headlam
group plc

Europe's leading floorcovering distributor

Annual Report and Accounts 2005

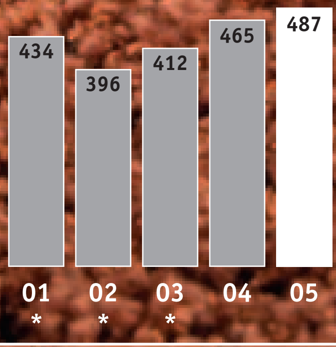
Headlam has a clear and focused strategy based on the creation of a diverse and autonomous structure. The group operates through 46 separate businesses in the UK and a further three in Continental Europe.

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 businesses.

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 subsequent performance enabling it to develop into Europe's leading floorcovering distributor.

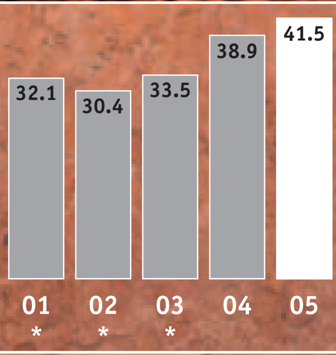
Financial Highlights

Sales (£m)



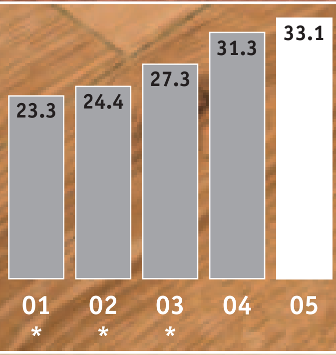
+4.7%

Operating Profit (£m)



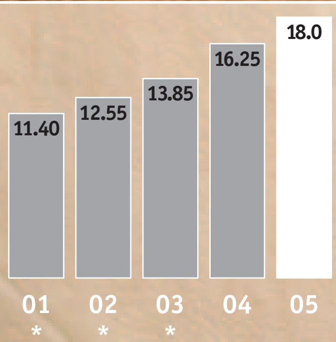
+2.6m

Earnings Per Share (p)



+5.8%

Proposed Dividends (p)



+10.8%

* not restated for IFRS

Market Presence

The UK operating structure incorporates 46 individual businesses located across 21 distribution centres. Of these, 25 are multi-product distribution businesses that trade on a regional basis. Six of the businesses provide national multi-product distribution whilst the remaining 15 are suppliers of specific types of floorcovering that target particular sectors within the residential and commercial markets.

Our business in France operates from two distribution centres and 20 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.

Regional Multi-product Distribution HFD

Market Presence (continued)

Regional Multi-product Distribution MCD

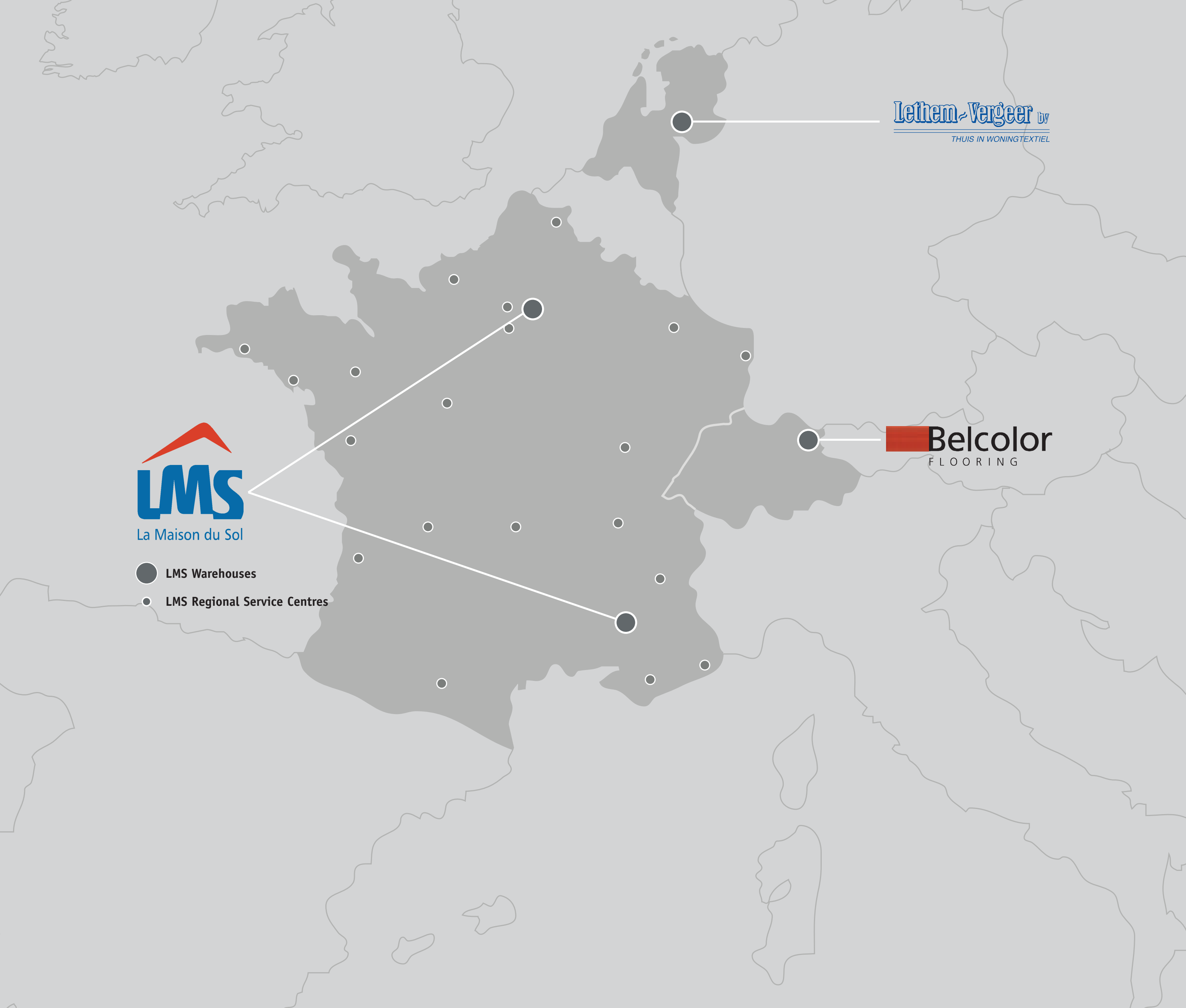
National Multi-product Distribution Network

Market Presence (continued)

National Residential and Commercial Specialist Products

European Multi-product Distribution

Lethem-Vergeer - The Netherlands
La Maison du Sol - France
Belcolor Flooring - Switzerland



We are able to offer the independent floor covering retailer and contractor a huge breadth of product including the latest trends and innovations.

Our businesses have clearly focused market objectives across a broad range of floorcovering products and are supported by comprehensive stockholdings.

Chairman's Statement

The group has had another successful year despite more difficult market conditions in 2005. The group's revenue and profit for the year were another record, with improvements being achieved across all sections of the business.

Revenues from the group's activities amounted to £486.6 million, an increase of 4.7% on last year, and profit before tax increased by 6.0% to £40.8 million.

Earnings and dividend

Basic earnings per share increased by 5.8% from 31.3p to 33.1p. The board is recommending a final dividend of 13.60p per share, an increase of 11.0% on last year. This increases the total dividend for the year by 10.8% from 16.25p to 18.00p. If approved, the final dividend will be paid on 3 July 2006 to shareholders on the register at 9 June 2006.

Operations

We have continued with our strategy of businesses operating autonomously to maximise market presence. We now have 46 businesses operating from 21 distribution centres in the UK and whilst enjoying this individuality, all the businesses operate to a defined strategy and comply with consistent reporting procedures.

These businesses have clearly focused market objectives across a broad range of floorcovering products and are supported by comprehensive stockholdings. This ensures that we have strong long-term relationships with the leading floorcovering manufacturers and most importantly, offer the independent floorcovering retailer and contractor a huge breadth of product, including the latest trends and innovations.

During the year, we completed the construction of the distribution facility in Tamworth at a cost of £5.2 million bringing the total amount invested on this facility to £13.9 million. Construction also commenced on the new purpose built freehold facility for our Wilkies business based in Leeds. During 2005, we invested £2.0 million and a further £9.4 million will be expended before the site becomes operational during the autumn of 2006.

The Board

I have now completed twelve years as a non-executive director of Headlam, the past six as Chairman and the time has come for me to retire from the board which I shall do at the conclusion of the forthcoming AGM.

Graham Waldron, who has a wealth of experience in the floorcovering industry, will continue to guide the strategy of the group in an executive capacity and following my retirement, be appointed Chairman.

I am pleased to have welcomed in recent months Dick Peters and Mike O'Leary to the board as non-executive directors, both of whom I expect will make positive contributions to the future growth and development of the group.

It is with much sadness that I record the death of Roger Dickens in January 2006 and we send our sincere sympathy to Lainey Dickens and family. Roger was a highly respected member of our board and we have lost a valued colleague and friend. We shall miss him.

Employees

The group has great strength in its management teams across the whole business. It has been a particular pleasure to see how this has developed over the twelve years I have been a director. The group's performance reflects the commitment, dedication and efforts of our employees in providing the services given to our customers. The board wishes to record its thanks to all our employees for their hard work and continued customer service.

Outlook

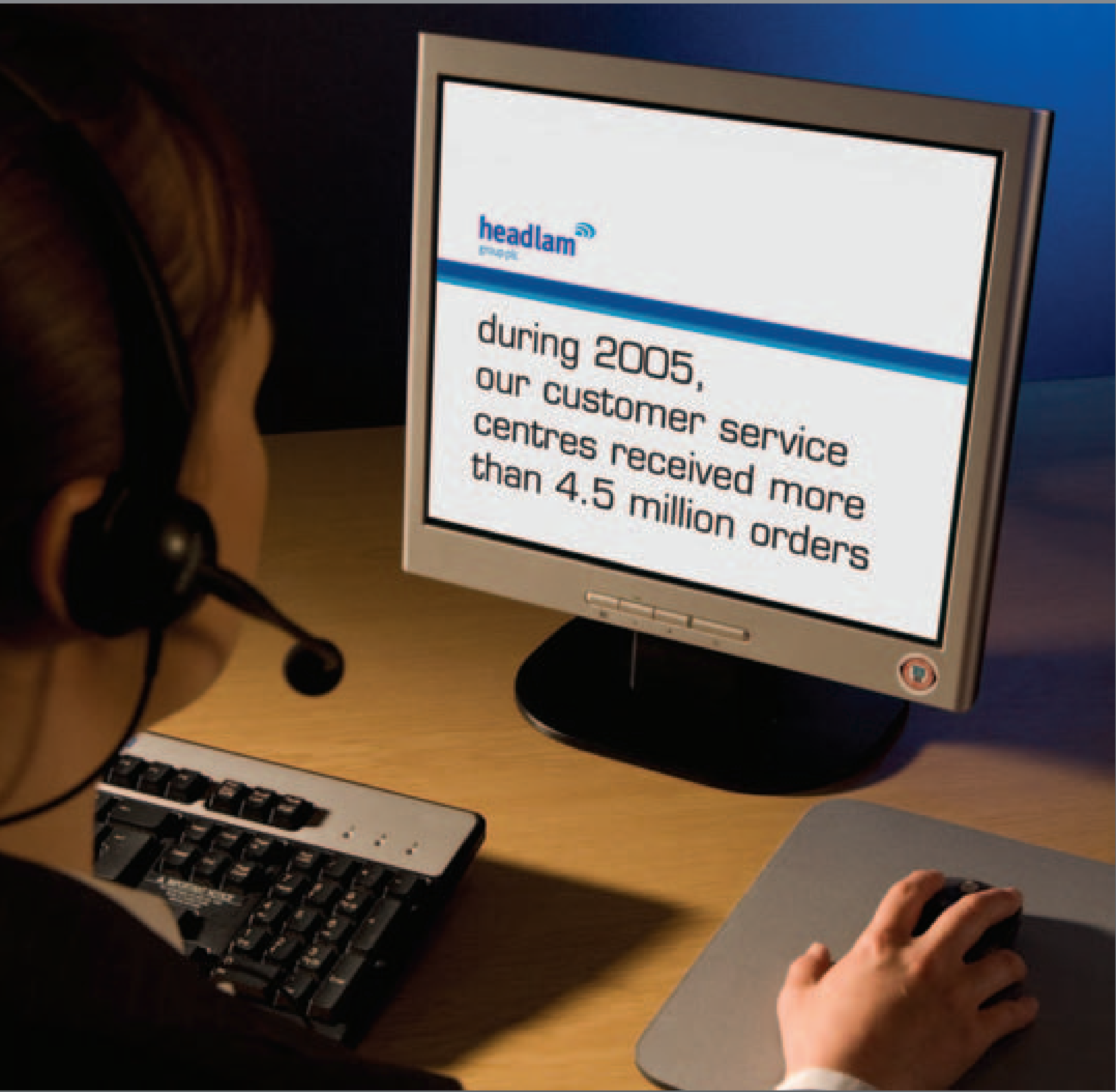
The group's structure and strategy of autonomous sales and marketing activities with common operational and financial disciplines is firmly established. This allows the individual businesses to optimise their relationship with suppliers and customers.

