidiary undertakings	19,909	19,909	23,272	19,839
Amounts due to subsidiary undertakings	(32,285)	(32,285)	(50,587)	(32,170)

The disclosure of the year end balance and the highest balance during the year is considered to provide a meaningful representation of transactions between the company and its subsidiaries in the year. The highest balance is generally at the start or close of the financial period since this is the time when the company levies its management charge.

Transactions reported in the income statement

	2007 £000	2006 £000
Rental income	5,265	5,095
Dividends received	33,629	34,775
Management charges	2,352	2,071
Interest income	483	48
Pension recharge	307	1,846

27 SUBSEQUENT EVENTS

There have been no events after the balance sheet date that require disclosure.

Principal Trading Subsidiaries

	Place of incorporation
* HFD Limited	Great Britain
* MCD Group Limited	Great Britain
Lethem-Vergeer BV	Netherlands
DFA SA	France
* Belcolor AG	Switzerland

All of these subsidiaries are wholly owned and are principally engaged as a distributor of floorcoverings and associated products

- * These subsidiaries are owned directly by Headlam Group plc. The investment in subsidiaries comprises ordinary share capital.

Financial Record

	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000
Trading results					
Revenue	412 295	464 789	486 653	509 899	544 718
Operating profit before goodwill amortisation	33 514	38 924	41 498	43 941	46 013
Goodwill amortisation	(835)	–	–	–	–
Operating profit	32 679	38 924	41 498	43 941	46 013
Profit before net financing costs	32 679	38 924	41 498	43 941	46 013
Net financing costs	(86)	(440)	(658)	(383)	(841)
Profit on ordinary activities before tax	32 593	38 484	40 840	43 558	45 172
Taxation	(10 464)	(11 738)	(12 352)	(13 067)	(13 534)
Profit on ordinary activities after taxation	22 129	26 746	28 488	30 491	31 638

Shareholder value					
Paid dividend per share	12 55p	13 85p	16 25p	18 00p	20 15p
Proposed dividend per share	13 85p	16 25p	18 00p	20 15p	23 10p
Earnings per share *	27 3p	31 3p	33 1p	35 1p	37 1p

Net assets

Non-current assets					
Property plant and equipment	64 236	71 754	74 640	85 032	92 097
Intangible assets	13 210	14 046	13 210	13 210	13 210
Deferred tax assets	–	8 167	8 199	9 182	5 942
	77 446	93 967	96 049	107 424	111 249
Current assets					
Inventories	73 889	79 692	91 160	94 217	101 491
Trade and other receivables	77 877	85 550	84 275	91 284	100 830
Cash and cash equivalents	32 336	37 747	36 193	41 861	16 805
	179 102	202 989	211 628	227 362	219 126
Non current assets classified as held for sale	1 042	203	3 471	–	–
Total assets	257 590	297 159	311 148	334 786	330 375
Current liabilities					
Bank overdraft	(216)	(279)	–	(1 010)	(103)
Other interest bearing loans and borrowings	(2 328)	(1 124)	(471)	(267)	–
Trade and other payables	(135 209)	(142 018)	(141 529)	(149 422)	(154 320)
Employee benefits	–	(722)	(1 080)	(1 102)	(1 491)
Income tax payable	(9 625)	(11 053)	(11 139)	(10 184)	(10 747)
	(147 378)	(155 206)	(154 219)	(161 985)	(166 661)
Non-current liabilities					
Other interest bearing loans and borrowings	(1 175)	(738)	(267)	–	–
Employee benefits	–	(17 643)	(19 432)	(16 124)	(9 837)
Other payables	(375)	–	–	–	–
Deferred tax liabilities	(402)	(1 212)	(1 403)	(3 665)	(3 836)
	(1 952)	(19 593)	(21 102)	(19 789)	(13 673)
Total liabilities	(149 330)	(174 799)	(175 321)	(181 774)	(180 334)
Net assets	108 260	122 360	135 827	153 012	150 041

* The earnings per share for 2003 is calculated by reference to operating profit before goodwill amortisation and exceptional items.

The information relating to 2003 has not been restated for IFRS

Shareholder Information

Shareholder helpline

Headlam's shareholder register is maintained by Capita Registrars ("Capita") who are responsible for making dividend payments and updating the register, including details of changes to shareholders' addresses and purchases or sales of Headlam shares. If you have a question about your shareholding in Headlam you should contact Capita Registrars, Northern House, Woodsome Park, Fenay Bridge, Huddersfield, HD8 0LA, telephone +44 (0)871 664 0300 (calls cost 10p plus network extras), email ssd@capitaregistrars.com

Frequent shareholder enquiries

If you change your address

Please notify Capita in writing. If shares are held in joint names, the notification must be signed by all named shareholders.

If you change your name

Please notify Capita in writing and enclose a copy of any marriage certificate or change of name deed as evidence.

Lost Headlam share certificate

If your share certificate is lost or stolen, you should call Capita immediately. A letter of indemnity will be sent to you to sign. Capita will charge for this service.

Duplicate shareholder accounts

If you receive more than one copy of Headlam communications you may have your shares registered inadvertently in at least two accounts. This happens when the registration details of separate transactions differ slightly. If you wish to consolidate such multiple accounts, call Capita to request the accounts are consolidated.

Buying and selling shares in the UK

If you wish to trade in Headlam shares you can do so at Capita's website, www.capitadeal.com or alternatively use a stockbroker or high street bank which trades on the London Stock Exchange. There are many telephone and online services available. If you are selling, you will need to present your share certificate at the time of sale.

Transferring Headlam shares

Transferring shares to someone else requires the completion of a stock transfer form. This form and details of the procedure you need to follow is available from Capita's website. Stamp duty is not normally payable if the transfer is to a relative or if there is no money being paid in exchange for the shares.

Share prices information

Shareholders can find share prices listed in most national newspapers. Ceefax and Teletext pages also display share prices that are updated regularly throughout the trading day. For a real-time buying or selling price you should contact a stockbroker. Additionally there is a link to the London Stock Exchange on the Headlam website.

The Headlam website

The Headlam website at www.headlam.com provides news and details of the company's activities plus information on the share price. The investor information section of the website contains up-to-date information for shareholders including the company's latest results and key dates such as dividend payment dates.

ShareGift

ShareGift, the charity share donation scheme, is a free service for shareholders wishing to give shares to charitable causes. It may be especially useful for those who wish to dispose of a small parcel of shares which would cost more to sell than they are worth. There are no capital gains tax implications (i.e. no gain or loss) on gifts of shares to charity and it is also possible to obtain income tax relief. Further information can be obtained at www.sharegift.org.

The Unclaimed Assets Register

The Unclaimed Assets Register is a unique search service that helps individuals to find their lost assets and re-establish contact with financial institutions. It has a database of unclaimed life policies, pensions unit trust holdings, and share dividends drawn from many companies and can search for lost assets and entitlements. The Unclaimed Assets Register charges a small fixed fee for each search, 10% of which goes to charity. For further information, visit www.uar.co.uk.

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