With the benefit of these activities, our businesses in the UK and Continental Europe have made a positive start to 2006 and we believe the group is well positioned to achieve its objectives for the year.

Trevor Larman, Chairman

Our businesses in the UK and Continental Europe have made a positive start to 2006 and we believe the group is well positioned to *achieve its objectives* for the year.

Trevor Larman, Chairman



We continue to invest in the latest order processing technology to help service our customers requirements.

We are committed to offering our customers a comprehensive product range with stock levels to service their demand.

Chief Executive's Review

We are very pleased with the performance of the group in 2005. The UK businesses produced a particularly positive result following the significant growth in 2004. These businesses were able collectively to increase sales by 2.4% on a like for like basis, in more difficult market conditions and therefore established a further increase in our market share.

The Continental European businesses in France, Switzerland and the Netherlands continue to improve their sales and profitability.

UK operations

The success of the UK businesses is established through the autonomous sales and marketing activities of 46 businesses operating from 21 distribution facilities. The experienced managers of these businesses continually work with the world's leading floorcovering manufacturers to develop and launch new products.

We have 297 employed external sales people who position these new products with independent flooring retailers and contractors, ensuring that our customers are at the forefront of all product innovation. These sales people subsequently maximise the market presence of their individual businesses and the group as a whole.

It is fundamental to the group strategy and culture that whilst encouraging this sales and marketing autonomy, each of the businesses operate from an identical IT platform and comply with standard operational and financial disciplines.

The businesses are defined into four specific sectors.

Regional multi-product: we have 25 businesses that operate regionally from their distribution facility, supplying floorcovering across all of our product categories. These businesses increased their sales by 1.9% and contribute 68% of UK turnover.

National multi-product: Mercado through its six business identities and extensive product range was again able to improve its market position.

Residential specialist: we enjoyed significant growth within the 12 businesses specialising in middle to high price carpet products, increasing their sales by 41% and now contributing 11% of UK turnover.

Commercial specialist: our three businesses increased sales by 2.8% and are now able to take full advantage of increased capacity following their relocation to the new facility in Tamworth.

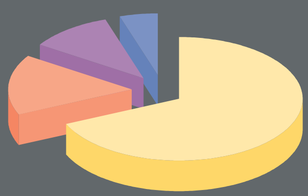
Customers

Our customers, principally independent floorcovering retailers and contractors, continued to prosper. The group's ongoing growth reflects the market presence of our active accounts which total 35,748.

The experienced managers of our businesses *continually work with the world's leading floorcovering manufacturers* to develop and launch new products.

Tony Brewer, Group Chief Executive

Business Sectors



- Regional Multi-product (68%)
- National Multi-product (16%)
- Residential Specialist (11%)
- Commercial Specialist (5%)

Proportion by Product

- Carpet (50%)
- Vinyl (13%)
- Laminate & Wood (5%)
- Accessories (6%)
- Contract (26%)

Chief Executive's Review (continued)

Products

Total carpet sales, which represent 50% of UK turnover, increased by 4%. This increase was aided by the launch of 2,486 new ranges, established in our customers through 626,482 point of sale items. Residential vinyl increased by 6%, supported by 693 new products marketed through 167,360 displays and samples. Wood and laminate products saw a small decline in sales, however this performance improved during the latter part of 2005.

All residential product categories including wood and laminate have seen an improving sales trend during the first three months of 2006.

Sales in the contract sector which represent 26% of UK turnover, showed strong growth of 8%. During the second half of 2005 and the first quarter of 2006, we have invested in additional sales people in order to enhance our market position and subsequently accelerate our sales growth in the contract sector.

Investments

The new purpose built freehold distribution facility in Tamworth became fully operational during the year and also allowed us to move four businesses from Coleshill, therefore releasing capacity in the Coleshill distribution facility.

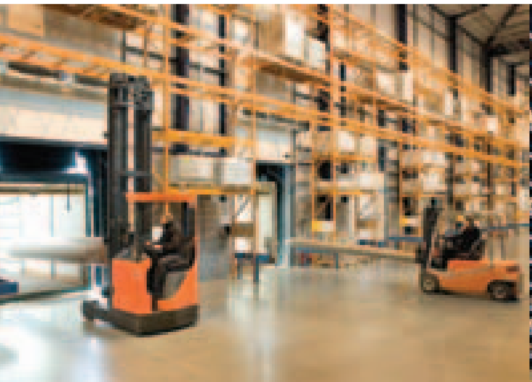
As planned, our stock increased during the year with the enlarged capacity at Tamworth and Coleshill, in addition to the extension to our facilities at Thatcham and Stockport. This further demonstrates our commitment to our customers to offer a comprehensive product range with stock levels to service their demand.

Construction is now underway for the 105,000 square feet purpose built freehold distribution facility for Wilkies, our regional multi-product business based in Leeds. This will be completed in the autumn of this year, enabling Wilkies to develop further its residential and commercial business in the north of England.

The strong cash generation by our operations allows continued investment to strengthen further the group's position. We have other projects at various stages of the planning and development process, to ensure that the group remains the leader in European floorcovering distribution.

Europe

It is very encouraging to see our Continental European businesses in France, Switzerland and the Netherlands continue to improve their performance. This has been achieved consistently over the last four years. Market conditions and



business development opportunities give every confidence that these businesses can continue to grow their sales and profitability over the coming years.

Acquisitions
During 2005 we acquired the businesses of Clarendon Carpets and Gaskell Wool Rich. We are currently investing in the sales and marketing of new products for both of these businesses along with the Gaskell Wool Rich brand of Mr Tomkinson Carpets and expect to enhance their performance during 2006.

We continue to evaluate other acquisition opportunities, both in the UK and Continental Europe and with a cautious approach, we would expect to further enlarge the number of business activities.

Information Technology
LMS, our French business with two warehouses and 20 regional facilities, was successfully converted onto our common IT platform in January 2006. This completes the process that all of our businesses in the UK and Continental Europe now operate on the same IT system. This reflects the group policy of allowing sales and marketing autonomy with identical operational and financial controls.

Outlook
The first 12 weeks of 2006 have shown a positive sales trend throughout our businesses in both the UK and Continental Europe.

Each of our businesses are clearly focused on maximising their individual market presence and with the contribution from all of these initiatives, we look forward to achieving another successful year.

Tony Brewer, Group Chief Executive

During the year the extensions to our facilities at Thatcham and Stockport and our new distribution facility in Tamworth all became fully operational.

Strong cash generation allows continued investment to ensure the group remains the leader in European floorcovering distribution.

Financial Review

International Financial Reporting Standards
Following a change in regulations, the group is reporting its financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The group formerly reported its results under UK Generally Accepted Accounting Principles (UK GAAP).

The results for 2005 comply with these new requirements and the accounting policies adopted under IFRS have been used to restate the comparative information for the year ended 31 December 2004.

Both the group and the company are preparing their financial statements in accordance with IFRS for the first time and consequently both have applied IFRS 1. An explanation of how the transition to IFRS has affected the reported financial performance, financial position and cash flows of the group is provided in note 33.

In addition to exempting companies from the requirement to restate comparatives for IAS 32 and IAS 39, IFRS 1 grants certain exemptions from the full requirements of IFRS in the transition period. The following exemptions have been taken in these financial statements:

Business combinations – Business combinations that occurred prior to 1 January 2004 have not been restated.

Properties - Both the group and the company have elected to restate the carrying value of freehold and long leasehold properties as at 1 January 2004 to historical cost. Previously, properties were stated at a combination of historical cost and market value.

Employee benefits – All cumulative actuarial gains and losses on defined benefit plans have been recognised in equity at 1 January 2004.

Cumulative translation differences – Cumulative translation differences for all foreign operations have been set to zero at 1 January 2004. Any gains and losses arising in the income statement on the subsequent disposal of an overseas subsidiary undertaking will only include those exchange gains or losses arising from the date of transition.

Share based payments – IFRS 2 - Share based payments, has been applied only to grants of equity settled share based payments made after 7 November 2002 that had not vested by 1 January 2005.

Following initial adoption, the group has taken the option not to comply with 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.

A summary of the differences arising from the change to IFRS compared with the reporting basis used prior to the introduction of IFRS are shown below for the consolidated income statement and balance sheet.

Consolidated income statement
for year ended 31 December

	2005	2004
	£000	£000
Profit before goodwill amortisation and taxation – previous reporting basis	**42,279**	39,259
Intangibles amortisation	**(836)**	(836)
Retirement benefit obligation	**(463)**	62
Share based payments	**(196)**	(57)
Property leases	**(3)**	(3)
Additional depreciation on revalued properties	**59**	59
Profit before tax – IFRS	**40,840**	38,484

Balance sheet
at 31 December

	2005	2004
	£000	£000
Net assets – previous reporting basis	**140,910**	126,868
Intangibles amortisation	**(1,672)**	(836)
Goodwill	**1,050**	918
Retirement benefit obligation	**(20,886)**	(17,853)
Deferred taxation	**7,828**	6,322
Revaluation reserve	**(6,916)**	(6,975)
Property leases	**(46)**	(42)
Dividends	**15,572**	13,958
Cash flow hedging	**(13)**	—
Net assets – IFRS	**135,827**	122,360

The group's operating profit *increased by 6.7%* from £38.9 to £41.5 million with the UK and Continental European businesses achieving *increases of 8.0% and 5.6% respectively*.

Stephen Wilson, Group Finance Director

Financial Review (continued)

Overall, the effects of the change on profit before tax have not been significant. For 2005, profit before goodwill amortisation and taxation, derived on the basis used for previous reporting, reduced by £1,439,000 or 3.4%. The equivalent adjustment for 2004 was a reduction in profit before goodwill amortisation and taxation of £775,000 or 2.0%.

As with the income statement, the overall effect on net assets arising from the adoption of IFRS, has not been particularly significant. Net assets derived from the previous reporting basis reduced by £5,083,000 in 2005 and £4,508,000 in 2004.

Trading performance
Group revenues increased during the year by 4.7% from £464.8 million to £486.6 million. Like for like improvement from the UK businesses amounted to 2.4% whilst the Continental European businesses achieved a collective like for like increase of 3.6% or 3.0% at constant rates of exchange.

Further contributions to revenue for 2005 were made by National Carpets and Kingsmead, the two businesses acquired during 2004 but registering their first full year results during 2005 and Clarendon and Gaskell Wool Rich acquired during 2005.

The group's operating profit increased by 6.7% from £38.9 million to £41.5 million with the UK and Continental European businesses achieving increases before unallocated corporate expenses of 8.0% and 5.6% respectively. At constant rates of exchange, the increase for Continental Europe was 5.0%.

Financial income and expense
The components of financial income and expense are as follows:

	2005 £000	2004 £000
Financial income		
Bank interest	**1,329**	886
Other interest received	**87**	141
Return on defined pension plan assets	**2,477**	2,273
	3,893	3,300
Financial expense		
Bank loans, overdrafts and other financial expenses	**(1,503)**	(997)
Interest on defined benefit pension plan obligation	**(2,987)**	(2,654)
Finance leases	**(61)**	(89)
	(4,551)	(3,740)
Net financing costs	**(658)**	(440)

Net financing costs excluding net expenses relating to the defined benefit pension plans increased from £59,000 to £148,000 mainly as a consequence of increased investment in inventory during 2005. Net finance expense relating to the pension plans was higher during the year, rising from £381,000 to £510,000, because of the net increase in the employee benefits liability.

Taxation
The effective rate of taxation reduced to 30.2% compared with 30.5% for the previous year. The rate reflects the group's current mix of business and it is anticipated that the effective tax rate should remain at around these levels for the foreseeable future.

Employee benefits
During the year, the net deficit relating to the defined benefit pension plans, as measured under IAS 19 – Employee benefits increased by £2.1 million from £18.4 million to £20.5 million. The deficit relates to the following:

	£000
UK plan	(20,226)
French retirement indemnity premium	(286)
	(20,512)

Whilst the UK plan asset base has benefited from the recent revival in the value of equities, the plan liabilities have increased at a faster rate because of the decline in bond yields.

During the year, the UK plan actuary completed the triennial actuarial valuation of the UK defined benefit pension plan. The net deficit, as at 31 March 2005, amounted to £13.1 million. The principal differences between the IAS 19 deficit and the actuarial valuation are as follows:

	£000
Actuarial valuation	(13,100)
Investment returns	4,500
Variation in assumptions relating to discount rates	(11,700)
Death in service liability	(1,000)
Other factors	1,074
IAS 19 deficit	**(20,226)**

Following final determination of the valuation, the company and trustees of the UK plan discussed a number of alternatives to assist with mitigating the cost of the plan. However, it was decided that these alternative arrangements would penalise the active members who currently represent 18% of total plan membership.

The company has elected to maintain its commitment to the plan and in order to discharge the deficit, agreed to pay additional contributions. The additional contributions are intended to remove the deficit over 15 years, a period that equates with the average remaining working life of active plan members and will be subject to review every three years at the time the plan actuary completes the plan valuation. Additional contributions during 2005 amounted to £722,000. These additional amounts to be paid in 2006 will total £1,080,000 and contributions will increase at the rate of salary inflation thereafter.

CASH FLOWS AND NET FUNDS

Cash generated from operating activities
Net cash generated from operating activities was £22.7 million, a decrease of £10.1 million compared with last year. The main reason for this decline was the net investment in working capital in 2005 of £10.7 million compared with a net cash release from working capital in 2004 of £2.7 million.

As already commented on in the Chief Executive's Review, the additional net investment in working capital this year was due to the inventory investment required to support the additional capacity available from the new and extended facilities. This additional inventory investment amounted to £9.0 million.

Cash flows from investing activities
Net cash outflows from investing activities totalled £9.5 million compared with £16.8 million during 2004. The year on year reduction was attributable to lower levels of expenditure on acquisitions and investment in property, plant and equipment. For 2006, gross investment on property, plant and equipment is forecast to increase to approximately £15.3 million.

Changes in net funds
Group net funds remained virtually unchanged compared with 2004 at £35.5 million.

Stephen Wilson, Group Finance Director

Directors, Officers and Advisors

BOARD OF DIRECTORS

T G Larman ◆●■
Non-executive Chairman
Trevor was appointed a non-executive director in March 1994 and became Chairman on 1 January 2000. He was formerly the Finance Director of NFC plc (now Exel plc). He is a fellow of the Institute of Chartered Certified Accountants and a fellow of the Association of Corporate Treasurers. Age 60.

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 28 years experience in the floorcovering industry. Age 45.

G Waldron ❊
Executive Director
Graham was appointed an executive director in June 1991. He is the non-executive Chairman of Tandem Group plc. He has 53 years experience in the floorcovering industry. Age 75.

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 51.

T J Anderson ◆●■
Non-executive Director
Tom was appointed a non-executive director in August 1998 and has chaired the Remuneration Committee since December 1998. He was formerly a non-executive director of Azlan Group PLC and a group general manager of Electrocomponents Plc. He is a chartered engineer and a member of the Institute of Electrical Engineers. Age 67.

R J Dickens, CBE, DL ◆●■
Non-executive Director
Roger was appointed a non-executive director in February 2004 and chaired the Audit Committee since March 2004. Age 58. Sadly Roger passed away on 29 January 2006.

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. Age 51.

M K O'Leary ◆●■
Non-executive Director
Mike was appointed a non-executive director in March 2006. He has more than twenty years of public company board experience, focused primarily in the technology sector. He spent 14 years in helping to build Misys into a global FTSE 100 company following its initial public offering in 1987 and has also served as Chief Executive at Marlborough Stirling, a FTSE 250 outsourcing business. Mike has worked in domestic and international markets and brings a wealth of general management experience to the company. Age 53.

G M Duggan
Company Secretary
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 45.

◆ Audit committee
● Remuneration committee
■ Nomination committee
▲ Executive management
❊ Charities committee

EXECUTIVE MANAGEMENT

A J W Simpson ▲
Managing Director UK Operations
Andrew joined the company during September 1991 and is the Managing Director of UK Operations. Andrew has 33 years experience in the floorcovering industry. Age 53.

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 42.

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 25 years experience in the floorcovering industry. Age 41.

K R Yates ▲
Managing Director, Mercado
Keith joined Mercado in April 1983 and was subsequently appointed its Managing Director in 1996. Keith has 23 years experience in the floorcovering industry. Age 50.

ADVISERS

Auditors
KPMG Audit Plc
2 Cornwall Street
Birmingham B3 2DL

Taxation Advisers
Deloitte & Touche
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

Solicitors
Eversheds
115 Colmore Row
Birmingham B3 3AL

Stockbrokers
Arden Partners Limited
Arden House
17 Highfield Road, Edgbaston
Birmingham B15 3DU

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

Financial Calendar

Group Results	
Annual General Meeting	1 June 2006
Interim results announced	September 2006
Full year results announced	March 2007

Dividend Dates	
Final dividend for 2005, if approved, payable to qualifying shareholders on the register as at 9 June 2006	3 July 2006
Interim dividend for 2006 announced	September 2006
Interim dividend for 2006 payable	January 2007

Director's Report

The directors present their annual report and the audited financial statements for the year ended 31 December 2005.

Directors
The names of the directors of the company at the date of this report and biographical details are given on page 24. A complete list of directors who served during the year is shown within the remuneration report on page 41. No other person has acted as a director of the company during the financial year ended 31 December 2005. Details of directors' service contracts are given in the report on corporate governance.

The company's articles require that one third of the directors retire by rotation each year. Accordingly, the directors retiring by rotation at the forthcoming Annual General Meeting ("AGM") are Graham Waldron and Tony Brewer, both of whom, being eligible, offer themselves for re-election. The ordinary resolution for the re-election of Graham Waldron will expire at the conclusion of the next AGM.

Dick Peters was appointed to the board on 1 December 2005 and, in accordance with the company's articles of association, offers himself for election at the forthcoming AGM. Dick has recently retired as the Senior Partner for the East Midlands practice of Deloitte & Touche based in Nottingham. He has considerable experience of auditing large companies, both UK and overseas, transactional support and project management activities and the board believes that his business knowledge and considerable 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 Dick Peters should be elected and makes such a recommendation to shareholders.

Mike O'Leary was appointed to the board on 10 March 2006 and in accordance with the company's articles of association, offers himself for election at the forthcoming AGM. Mike has more than twenty years of public company board experience, focused primarily in the technology sector. He has worked in domestic and international markets and brings a wealth of general management experience to the company. In accordance with the recommendations of the Combined Code relating to non-executive directors, the board believes that Mike O'Leary should be elected and makes such a recommendation to shareholders.

Roger Dickens sadly passed away on 19th January 2006.

Trevor Larman retires from the board at the conclusion of the forthcoming AGM having completed twelve years as a non-executive director, at which time he will be succeeded in the short term by Graham Waldron. It had been the board's intention that Roger Dickens succeed Trevor however this sadly was not possible. We are actively seeking to appoint an additional non-executive director and would hope to be able to announce a successor to Graham in the next twelve months. Graham has extensive experience in the flooring industry and has guided the company for many years, serving as Chairman from 1991 until 2000 when Trevor was appointed. Graham will not be joining the various committees of the board and will not participate in any bonus or share option schemes.

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' interests in the company's shares are shown on pages 42 and 43.

Principal activity
The group's activities are wholly aligned to the sales, marketing, supply and distribution of floorcovering products. The principal subsidiary undertakings are listed on page 109.

Review of the business
A review of the group's trading operations and future developments is contained in the Chairman's Statement, the Group Chief Executive's Review and the Financial Review on pages 10 to 23.

Dividends
An interim dividend of 4.4p per share (2004: 4.00p) was paid on 3 January 2006 and your board is recommending a final dividend of 13.60p per share (2004: 12.25p), making a total dividend of 18.00p per share for the year (2004: 16.25p). The final dividend, if approved by shareholders at the AGM, will be payable on 3 July 2006 to shareholders whose names appear on the register at the close of business on 9 June 2006.

Director's Report continued

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 2005 was 41 days (2004: 41 days).

Employment, training and development
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.

The directors encourage employee interest in the group's performance through the executive and savings related share option schemes.

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 programmes.

Health and safety
The group monitors its health and safety processes and seeks to make continual improvements. The group provides guidance and solutions 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 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. The group continues to improve its health and safety performance with a reduction in reportable accidents and dangerous occurrences to the Health and Safety Executive. There were no prosecutions for breaches of health and safety in the year and furthermore, there were no fatalities.

Director's Report continued

Corporate and Social Responsibility

Introduction
This is the first year that we have formally reported on our environmental and social responsibility performance. Whilst we have not previously highlighted these aspects of the business, we have had a management structure in place for many years that 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 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 corporate social responsibility 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.
- achieving sustained growth and profitability.

These areas reflect our main responsibilities as the leading European floorcovering distributor. They will be widened to encompass other stakeholders as our corporate and social responsibility 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 CO^2 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 the commercial and private vehicles that we operate replacing them every five and three years respectively, so improving operational efficiencies and reducing operating costs and vehicle emissions.

Our operations predominantly create waste materials in the form of protective plastic wrapping, cardboard and wooden pallets. We aim to collect the plastic and cardboard in discreet types and, with the use of baler units that we have invested in over the last few years, despatch 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 seek to reduce 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.

Director's Report continued

Corporate and Social Responsibility – continued

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

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 above 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, clients, 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.
- Personnel are aware of this policy.
- We maintain high standards of health and safety.
- A consistent reporting structure is maintained.
- Adequate resources are provided.

Further details are given above 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 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.

Protecting the environment
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 groups 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 be investigating the benefits from using green specification guides and developing an appropriate strategy.
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.

Director's Report continued

Corporate and Social Responsibility – continued

We place great importance on effectively managing our operations to minimise the likelihood of adverse impact. We pro-actively 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. Our new facility under construction in Leeds to re-house the Wilkies business is on the site of a former engineering business, the former premises having been removed by specialists and areas of environmental concern remediated.

Financial Risk Management

The financial risk management and objectives of the group and the exposure of the group to credit, interest rate and foreign currency risk are set out in note 23.

Donations

The group's Charities Committee considers requests for charitable donations within a set criteria. The group contributed charitable donations of £36,289 (2004: £26,705) during the year. The board has maintained its policy of not making political donations.

Share Capital

Details of the company's share capital, including the number of shares issued during the period under review are given in note 22 to the financial statements. Since the year end the company has issued 194,613 ordinary shares pursuant to the exercise of options under the Headlam Group 2002 Savings Related Share Option Scheme.

During the year under review options over 1,300,000 shares (2004: nil) were granted to the group's directors and employees under the company's share option schemes.

Substantial shareholdings

At the date of this report, the following interests in 3% or more of the issued ordinary share capital had been notified to the company.

	Number of shares	%
Legal & General Investment Management	3,346,519	3.89
Aberforth Smaller Companies trust plc	2,744,600	3.17
Aviva plc	2,715,594	3.15

AGM

The notice of the fifty eighth AGM to be held at 10.00am on 1 June 2006 at the group's distribution facility in Coleshill, Warwickshire has been mailed to shareholders with this Annual Report.

Allotment of shares

The directors have received authority from shareholders to allot ordinary shares for cash otherwise than on a pro-rata basis. The authority is limited to allotting up to 4,335,748 ordinary shares, representing approximately 5% of the issued share capital at that time. Although no such issues have been made, the directors will seek renewal of these two authorities from shareholders at the AGM.

Purchase of own shares

In common with many other companies, the group seeks annually a limited authority from shareholders to purchase its own ordinary shares. Legislation now permits shares purchased by the company to be held in treasury rather than being cancelled immediately, for future resale in the market, for use in connection with employee share schemes or for cancellation at a later date. The purchase of the company's own shares would only be made if the directors regarded such purchase as earnings enhancing. Although no such purchases have been made, the directors will seek to renew the authority from shareholders at the AGM.

Director's Report continued

Corporate and Social Responsibility – continued

Directors fees

Article 98 of the articles of association of the company prescribes the maximum amount in fees payable in aggregate to non-executive directors each year. Current fees for non-executive directors are approaching this figure and the board believes that it is prudent to raise the authority thereunder to allow the board, should it deem it appropriate, to increase non-executive fees beyond that level. It is therefore proposed to increase the maximum amount from £150,000 to £200,000.

Indemnity to Directors and Officers

The articles of association of the company currently provide that every director or other officer of the company shall, in certain circumstances, be indemnified out of the assets of the company against any liability incurred by him in defending any proceedings, whether civil or criminal, for negligence, default, breach of duty or breach of trust in relation to the affairs of the company. The amendment proposed by resolution 11 of the notice of meeting will, if approved, enable the company to make use of the changes introduced by the Companies (Audit, Investigations and Community Enterprise) Act 2004 that relax certain of the current prohibitions on companies indemnifying their directors against liability and permit companies to pay directors' defence costs as they are incurred.

Auditors

KPMG Audit Plc has expressed its willingness to continue in office as auditor of the company and a resolution for its re-appointment and to authorise the directors to agree its remuneration will be proposed at the forthcoming AGM. Auditors remuneration and fees paid are set out in note 3 to the financial statements.

Corporate Governance

The Combined Code on Corporate Governance came into effect for UK listed companies for reporting years beginning on or after 1 November 2003. Following publication of the Code, the board reviewed its procedures with a view to complying with its detailed provisions. The following paragraphs, together with the report on directors' remuneration on pages 38 to 44, provide a description of how the group has applied the main and supporting principles of the Combined Code. The directors' statement of compliance with the Code is given on page 37.

The Board of Directors

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, review management performance; to set the group's values and standards and ensure that its obligations to its shareholders and others are understood and met.

Specific responsibilities reserved to the board include:

- 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' contracts.
- ensuring that a satisfactory dialogue takes place with shareholders.

The directors' responsibility for the preparation of accounts is explained on page 45. The directors confirmation that they consider it appropriate to prepare the accounts for 2005 on a going concern basis is given on page 37.

Further details of the board's role in relation to the group's systems of internal control and risk management are given on pages 35 and 36. Descriptions of the specific responsibilities which have been delegated to the principal board committees are given on pages 33 to 34.

At the end of 2005 the board comprised three executive and four non-executive directors including the Chairman. Biographical details of the directors are given on page 24. With the exception of the Chairman, who is presumed under the Combined Code not to be independent, all the non-executive directors are regarded by the board as independent. The board does not consider that any relationships or circumstances exist that are likely to affect the judgement of any director.

Director's Report continued

Corporate Governance – continued

The board normally meets ten times a year, including at least one meeting at a group operating business. Comprehensive briefing papers are provided to all directors one week before board meetings. 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.

All directors have direct access to the advice and services of the Company Secretary who is tasked with ensuring that board procedures are followed. In addition, directors may, in furtherance of their duties, take independent professional advice, if necessary, at the company's expense.

Chairman and Chief Executive

The roles of Chairman and Chief Executive are split. 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 running the business.

The other significant current commitments of the Chairman are listed in his biography on page 24 and the board is satisfied that his existing commitments do not unduly restrict his availability to the group.

Induction and professional development

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, both with the board as a whole and with the Group Chief Executive, and 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 remuneration committees, seminars facilitated by external audit practices on the implementation of International Financial Reporting Standards and workshops run by external bodies on various commercial and regulatory matters.

Board appointments and performance evaluation

There is a formal, rigorous 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 and rigorous evaluation of its own performance and that of its committees and individual directors, including the Chairman. The process involved the completion of detailed questionnaires in respect of each board member. The output from the questionnaires was compiled into a report prepared for the board at its meeting in October. No actions were considered necessary as a result of the evaluations. The board intends to conduct a further evaluation of its performance during 2006.

Director re-election

All directors are subject to re-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.

Communicating with shareholders

Meetings between directors, senior management and major institutional shareholders are held during the year.

The Senior Independent Director and the other non-executive directors are encouraged to attend presentations to analysts and shareholders, in particular the annual and interim results presentations.

The Group Finance Director reports twice a year to the board on meetings with investors. 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.

Director's Report continued

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. 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 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.

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

Audit Committee
The audit committee consists of the independent non-executive directors which operated under the Chairmanship of Roger Dickens during 2005.

Following the death of Roger Dickens subsequent to the year end, Dick Peters was appointed Chairman of the audit committee on 27 February 2006 having joined the audit committee in December 2005. 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 auditors is maintained, including reviewing non-audit services and fees, and makes recommendations to the board on the appointment, reappointment or dismissal of the external auditors. 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 audit committee meets at least twice a year, including meetings before the annual and interim results announcements.

Members' attendance record at meetings of the committee in 2005 is given on page 35. 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.

Only members of the committee are entitled to be present at meetings however the auditors, Group Chief Executive and Group Finance Director attend when appropriate. At each meeting there is an opportunity for the external auditors to discuss matters with the committee without any executive management being present. The committee has independent access to the external auditors who have 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 auditors in order to ensure that objectivity and independence are maintained. The external auditors have in place processes to ensure their independence is maintained including safeguards to ensure that, where they do provide non-audit services, their independence is not compromised. They have written to the audit committee confirming that, in their opinion, they are independent.

In 2005, the audit committee discharged its responsibilities by:

- reviewing the group's draft 2004 preliminary annual results announcement and financial statements and 2005 interim results statement prior to board approval, including consideration of the significant accounting judgements 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 appropriateness of the group's accounting policies including changes necessary in the light of the transition to IFRS.

- reviewing regularly the potential impact on the group's financial statements of certain matters such as impairment of asset values, employee benefits and IFRS.

Director's Report continued

Corporate Governance – continued

- reviewing the effectiveness of the 2004 external audit process and recommending to the board, after due consideration, the reappointment of the incumbent external auditors at the AGM.

- reviewing the application of the board's policy on non-audit work performed by the group's external auditors together with the non-audit fees payable to the external auditors in 2004.

- reviewing the external auditors' plan for the audit of the group's 2005 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.

- reviewing reports from the external auditors on the group's systems of internal control in advance of the announcement of the group's results for 2004 (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.

- reviewing the results of the performance evaluation questionnaire (see page 32) as it related to the committee and approving certain consequential changes to the committee's procedures.

Remuneration Committee

The remuneration committee consists of the independent non-executive directors under the chairmanship of Tom Anderson. The committee is responsible for approving the terms of service and setting the remuneration of the executive directors in accordance with a remuneration policy which is approved by the board. It is also responsible for determining the terms upon which the service of executive directors is terminated, and for monitoring the remuneration of senior managers just below board level. Non-executive directors' fees are determined by the board as a whole and no director may influence their own remuneration benefits.

The committee meets periodically when required. Members' attendance record at meetings of the committee in 2005 is given on page 35. Only the members of the committee are entitled to be present at meetings however the Group Chief Executive and Group Finance Director attend when appropriate. 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. It is responsible for appointing consultants in respect of executive directors' remuneration.

The committee's report on directors remuneration is set out in the remuneration report on page 41.

Nominations Committee

The nominations committee consists of the non-executive directors and the Chief Executive under the chairmanship in 2005 of Roger Dickens (except when the committee is dealing with the appointment of a successor as Chairman of the board when the Senior Independent Director chairs the committee). 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 2005 is given on page 35. 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 2005 of Dick Peters 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.

Director's Report continued

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 2005 was as follows:

	Scheduled board (10 meetings)	Remuneration committee (3 meetings)	Audit committee (3 meetings)	Nominations committee (4 meetings)
Non-executive director				
Trevor Larman (Chairman)	10	3	3	4
Executive directors				
Tony Brewer (Group Chief Executive)	10	*	*	4
Stephen Wilson (Group Finance Director)	10	*	*	*
Graham Waldron	10	*	*	*
Non-executive directors				
Tom Anderson (Senior Independent Director)	10	3	3	4
Roger Dickens	6	0	0	1
Dick Peters (appointed 1 December 2005)	1/1#	1/1#	1/1#	1/1#

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

Actual attendance/maximum number of meetings director could attend as a member.

Risk Management and Internal Controls

In accordance with the guidance of the Turnbull committee, the directors are responsible for establishing and maintaining the group's systems of internal control and for reviewing their effectiveness. 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 system 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 perform 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 receive reports from the external auditor on matters identified in the course of its statutory audit work.

Director's Report continued

Corporate Governance – continued

These 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 system of controls 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 system 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 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 management 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 through 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.

Director’s Report continued

Corporate Governance – continued

Compliance with the Combined Code
Throughout 2005, the group was in compliance with the relevant provisions of the Combined Code on Corporate Governance, except with regard to the following aspects:

The Code provision A.3.1 states that the board should identify in the annual report each non-executive director it considers to be independent. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including, amongst the seven stated reasons, if the director has served on the board for more than nine years from the date of their first election. Trevor Larman was first appointed on 28 March 1994 and has therefore served for a term of more than nine year’s. However the board considers that he continues to act independently.

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 board considers that compliance should have regard to the size of the group’s operations and believes that the structure of the Chairman, two non-executive’s and three executive directors is appropriate for the business.

The Code provision B1.6 refers to directors service contracts and compensation and states that ‘notice or contract periods should be set at one year or less. The company complied with this rule following the signing of new agreements with executive directors on 11 October 2005 which provide for a notice period of twelve months. Prior to this change, executive directors notice period in the event of a change of control was reducing from two years to one year by January 2006. New executive appointments to the board will similarly be subject to Code compliant service contracts.

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 this provision following the appointment of Dick Peters who became a member of each of the remuneration, audit and nomination committees.

The Code provision D.1.1 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 final results and at other times as appropriate.

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 therefore to continue to adopt the going concern basis in preparing the financial statements.

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

Geoff Duggan
Company Secretary
10 April 2006

Registered office
PO Box 1
Gorsey Lane
Coleshill
Birmingham
B46 1LW
Company registered in England and Wales No. 460129

Remuneration Report

Composition and role of the remuneration committee
The board's remuneration committee comprises the independent non-executive directors and is Chaired by Tom Anderson. Trevor Larman and Roger Dickens were members of the committee throughout 2005. Dick Peters became a member of the committee when he joined the board in December 2005.

The committee makes recommendations to the board, within formal terms of reference, on the policy and framework of executive remuneration and its cost to the company. The committee is also responsible for the implementation of remuneration policy and determining specific remuneration packages for each of the executive directors. It has access to advice provided by the Group Chief Executive, Company Secretary and external consultants. During 2005 the committee sought information from a wide variety of freely available published sources to assist in the formulation of the committee's recommendations. Similar information was sought in respect of retirement benefits and non-executive directors' fees during the year.

This report, which will be submitted to the forthcoming AGM for approval, explains how the company has applied the principles of the Combined Code on Corporate Governance that relate to directors' remuneration during the period. No director is involved in the determination of, or votes on any matter relating to, their own remuneration.

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, taking into account the company's performance, the markets in which the group operates and pay and conditions elsewhere in the group.

In constructing the remuneration packages, the committee aims to achieve a balance between fixed and variable compensation for each director. Accordingly, a significant proportion of the remuneration package depends on the attainment of demanding performance objectives. In determining the level of base salaries and the annual performance bonus scheme, the committee takes into consideration the potential maximum remuneration that executives could receive. The committee reviews these packages and varies individual elements when appropriate from year to year.

To recognise performance against agreed objectives, the committee has put in place an annual bonus scheme for executive directors similar to that applying to other senior executives in the group. Annual bonuses for executive directors are only paid on the achievement of demanding individual, business and corporate objectives.

Under the executive share option scheme (ESOS) the practice is to make conditional awards up to a maximum of 200% of gross earnings when deemed appropriate. This scheme is 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 group does not currently operate a long term incentive plan.

Executive directors also participate in a non-contributory final salary pension plan, details of which are given on page 44.

The committee believes that these arrangements, which are further explained below, are important in providing a potential remuneration package that will attract, retain and continue to motivate executive directors and other senior executives in a marketplace that is challenging and competitive in both commercial and human resource terms. It is intended that the current remuneration policy, of which the ESOS element has been approved by shareholders, will continue for 2006 and succeeding years.

The total emoluments of the executive directors are disclosed on page 41.

Components of remuneration
Base salary
The committee seeks to establish a base 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. Base salaries are reviewed annually. Base salary is the only element of remuneration that is pensionable.

Remuneration Report

Annual performance bonus

At the beginning of each year, the committee reviews the bonus scheme to ensure that it remains competitive in the marketplace, continues to incentivise the executive directors and other senior executives and aligns their interests with those of shareholders. 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 elements 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' remuneration for the year on page 41.

Executive share option schemes (ESOS)

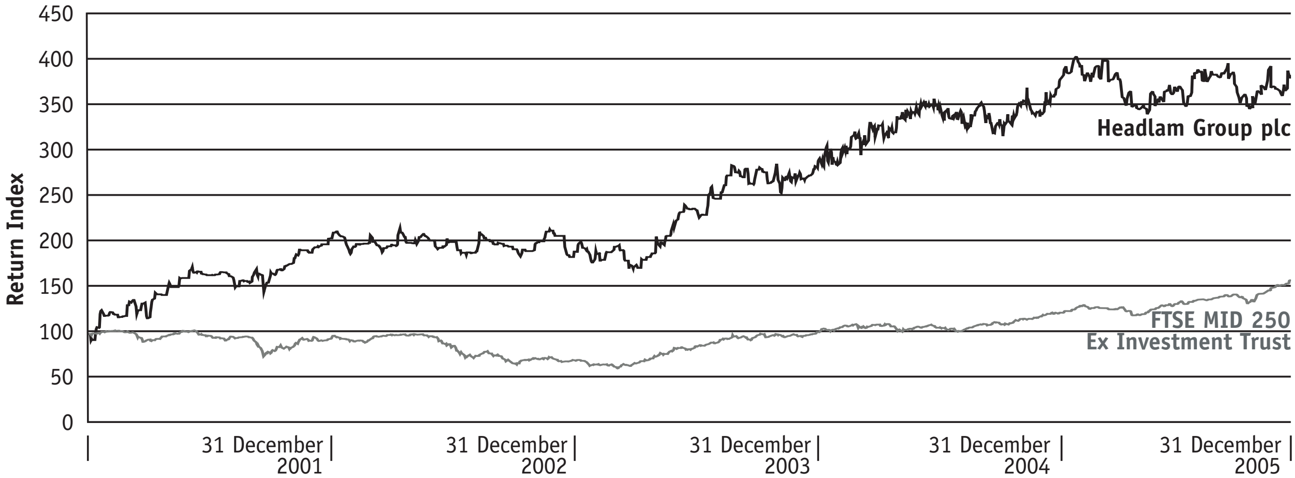
To the extent that performance conditions are satisfied, options granted under the ESOS become exercisable three years after the date of grant and remain so until the tenth anniversary of grant in respect of the approved scheme and the seventh anniversary of grant in respect of the unapproved scheme. Performance conditions are based on the extent to which growth in the group's earnings per share (EPS growth) exceeds growth in the Retail Prices Index (RPI growth) 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. During 2006, it will consider the impact on EPS of the change in reporting under IFRS in order to determine whether EPS will remain the most appropriate and consistent performance measure for this scheme. In August 2005, options were granted to Tony Brewer and Steve Wilson equal to 82% and 80% respectively of their base salary and, at lower rates, to certain other senior executives. Details of options granted to executive directors are shown on page 43. It is the company's intention that new shares be issued, subject to institutional guidelines, to satisfy the exercise of options granted under the ESOS.

Long term incentive scheme (LTIS)

The group does not currently operate a long term incentive plan.

Remuneration Report continued

5 Year Return Index for FTSE 250 Index as at 31 December 2005



Source: Thomson Financial

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 2005 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.

Pension
Executive directors also participate in a non-contributory, final salary pension plan, details of which are given on page 44.

Other employment benefits
In common with other senior management, executive directors are entitled to a range of benefits, including a company car, life assurance 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. Executive directors' service contracts were renewed in October 2005 to reflect a notice period of one year.

Remuneration Report continued

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 2005 in respect of non-executive appointments by Graham Waldron and Steve Wilson were £50,000 and £44,000 respectively.

Non-executive directors
Non-executive directors including the Chairman do not hold service contracts. Their appointment is subject to the articles of association and the dates they joined the board are shown on page 24. Their fees are approved by the board. Upon the recommendation of the board, the fees payable to Trevor Larman as Chairman were agreed by the board as £75,000 per annum.

Following the examination of the role of non-executive directors in the Higgs Report and the subsequent changes to the Combined Code, in 2005 the board conducted a review of non-executive directors' fees (excluding fees paid to the chairman). This took 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 new Code, and the fees paid by other companies. The board received survey and other information from a variety of freely available sources. As a result of this review, their annual fees were increased from £30,000 to £31,500, with an additional £5,000 being paid to the respective Chairmen of the audit and remuneration committees. The non-executive directors, including the Chairman, do not participate in any of the company's share schemes, incentive plans or pension schemes. The remuneration report from page 38 to page 41 up to this statement, with the exception of the performance graph on page 40, has not been audited. From this point until the end of the report on page 44 the disclosures have been audited by the company's auditors, KPMG.

Directors' emoluments
Details of directors' emoluments for the year ended 31 December 2005 are set out below.

	Salary and fees		**Benefits**		**Performance related pay**		**Total**	
	2005	2004	**2005**	2004	**2005**	2004	**2005**	2004
	£000	£000	**£000**	£000	**£000**	£000	**£000**	£000
Executive								
Tony Brewer	**425**	375	**27**	26	**465**	562	**917**	963
Steve Wilson	**310**	285	**31**	29	**350**	427	**691**	741
Graham Waldron	**80**	75	**21**	17	**—**	—	**101**	92
Non-executive								
Trevor Larman	**70**	65	**—**	—	**—**	—	**70**	65
Tom Anderson	**35**	30	**—**	—	**—**	—	**35**	30
Roger Dickens	**35**	27	**—**	—	**—**	—	**35**	27
Dick Peters (iii)	**3**	—	**—**	—	**—**	—	**3**	—
	958	857	**79**	72	**815**	989	**1,852**	1,918

Benefits include all taxable benefits arising from employment by the company, mainly the provision of a company car.
Pensions 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 £363,750 (2004: £998,000).

Remuneration Report continued

Directors' Interests in Shares

The following table and the tables on page 43 show the beneficial interests of the directors who held office at the end of the year in the ordinary shares of the company and the interests of the executive directors who served during the year in the company's share schemes:

	Shareholdings at 31 December 2005	Shareholdings at 31 December 2004
Executive Directors		
Graham Waldron	**471,667**	471,667
Tony Brewer	**443,874**	443,874
Steve Wilson	**336,433**	211,433
Non-executive Directors		
Trevor Larman	**6,944**	6,944
Tom Anderson	**4,000**	4,000

As at 5 January 2006, the beneficial shareholding of Graham Waldron had increased by 4,796 shares following the exercise of SAYE options on their normal maturity date.

Directors' interest in share option schemes

Executive schemes

During the year options held under the 1996 and 1998 unapproved schemes were exercised, details of which are shown under gains on share options below.

Remuneration Report continued

Details of executive options held by executive directors are set out below, a description of which is given on page 39.

	Options held at 1 January 2005	Options granted during the year	Options exercised during the year	Options held at 31 December 2005	Exercise price (pence)	Date from which exercisable	Expiry date
Tony Brewer							
1996 USOS(i)	25,000	—	25,000[b]	—	225.50	Dec 2001	Dec 2005
1998 USOS (ii)	—	342,858	—	342,858	420.00	Aug 2008	Aug 2012
1998 ESOS(iii)	—	7,142	—	7,142	420.00	Aug 2008	Aug 2015
Sharesave(iv)	8,337	—	—	8,337	197.00	Jan 2008	Jun 2008
Steve Wilson							
1996 USOS(i)	25,000	—	25,000[a]	—	225.50	Dec 2001	Dec 2005
1998 USOS (ii)	100,000	—	100,000[c]	—	128.00	Jan 2004	Jan 2008
1998 USOS(ii)	—	242,858	—	242,858	420.00	Aug 2008	Aug 2012
1998 ESOS(iii)	—	7,142	—	7,142	420.00	Aug 2008	Aug 2015
Sharesave(iv)	8,337	—	—	8,337	197.00	Jan 2008	Jun 2008
Graham Waldron							
Sharesave(iv)	4,796	—	—	4,796	197.00	Jan 2006	Jun 2006

(i) Headlam Group Unapproved Executive share option scheme 1996 (1996 USOS)
Options were granted to executives under the terms of the 1996 USOS on 14 April 1998. Details of the operation of the scheme are provided on page 39.

(ii) Headlam Group Unapproved Executive share option scheme 1998 (1998 USOS)
Options were granted to executives under the terms of the 1998 USOS on 22 August 2005. Details of the operation of the scheme are provided on page 39.

(iii) Headlam Group Approved Executive share option scheme 1998 (1998 ESOS)
Options were granted to executives under the terms of the 1998 ESOS on 22 August 2005 Details of the operation of the scheme are provided on page 39.

(iv) 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 40.

(v) Exercise of share options
The market prices of shares on the dates options were exercised were:
(a) 3 May 2005 at 398.00 pence
(b) 6 December 2005 at 400.00 pence
(c) 16 December 2005 at 405.00 pence

The closing price of a Headlam Group plc ordinary share on the last trading day of 2005 (30 December) was 432.00 pence. The range during the year was 464.25 pence (high) and 385.00 pence (low).

Remuneration Report continued

Pension Benefits

Tony Brewer and Stephen Wilson participate in the group's defined benefit (final salary) pension scheme which provides benefits at a normal retirement age of sixty 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 four times earnings lump sum death-in-service benefits and pension provisions for members' dependents. During 2006, the company will be reviewing its pension policy as a result of the 2004 Pensions Act, the 2004 Finance Act and the result of the triennial valuation at the end of March 2005.

Details of pensions earned by the executive directors for the year ended 31 December 2005 are shown below

	Increase in accrued pension during the year £pa	**Transfer value of increase £**	**Accumulated accrued pension at 31 December 2005 £pa**	**Change in accrued pension over the year £pa**	Accumulated accrued pension at 31 December 2004 £pa
Tony Brewer	**2,578**	**31,784**	**35,403**	**3,565**	31,838
Steve Wilson	**3,274**	**51,478**	**43,741**	**4,491**	39,250

The increase in accrued pension during the year excludes any increase due to inflation of the accumulated accrued pension at the start of the year.

The change in accrued pension over the year includes any increase due to inflation of the accumulated accrued pension at the start of the year.

	Transfer value of accrued pension at 31 December transfer 2005 £	**Change in value over the year £pa**	Transfer value of accrued pension at 31 December 2004 £
Tony Brewer	**438,955**	**90,277**	348,678
Steve Wilson	**689,336**	**145,325**	544,011

In addition to salary, Graham Waldron benefits from a payment of £7,000 (2004: £26,000) which is made directly to a personal pension arrangement. The final contribution to these pension arrangements was made on 14 April 2005 on Graham Waldron reaching his 75th birthday.

On 23 March 2006 the normal retirement date of certain senior executives was moved from sixty to fifty five, including the two executive directors participating in the scheme.

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

Geoff Duggan
Company Secretary
10 April 2006

Statement of Directors' Responsibilities

in respect of the Annual Report and the financial statements

The directors are responsible for preparing the Annual Report and the group and parent 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 the directors are required to prepare the group financial statements in accordance with IFRS as adopted by the EU 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 IFRS 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 IFRS as adopted by the EU.

- 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 a 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 the 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.

Independent Auditors' 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 2005 which comprise the Consolidated Income Statement, the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statement, the Consolidated and Parent Company Statements of Recognised Income and Expense 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 (IFRS) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 45.

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 financial statements, Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if 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 2003 FRC 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 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.

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 IFRS as adopted by the EU, of the state of the group's affairs as at 31 December 2005 and of its profit for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRS 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 a 31 December 2005; and
- 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 financial statements, Article 4 of the IAS Regulation.

KPMG Audit Plc
Chartered Accountants
Registered Auditor

2 Cornwall Street
Birmingham
B3 2DL

10 April 2006

Consolidated Income Statement

for the year ended 31 December 2005

	Note	2005 £000	2004 £000
Revenue	2	**486,635**	464,789
Cost of sales		**(336,570)**	(323,924)
Gross profit		**150,065**	140,865
Distribution expenses		**(77,507)**	(70, 592)
Administrative expenses		**(31,060)**	(31,349)
Operating profit	2	**41,498**	38,924
Financial income	6	**3,893**	3,300
Financial expenses	6	**(4,551)**	(3,740)
Net financing costs		**(658)**	(440)
Profit before tax	3	**40,840**	38,484
Taxation	7	**(12,352)**	(11,738)
Profit for the year		**28,488**	26,746
Dividend per share	22	**16.25p**	13.85p
Earnings per share			
Basic	9	**33.1p**	31.3p
Diluted	9	**32.8p**	31.0p

Statements of Recognised Income and Expense

for year ended 31 December 2005

		Group		Company	
	Note	**2005 £000**	2004 £000	**2005 £000**	2004 £000
Foreign exchange translation differences arising on translation of overseas operations		**(321)**	(256)	**–**	(1,759)
Recycling of cash flow hedging reserve balance		**13**	–	**–**	–
Actuarial gains and losses on defined benefit pension plans		**(2,571)**	(3,748)	**(2,571)**	(3,748)
Tax recognised on income and expenses recognised directly in equity		**910**	1,143	**910**	1,143
Net income recognised directly in equity		**(1,969)**	(2,861)	**(1,661)**	(4,364)
Profit for the year		**28,488**	26,746	**39,352**	20,965
Total recognised income and expense	22	**26,519**	23,885	**37,691**	16,601
Effect of change in accounting policy					
Effect of adoption of IAS 32 and 39, net of tax, on 1 January 2005 (with 2004 not restated) on: cash flow hedge reserve		**13**	–	**–**	–
		13	–	**–**	–

Balance Sheets

at 31 December 2005

	Note	Group		Company	
		2005	2004	**2005**	2004
		£000	£000	**£000**	£000
Non-current assets					
Property, plant and equipment	10	**74,640**	71,754	**58,665**	58,300
Investments in subsidiary undertakings	12	**–**	–	**94,835**	94,710
Intangible assets	11	**13,210**	14,046	**–**	–
Deferred tax assets	13	**8,199**	8,167	**6,629**	5,704
		96,049	93,967	**160,129**	158,714
Current assets					
Inventories	14	**91,160**	79,692	**–**	–
Trade and other receivables	15	**84,275**	85,550	**2,320**	2,678
Amounts due from subsidiary undertakings		**–**	–	**23,272**	25,163
Cash and cash equivalents	16	**36,193**	37,747	**31,265**	5,473
		211,628	202,989	**56,857**	33,314
Non-current assets classified as held for sale	17	**3,471**	203	**3,471**	203
Total assets		**311,148**	297,159	**220,457**	192,231
Current liabilities					
Bank overdraft	18	**–**	(279)	**–**	–
Other interest-bearing loans and borrowings	18	**(471)**	(1,124)	**(471)**	(430)
Amounts due to subsidiary undertakings		**–**	–	**(855)**	–
Trade and other payables	19	**(141,529)**	(142,028)	**(5,532)**	(5,331)
Employee benefits	20	**(1,080)**	(722)	**(1,080)**	(722)
Income tax payable		**(11,139)**	(11,053)	**(3,500)**	(4,841)
		(154,219)	(155,206)	**(11,438)**	(11,324)
Non-current liabilities					
Other interest-bearing loans and borrowings	18	**(267)**	(738)	**(267)**	(738)
Amounts due to subsidiary undertakings		**–**	–	**(49,732)**	(48,930)
Employee benefits	20	**(19,432)**	(17,643)	**(19,146)**	(17,192)
Deferred tax liabilities	13	**(1,403)**	(1,212)	**(1,616)**	(96)
		(21,102)	(19,593)	**(70,761)**	(66,956)
Total liabilities		**(175,321)**	(174,799)	**(82,199)**	(78,280)
Net assets		**135,827**	122,360	**138,258**	113,951

Balance Sheets continued

at 31 December 2005

		Group		Company	
	Note	**2005**	2004	**2005**	2004
		£000	£000	**£000**	£000
Equity attributable to equity holders of the parent					
Share capital	22	**4,326**	4,306	**4,326**	4,306
Share premium	22	**52,280**	51,731	**52,280**	51,731
Special reserve	22	**–**	–	**20,578**	20,578
Translation reserves	22	**(577)**	(256)	**(1,759)**	(1,759)
Retained earnings	22	**79,798**	66,579	**62,833**	39,095
Total equity		**135,827**	122,360	**138,258**	113,951

These financial statements were approved by the board of directors on 10 April 2006 and were signed on its behalf by:

Tony Brewer
Director

Stephen Wilson
Director

Cash Flow Statements

for year ended 31 December 2005

	Note	Group		Company	
		2005	2004	**2005**	2004
		£000	£000	**£000**	£000
Cash flows from operating activities					
Profit before tax for the year		**40,840**	38,484	**135**	1,558
Adjustments for:					
Depreciation, amortisation and impairment		**5,133**	4,313	**1,249**	913
Financial income		**(3,893)**	(3,300)	**(1,280)**	(759)
Financial expense		**4,551**	3,740	**2,035**	597
(Profit)/loss on sale of property, plant and equipment		**(228)**	11	**(206)**	(1)
Equity settled share-based payment expenses		**196**	57	**71**	2
Operating profit before changes in working capital and provisions		**46,599**	43,305	**2,004**	2,310
Decrease/(increase) in trade and other receivables		**1,699**	(8,118)	**1,801**	3,560
Increase in inventories		**(11,335)**	(3,753)	**–**	–
(Decrease)/increase in trade and other payables		**(1,085)**	14,588	**832**	573
Cash generated from the operations		**35,878**	46,022	**4,637**	6,443
Interest paid		**(1,456)**	(1,093)	**(1,518)**	(303)
Tax (paid)/received		**(10,994)**	(12,082)	**843**	(725)
Additional contributions to defined benefit pension plan		**(722)**	–	**(722)**	–
Net cash from operating activities		**22,706**	32,847	**3,240**	5,415
Cash flows from investing activities					
Proceeds from sale of property, plant and equipment		**598**	282	**445**	152
Interest received		**1,335**	1,055	**1,154**	949
Dividends received		**–**	–	**39,910**	18,345
Acquisition of subsidiary, net of cash acquired		**(426)**	(3,779)	**–**	(4,501)
Acquisition of property, plant and equipment		**(10,965)**	(14,374)	**(5,121)**	(12,339)
Net cash from investing activities		**(9,458)**	(16,816)	**36,388**	2,606
Cash flows from financing activities					
Proceeds from the issue of share capital		**570**	2,763	**570**	2,763
Repayment of borrowings		**(662)**	(1,121)	**–**	–
Payment of finance lease liabilities		**(438)**	(498)	**(430)**	(393)
Dividends paid		**(13,976)**	(11,795)	**(13,976)**	(11,795)
Net cash from financing activities		**(14,506)**	(10,651)	**(13,836)**	(9,425)
Net increase in cash and cash equivalents		**(1,258)**	5,380	**25,792**	(1,404)
Cash and cash equivalents at 1 January		**37,468**	32,119	**5,473**	6,877
Effect of exchange rate fluctuations on cash held		**(17)**	(31)	**–**	
Cash and cash equivalents at 31 December	25	**36,193**	37,468	**31,265**	5,473

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 parent company's financial statements present information about the company as a separate entity and not about its group.

Both the parent 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 ("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 accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these consolidated financial statements and in preparing an opening IFRS balance sheet at 1 January 2004 for the purposes of the transition to IFRS. The principal exception is that, as more fully explained below, financial instruments accounting is determined on different bases in 2005 and 2004 due to the transitional provisions of IAS 32 and IAS 39.

Judgements made by the directors, in the application of these accounting policies that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 31.

Transition to IFRS
Both the company and the group are preparing their financial statements in accordance with IFRS for the first time and consequently both have applied IFRS 1. An explanation of how the transition to IFRS has affected the reported financial performance of the group and the financial position and cash flows of the company and group is provided in note 32.

In addition to exempting companies from the requirement to restate comparatives for IAS 32 and IAS 39, IFRS 1 grants certain exemptions from the full requirements of IFRS in the transition period. The following exemptions have been taken in these financial statements:

- Business combinations – Business combinations that took place prior to 1 January 2004 have not been restated.

- The company and the group have elected to restate the carrying value of freehold and long leasehold properties as at 1 January 2004 to historical cost. Previously, properties were stated at a combination of historical cost and market value.

- Employee benefits – All cumulative actuarial gains and losses on defined benefit plans have been recognised in equity at 1 January 2004.

- Cumulative translation differences – Cumulative translation differences for all foreign operations have been set to zero at 1 January 2004. Any gains and losses arising in the income statement on the subsequent disposal of an overseas subsidiary undertaking will only include those exchange gains or losses arising from the date of transition.

- Share based payments – IFRS 2 – Share based payments, has been applied only to grants of equity settled share based payments made after 7 November 2002 which had not vested by 1 January 2005.

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.

Measurement convention
The company and group financial statements are prepared on the historical cost basis except for derivative financial instruments classified as fair value through the income statement. Non-current assets held for sale are stated at the lower of previous carrying amount and fair value less costs to sell.

Notes to the Financial Statements continued

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.

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 or the contracted 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 operations, 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 operations 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 operations are taken directly to the translation reserve. They are released into the income statement upon disposal.

The group has taken advantage of relief available in IFRS 1 to deem the cumulative translation differences for all foreign operations to be zero at the date of transition to IFRS on 1 January 2004.

Classification of financial instruments issued by the group
Following the adoption of IAS 32, 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.

Notes to the Financial Statements continued

1 ACCOUNTING POLICIES – CONTINUED
Derivative financial instruments and hedging
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. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged as described below.

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.

Cash flow hedges
On initial adoption of IAS 39, where a derivative financial instrument was designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any cumulative gain or loss on the derivative financial instrument since the inception of the hedge relationship was recognised directly in the hedging reserve.

The associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects profit or loss.

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.

Effect of first time adoption of IAS 32 and IAS 39 on 1 January 2005
The group has taken advantage of the transitional arrangements of IFRS 1 not to restate corresponding amounts in accordance with IAS 32 and IAS 39. Instead the following policies were applied in respect of financial instruments issued by the group, investments in debt and equity securities, derivative financial instruments and hedging:

In the comparative period, other than the following exceptions, all financial assets and financial liabilities were carried at cost, amortised as appropriate, less, in the case of financial assets, provision for any permanent diminution in value. Gains and losses on forward foreign exchange contracts treated as hedging instruments were not recognised in the income statement. On recognition of the hedged transaction the unrecognised gains and losses arising on the instrument were recognised, either in the income statement or combined into the carrying value of the associated asset or liability.

The following adjustments necessary to implement the revised policy have been made as at 1 January 2005 with the net adjustment to net assets, after tax, taken through the 2005 statement of recognised income and expense. Corresponding amounts for 2004 are presented and disclosed in accordance with the requirements of the Companies Act 1985, SSAP 20 and FRS 4, as applicable in 2004. The main differences between the 2004 and 2005 bases of accounting are shown and described below:

Effect on the balance sheets at 1 January 2005

	Group £000	Company £000
Trade and other payables		
Interest payable	(13)	–
Cash flow hedging reserve	13	–

Notes to the Financial Statements continued

The nature of the main effects upon the balance sheets at 1 January 2005 and upon the 2005 income statement, statements of recognised income and expense and cash flow statements are as follows:

- In 2005 hedging instruments and hedged items are accounted for separately in the balance sheet. Gains and losses in both are included in profit for the year when they arise, i.e. fair value hedges, or when the hedged transaction occurs having first recorded those on the hedging instrument in equity, i.e. cash flow hedges, to the extent effective. In 2004 hedging instruments were not recognised and hedged items were held at cost, amortised as appropriate, without any adjustment in respect of the hedged risk. On 1 January 2005, the hedged items and hedging instruments are brought separately on to the balance sheet in accordance with the 2005 policy. The cash flow statements are unaffected by this change in accounting policy.

The main effects on the primary statements in the comparative year, had IAS 32 and IAS 39 been adopted, would have been similar to those stated above.

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 as finance leases. Where land and buildings are held under finance leases the accounting treatment of the land is considered separately from that of the buildings. Leased assets acquired by way of finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and 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%

Intangible assets and goodwill
Subject to the transitional relief in IFRS 1, all business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries. 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 net identifiable assets 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 is tested annually for impairment. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associate.

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. On transition, certain items recognised as other intangibles under IFRS, but not all such items, have been separately accounted for with appropriate adjustments against goodwill and amortisation of goodwill has ceased as required by IFRS 1.

Notes to the Financial Statements continued

1 ACCOUNTING POLICIES – CONTINUED

Intangible assets and goodwill –continued

Goodwill relating to acquisitions made prior to 1 January 1998, and written off to reserves under UK GAAP, will not be charged to the consolidated income statement on subsequent disposal or termination of the acquired business.

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.

Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the group has sufficient resources to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses.

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 are as follows:

Customer lists	24 months

Trade and other receivables

Trade and other receivables are stated at their nominal amount, discounted if material, less impairment losses.

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 statement of cash flows.

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 asset's recoverable amount is estimated.

For goodwill, assets that have an indefinite useful life 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.

Goodwill, assets that have an indefinite useful life and intangible assets that are not yet available for use were tested for impairment as at 1 January 2004, the date of transition to IFRS, even through no indication of impairment existed.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in profit or loss even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

Notes to the Financial Statements continued

Calculation of recoverable amount
The recoverable amount of the group's investments in held-to-maturity securities and 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.

The recoverable amount of other assets is the greater of their net selling price 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 held-to-maturity security or 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 an investment in an equity instrument classified as available for sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

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 has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

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 as at 1 January 2004, the date of transition to IFRS, were recognised. In respect of actuarial gains and losses that arise subsequent to 1 January 2004, the group recognises them in the period they occur directly into equity through the statement of recognised income and expense.

Notes to the Financial Statements continued

1 ACCOUNTING POLICIES – CONTINUED

Defined benefit plans – continued

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 group wide defined benefit pension plan. As there is no contractual agreement or stated group policy for charging the net defined benefit cost of the plan to participating entities, the net defined benefit cost of the pension plan is recognised fully by the sponsoring employer, which is Headlam Group plc. The company then recognises a cost equal to its contribution payable for the period.

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.

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 options are subject to the movement of the group's earnings per share exceeding that of the General Index of Retail Prices, all items, over the relevant period.

Unapproved

These share options are subject to the movement of the group earnings per share exceeding that of the General Index of Retail Prices, all items, by 2% per annum and 3% per annum over the relevant period.

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 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.

Revenue

Revenue from the sale of goods is measured at the fair value of the consideration, net of trade discounts. 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.

Notes to the Financial Statements continued

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. 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 sale rather than through continuing use, it is available for immediate sale and sale 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. IFRS 5 was adopted early on 1 January 2004.

IFRS not yet applied
The following IFRS's are available for early application but have not been applied by the company or group in these financial statements:

- IFRS 7 'Financial instruments: Disclosure' applicable for years commencing on or after 1 January 2007

- Amendment to IFRS 39: Financial Guarantee Contracts' applicable for years commencing on or after 1 January 2006

The application of IFRS 7 in 2005 would not have affected the balance sheets or income statement as the standard is concerned only with disclosure. The group plans to adopt it on 1 January 2007.

The application of the amendment to IFRS 39 is not expected to have any significant effect on the income statement.

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	
	2005 £000	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000
Revenue						
External sales	**415,038**	395,696	**71,597**	69,093	**486,635**	464,789
Result						
Segment result	**41,905**	38,784	**1,815**	1,719	**43,720**	40,503
Unallocated corporate expenses					**(2,222)**	(1,579)
Operating profit					**41,498**	38,924
Financial income					**3,893**	3,300
Financial expense					**(4,551)**	(3,740)
Taxation					**(12,352)**	(11,738)
Profit for the year					**28,488**	26,746
Other information						
Segment assets including inter segment assets	**274,303**	263,171	**28,769**	29,229	**303,072**	292,400
Inter segment assets	**(3,229)**	(3,424)	**(365)**	(187)	**(3,594)**	(3,611)
Segment assets	**271,074**	259,747	**28,404**	29,042	**299,478**	288,789
Unallocated assets					**11,670**	8,370
Consolidated total assets					311,148	297,159
Segment liabilities including inter segment liabilities	**(127,623)**	(127,560)	**(18,238)**	(20,219)	**(145,861)**	(147,779)
Inter segment liabilities	**365**	187	**3,229**	3,424	**3,594**	3,611
Segment liabilities	**(127,258)**	(127,373)	**(15,009)**	(16,795)	**(142,267)**	(144,168)
Unallocated liabilities					**(33,054)**	(30,631)
Consolidated total liabilities					**(175,321)**	(174,799)
Capital expenditure	**10,462**	13,907	**503**	467	**10,965**	14,374
Depreciation	**3,451**	2,937	**631**	599	**4,082**	3,536
Amortisation	**836**	836	–	–	**836**	836
Asset impairment	**215**	–	–	–	**215**	–

Each segment is a continuing operation.

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

Notes to the Financial Statements continued

Management has access to information that provides details on sales and gross margin by principal product group and across the four principal business sectors which comprise Regional multi-product, National multi-product, 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.

3 PROFIT BEFORE TAX AND AUDITORS' REMUNERATION

The following are included in profit before tax:

	2005	2004
	£000	£000
Depreciation on property, plant and equipment	**4,082**	3,554
Amortisation of intangible assets	**836**	836
Impairment loss on property, plant and equipment	**215**	–
(Profit)/loss on sale of property, plant and equipment	**(228)**	11
Equity settled share-based payment expenses	**196**	57
Operating lease rentals		
Plant and machinery	**7,369**	6,819
Land and buildings	**1,707**	1,844

Auditors' remuneration:

		2005	2004
		£000	£000
Group	– audit	**181**	170
	– fees receivable by the auditors and their associates in respect of other services	**63**	42
Company	– audit	**59**	37

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	
	2005	2004	**2005**	2004
By sector:				
Floorcoverings	**2,025**	1,911	**–**	–
Central operations	**9**	9	**9**	9
	2,034	1,920	**9**	9
By function:				
Sales and distribution	**1,853**	1,747	**–**	–
Administration	**181**	173	**9**	9
	2,034	1,920	**9**	9

The aggregate payroll costs were as follows:

	£000	£000	£000	£000
Wages and salaries	**49,617**	47,911	**2,603**	2,196
Equity settled transactions	**196**	57	**71**	2
Social security costs	**6,437**	5,896	**324**	215
Contributions to defined contribution plans	**1,307**	1,158	**8**	7
Increase in liability for defined benefit plans	**1,644**	1,372	**1,644**	1,372
	59,201	56,394	**4,650**	3,792

5 DIRECTORS' EMOLUMENTS

	2005	2004
	£000	£000
Directors' emoluments	**1,852**	1,918
Gains made on share options	**364**	998
Company contributions to money purchase pension plans	**7**	26

Further details of directors' emoluments, share options and pension entitlement are given in the remuneration report on pages 38 and 44.

Notes to the Financial Statements continued

6 FINANCE INCOME AND EXPENSE

	2005 £000	2004 £000
Interest income		
Bank interest	**1,329**	886
Other	**87**	141
Return on defined pension plan assets	**2,477**	2,273
Financial income	**3,893**	3,300
Interest expense		
Bank loans, overdrafts and other financial expenses	**(1,503)**	(997)
Interest on defined benefit pension plan obligation	**(2,987)**	(2,654)
Finance leases and similar hire purchase contracts	**(61)**	(89)
Financial expenses	**(4,551)**	(3,740)

7 TAXATION

Recognised in the income statement

	2005 £000	2004 £000
Current tax expense		
Current year	**12,764**	12,685
Adjustments for prior years	**(1,652)**	331
Deferred tax expense	**11,112**	13,016
Origination and reversal of temporary differences	**(101)**	(212)
Adjustments for prior years	**1,341**	(1,490)
	1,240	(1,278)
Total tax in income statement	**12,352**	11,738

Reconciliation of effective tax rate

	2005 %	2005 £000	2004 %	2004 £000
Profit before tax		**40,840**		38,484
Tax using the UK corporation tax rate	**30%**	**12,252**	30%	11,545
Non-deductible expenses	**0.9%**	**362**	3.2%	1,242
Effect of tax rates in foreign jurisdictions	**(0.1%)**	**(38)**	0.0%	(9)
Losses not recognised	**0.2%**	**87**	0.5%	206
Non-taxable gain on disposal		**–**	0.2%	(87)
Over provided in prior years	**(0.8%)**	**(311)**	(3.0%)	(1,159)
Total tax in income statement	**30.2%**	**12,352**	30.5%	11,738

During the period, certain computations under enquiry with HM Revenue and Customs have been finalised and agreed. The current position has been reconciled to date, giving a net prior year credit of £311,000. This is made up of a current tax credit of £1,652,000 which, to a large extent, is matched with a corresponding deferred tax charge of £1,341,000.

Notes to the Financial Statements continued

8 CURRENT TAX LIABILITIES

The current tax liability of £11,139,000 *(2004: £11,053,000)* represents the amount of income taxes payable in respect of current and prior year periods which exceed any amounts recoverable.

9 EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share is based on the following data:

	2005 £000	2004 £000
Earnings		
Earnings for the purposes of basic earnings per share being profit attributable to equity holders of the parent	**28,488**	26,746
Earnings for the purposes of diluted earnings per share	**28,488**	26,746
Number of shares		
Issued ordinary shares at 1 January	**86,111,437**	84,265,339
Effect of shares issued during the period	**86,272**	1,087,250
Weighted average number of ordinary shares for the purposes of basic earnings per share	**86,197,709**	85,352,589
Effect of diluted potential ordinary shares:		
Weighted average number of ordinary shares at 31 December	**86,197,709**	85,352,589
Share options	**2,407,331**	1,534,175
Number of shares that would have been issued at fair value	**(1,813,602)**	(737,011)
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**86,791,438**	86,149,753

Notes to the Financial Statements continued

10 PROPERTY, PLANT AND EQUIPMENT – GROUP AND COMPANY

Group	Land & buildings					
	Freehold £000	Long leasehold £000	Short leasehold £000	Plant & equipment £000	Under construction £000	Total £000
Cost						
Balance at 1 January 2004	48,693	2,136	363	13,496	3,441	68,129
Acquisitions through business combinations	–	–	–	455	–	455
Additions	1,101	2,737	30	2,001	8,505	14,374
Transfer to non-current assets held for sale	(926)	–	–	–	–	(926)
Disposals	–	–	–	(1,063)	–	(1,063)
Effect of movements in foreign exchange	62	–	2	31	–	95
Reclassification	119	–	(97)	(22)	–	–
Balance at 31 December 2004	49,049	4,873	298	14,898	11,946	81,064
Balance at 1 January 2005	49,049	4,873	298	14,898	11,946	81,064
Additions	3,052	-	188	5,747	1,977	10,964
Transfer to non-current assets held for sale	(3,912)	–	–	–	–	(3,912)
Disposals	–	–	–	(1,696)	–	(1,696)
Effect of movements in foreign exchange	(169)	–	–	(135)	–	(304)
Asset impairment	(215)	–	–	–	–	(215)
Reclassification	11,922	–	–	–	(11,922)	–
Balance at 31 December 2005	59,727	4,873	486	18,814	2,001	85,901
Depreciation						
Balance at 1 January 2004	3,198	20	269	3,018	–	6,505
Depreciation charge for the year	1,118	21	6	2,391	–	3,536
Acquisitions through business combinations	–	–	–	201	–	201
Transfer to non-current assets held for sale	(47)	–	–	–	–	(47)
Disposals	–	–	–	(932)	–	(932)
Effect of movements in foreign exchange	27	–	1	19	–	47
Reclassification	59	–	(36)	(23)	–	–
Balance at 31 December 2004	4,355	41	240	4,674	-	9,310
Balance at 1 January 2005	4,355	41	240	4,674	–	9,310
Depreciation charge for the year	1,170	76	16	2,820	–	4,082
Transfer to non-current assets held for sale	(441)	–	–	–	–	(441)
Disposals	–	–	–	(1,530)	–	(1,530)
Effect of movements in foreign exchange	(60)	–	–	(100)	–	(160)
Balance at 31 December 2005	5,024	117	256	5,864	–	11,261
Net book value						
At 1 January 2004	45,495	2,116	94	10,478	3,441	61,624
At 31 December 2004 and 1 January 2005	44,694	4,832	58	10,224	11,946	71,754
At 31 December 2005	**54,703**	**4,756**	**230**	**12,950**	**2,001**	**74,640**

Notes to the Financial Statements continued

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

Asset impairment

The asset impairment is recognised in administration expenses in the income statement. The impairment arises in connection with a property that will be vacated during 2007 and which does not presently meet the requirements of IFRS 5 relating to non-current assets held for sale. A preliminary assessment has indicated that net book value exceeds the property's fair value which equates to market value less marketing and selling costs.

Company	Land & buildings					
	Freehold £000	**Long leasehold £000**	**Short leasehold £000**	**Plant & equipment £000**	**Under construction £000**	**Total £000**
Cost						
Balance at 1 January 2004	44,090	2,136	196	573	3,441	50,436
Additions	1,096	2,737	–	2	8,505	12,340
Transfer to non-current assets held for sale	(926)	–	–	–	–	(926)
Disposals	–	–	–	(22)	–	(22)
Balance at 31 December 2004	44,260	4,873	196	553	11,946	61,828
Balance at 1 January 2005	44,260	4,873	196	553	11,946	61,828
Additions	3,031	–	–	113	1,977	5,121
Transfer to non-current assets held for sale	(3,912)	–	–	–	–	(3,912)
Disposals	–	–	–	(108)	–	(108)
Reclassification	11,922	–	–	–	(11,922)	–
Asset impairment	(215)	–	–	–	–	(215)
Balance at 31 December 2005	55,086	4,873	196	558	2,001	62,714
Depreciation						
Balance at 1 January 2004	1,987	20	196	481	–	2,684
Depreciation charge for the year	860	21	–	32	–	913
Disposals	–	–	–	(22)	–	(22)
Transfer to non-current assets held for sale	(47)	–	–	–	–	(47)
Balance at 31 December 2004	2,800	41	196	491	-	3,528
Balance at 1 January 2005	2,800	41	196	491	–	3,528
Depreciation charge for the year	928	76	–	30	–	1,034
Transfer to non-current assets held for sale	(441)	–	–	–	–	(441)
Disposals	–	–	–	(72)	–	(72)
Balance at 31 December 2005	3,287	117	196	449	–	4,049
Net book value						
At 1 January 2004	42,103	2,116	-	92	3,441	47,752
At 31 December 2004 and 1 January 2005	41,460	4,832	–	62	11,946	58,300
At 31 December 2005	**51,799**	**4,756**	**–**	**109**	**2,001**	**58,665**

Notes to the Financial Statements continued

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

Leased plant and machinery

At 31 December 2005, the net carrying amount of leased plant and machinery was £nil (2004: £100,000). Depreciation for the year on this asset was £nil (2004: £43,000).

Property, plant and equipment under construction

During the year ended 31 December 2005, the group acquired land in Leeds with the intention of building a new warehouse and distribution facility on the site. The costs incurred up to the balance sheet date on this new facility were £2,001,000.

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 2004 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 £3,730,000 which when added to previous revaluations brings the total surplus at 31 December 2004 to £6,615,000. Following the adoption of IFRS, the revaluation surplus is not reflected in the balance sheets of the company or the group.

Notes to the Financial Statements continued

11 INTANGIBLE ASSETS – GROUP

	Goodwill £000	Customer lists £000	Total £000
Cost			
Balance at 1 January 2004	78,778	–	78,778
Acquisitions through business combinations	–	1,672	1,672
Balance at 31 December 2004	78,778	1,672	80,450
Balance at 1 January 2005 and 31 December 2005	78,778	1,672	80,450
Amortisation			
Balance at 1 January 2004	65,568	–	65,568
Amortisation for the year	–	836	836
Balance at 31 December 2004	65,568	836	66,404
Balance at 1 January 2005	65,568	836	66,404
Amortisation for the year	–	836	836
Balance at 31 December 2005	65,568	1,672	67,240
Net book value			
At 1 January 2004	13,210	–	13,210
At 31 December 2004 and 1 January 2005	13,210	836	14,046
At 31 December 2005	**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:

	2005 £000	2004 £000
UK	**6,671**	7,507
Continental Europe	**6,539**	6,539
	13,210	14,046

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 2005 and extrapolating forward assuming forecast inflationary growth rates for the territories in which the cash-generating units are located.

Notes to the Financial Statements continued

12 INVESTMENTS IN SUBSIDIARIES

The company has the following investments in subsidiaries:

	Country of Incorporation	Ownership	
		2005	**2004**
Company			
HFD Limited	Great Britain	**100%**	100%
MCD Group Limited	Great Britain	**100%**	100%
Lethem-Vergeer BV	Netherlands	**100%**	100%
DFA SA	France	**100%**	100%
Belcolor AG	Switzerland	**100%**	100%

Summary information on investments in subsidiary undertakings is as follows:

	Shares £000	Loans £000	Total £000
Cost			
At 1 January 2005	118,143	28,437	146,580
Share options granted to employees of subsidiary undertakings	125	–	125
At 31 December 2005	118,268	28,437	146,705
Provisions			
At 1 January 2005 and 31 December 2005	51,870	–	51,870
At 31 December 2004	66,273	28,437	94,710
Carrying value			
At 31 December 2005	**66,398**	**28,437**	**94,835**

Loans shown as part of investment in subsidiaries occurred on acquisition and are deemed to be part of the investment cost of the related business.

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	
	2005	2004	**2005**	2004	**2005**	2004
	£000	£000	**£000**	£000	**£000**	£000
Property, plant and equipment			**1,403**	1,139	**1,403**	1,139
Intangible assets	**(539)**	(386)		73	**(539)**	(313)
Employee benefits	**(7,047)**	(5,772)		–	**(7,047)**	(5,772)
Provisions	**(377)**	(382)		–	**(377)**	(382)
Other items	**(236)**	(1,627)		–	**(236)**	(1,627)
Tax (assets) / liabilities	**(8,199)**	(8,167)	**1,403**	1,212	**(6,796)**	(6,955)

Movement in deferred tax during the year

	1 January 2005 £000	**Recognised in income £000**	**Recognised in equity £000**	**31 December 2005 £000**
Property, plant and equipment	**1,139**	**264**	**–**	**1,403**
Intangible assets	**(313)**	**(226)**	**–**	**(539)**
Employee benefits	**(5,772)**	**(194)**	**(1,081)**	**(7,047)**
Provisions	**(382)**	**5**	**–**	**(377)**
Other	**(1,627)**	**1,391**	**–**	**(236)**
	(6,955)	**1,240**	**(1,081)**	**(6,796)**

Movement in deferred tax during the prior year

	1 January 2004 £000	Recognised in income £000	Recognised in equity £000	31 December 2004 £000
Property, plant and equipment	1,981	(842)	–	1,139
Intangible assets	(70)	(243)	–	(313)
Employee benefits	(5,478)	1	(295)	(5,772)
Provisions	(188)	(194)	–	(382)
Other	(1,627)	–	–	(1,627)
	(5,382)	(1,278)	(295)	(6,955)

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	
	2005 £000	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000
Property, plant and equipment	**–**	–	**1,616**	96	**1,616**	96
Employee benefits	**(6,480)**	(5,704)	**–**	–	**(6,480)**	(5,704)
Provisions	**(149)**	–	**–**	–	**(149)**	–
Tax (assets)/liabilities	**(6,629)**	(5,704)	**1,616**	96	**(5,013)**	(5,608)

Movement in deferred tax during the year

	1 January 2005 £000	**Recognised in income £000**	**Recognised in equity £000**	**31 December 2005 £000**
Property, plant and equipment	**96**	**1,520**	**–**	**1,616**
Employee benefits	**(5,704)**	**(157)**	**(619)**	**(6,480)**
Provisions	**–**	**(149)**	**–**	**(149)**
	(5,608)	**1,214**	**(619)**	**(5,013)**

Movement in deferred tax during the prior year

	1 January 2004 £000	Recognised in income £000	Recognised in equity £000	31 December 2004 £000
Property, plant and equipment	1,361	(1,265)	–	96
Employee benefits	(4,608)	20	(1,116)	(5,704)
Provisions	(64)	64	–	–
	(3,311)	(1,181)	(1,116)	(5,608)

Notes to the Financial Statements continued

14 INVENTORIES

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
Finished goods and goods held for resale	**91,160**	79,692	**–**	–

Cost of sales consists of the following:

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
Material cost	**330,147**	316,272	**–**	–
Processing cost	**3,616**	4,565	**–**	–
Other	**2,807**	3,087	**–**	–
	336,570	323,924	**–**	–

Processing cost includes the net movement in inventory provisions. During the year provisions increased by £136,000 (2004: £664,000) to £5,869,000 (2004: £5,733,000). Inventory held at net book value at 31 December 2005 amounted to £24,882,000 (2004: £23,987,000).

15 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
Trade receivables	**66,602**	66,274	**217**	22
Prepayments and accrued income	**3,480**	3,794	**420**	310
Other receivables	**14,193**	15,482	**1,683**	2,346
	84,275	85,550	**2,320**	2,678

Included within trade and other receivables is £1,500,000 (2004: £1,500,000) for the group and £1,500,000 (2004: £1,500,000) for the company expected to be recovered in more than twelve months.

16 CASH, CASH EQUIVALENTS AND BANK OVERDRAFTS

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
Cash and cash equivalents per balance sheet	**36,193**	37,747	**31,265**	5,473
Bank overdrafts	**–**	(279)	**–**	–
Cash and cash equivalents per cash flow statements	**36,193**	37,468	**31,265**	5,473

Notes to the Financial Statements continued

17 NON-CURRENT ASSETS HELD FOR SALE

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
Assets classified as held for sale:				
Property, plant and equipment	**3,471**	203	**3,471**	203

At 31 December 2005, assets classified as held for sale comprise two properties which are expected to be sold during 2006. Proceeds, net of sales and marketing costs, are likely to be £4,200,000.

At 31 December 2004, a property at Somerton was held for sale with a carrying value of £203,000 and, on 29 July 2005, it was subsequently sold for proceeds of £397,000 net of costs totalling £5,000, creating a profit on disposal of £194,000. There was no gain or loss on initial classification of this asset.

18 OTHER INTEREST-BEARING LOANS AND BORROWINGS

This note provides information about the contractual terms of the group's 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 23.

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
Non-current liabilities				
Finance lease liabilities	**267**	738	**267**	738
	267	738	**267**	738
Current liabilities				
Unsecured bank loans	**–**	687	**–**	–
Finance lease liabilities	**471**	437	**471**	430
	471	1,124	**471**	430

The group has undrawn committed borrowing facilities expiring in one year or less which, at 31 December 2005, amounted to £51,802,000 (2004: £54,529,000).

Terms and debt repayment schedule
The unsecured bank loan from a Swiss bank, on which the interest was paid at a fixed rate of 1.98% was repaid during the year.

As more fully explained in note 23, classifications of financial liabilities are determined on different bases in 2005 and 2004 due to the transitional provisions of IAS 32 and IAS 39.

Notes to the Financial Statements continued

18 OTHER INTEREST-BEARING LOANS AND BORROWINGS – CONTINUED

Analysis of debt in 2004

Debt may be analysed as falling due as follows:

	Group £000	Company £000
Bank loans and overdrafts		
On demand	279	–
Within one year	687	–
	966	–

Finance lease liabilities

Finance lease liabilities are payable as follows:

Group	**Minimum lease payments 2005 £000**	**Interest 2005 £000**	**Principal 2005 £000**	Minimum lease payments 2004 £000	Interest 2004 £000	Principal 2004 £000
Less than one year	**516**	**(45)**	**471**	523	(86)	437
Between one and five years	**267**	**–**	**267**	738	(45)	783
	783	**(45)**	**738**	1,306	(131)	1,175

Company	**Minimum lease payments 2005 £000**	**Interest 2005 £000**	**Principal 2005 £000**	Minimum lease payments 2004 £000	Interest 2004 £000	Principal 2004 £000
Less than one year	**516**	**(45)**	**471**	523	(86)	437
Between one and five years	**267**	**–**	**267**	738	(45)	783
	783	**(45)**	**738**	1,306	(131)	1,175

19 TRADE AND OTHER PAYABLES

	Group		**Company**	
	2005 £000	2004 £000	**2005 £000**	2004 £000
Trade payables	**109,765**	110,455	**192**	1,506
Taxation and social security	**10,585**	9,204	**365**	–
Non-trade payables and accrued expenses	**21,179**	22,369	**4,975**	3,825
	141,529	142,028	**5,532**	5,331

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS

Pension plans
During the year, the group operated defined benefit and of defined contribution plans. 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 £2,951,000 (2004: £2,530,000) and, at 31 December 2005, there was an amount of £156,000 (2004: £226,000) owed to the plans, being employer and employee contributions due for December 2005 but not received by 31 December 2005.

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 £1,307,000 (2004: £1,158,000). Contributions amounting to £76,000 (2004: £103,000) were payable to the scheme at 31 December 2005 and these are included in creditors.

As there is no contractual agreement or stated group policy for charging the net defined benefit cost of the plan to participating entities, the net defined benefit cost of the pension plan is recognised fully by the sponsoring employer, which is Headlam Group plc. The company then recognises a cost equal to its contribution payable for the period.

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
Present value of funded defined benefit obligations	**(64,750)**	(54,729)	**(64,750)**	(54,729)
Fair value of plan assets	**44,524**	36,815	**44,524**	36,815
Net obligations	**(20,226)**	(17,914)	**(20,226)**	(17,914)
Recognised liability for defined benefit obligations	**(20,226)**	(17,914)	**(20,226)**	(17,914)
Other long term employee benefits	**(286)**	(451)	**–**	–
Total employee benefits	**(20,512)**	(18,365)	**(20,226)**	(17,914)
Split:				
Current liabilities	**(1,080)**	(722)	**(1,080)**	(722)
Non-current liabilities	**(19,432)**	(17,643)	**(19,146)**	(17,192)
Total employee benefits	**(20,512)**	(18,365)	**(20,226)**	(17,914)

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

Pension plans (continued)

Movements in present value of defined benefit obligation

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
At 1 January	**54,729**	47,184	**54,729**	47,184
Current service cost	**1,134**	991	**1,134**	991
Interest cost	**2,987**	2,646	**2,987**	2,646
Actuarial losses	**6,711**	4,786	**6,711**	4,786
Benefits paid	**(1,072)**	(1,138)	**(1,072)**	(1,138)
Contributions by members	**261**	260	**261**	260
At 31 December	**64,750**	54,729	**64,750**	54,729

Movements in fair value of plan assets

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
At 1 January	**36,815**	33,018	**36,815**	33,018
Expected return on plan assets	**2,477**	2,273	**2,477**	2,273
Actuarial gains	**4,134**	1,030	**4,134**	1,030
Contributions by employer	**1,909**	1,372	**1,909**	1,372
Contributions by members	**261**	260	**261**	260
Benefits paid	**(1,072)**	(1,138)	**(1,072)**	(1,138)
At 31 December	**44,524**	36,815	**44,524**	36,815

Expense recognised in the income statement

	Group	
	2005	2004
	£000	£000
Current service cost	**1,134**	991
Interest on defined benefit pension plan obligation	**2,987**	2,654
Expected return on defined benefit pension plan assets	**(2,477)**	(2,273)
Total	**1,644**	1,372

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

Pension plans (continued)
The expense is recognised in the following line items in the income statement:

	Group	
	2005	2004
	£000	£000
Administrative expenses	**1,134**	991
Finance expense	**510**	381
	1,644	1,372

Cumulative actuarial gains and losses reported in the statement of recognised income and expenses since 1 January 2004, the transition date to IFRS, are £6,325,000 (2004: £3,756,000). Company £6,325,000 (2004: £3,756,000).

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

	Group		Company	
	2005	2004	**2005**	2004
	Fair value	Fair value	**Fair value**	Fair value
	£000	£000	**£000**	£000
Equities	**28,975**	23,888	**28,975**	23,888
Government debt	**11,856**	9,886	**11,856**	9,886
Annuities	**3,195**	2,982	**3,195**	2,982
Other	**498**	59	**498**	59
	44,524	36,815	**44,524**	36,815
Actual return on plan assets	**6,611**	3,303	**6,611**	3,303

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

20 EMPLOYEE BENEFITS – CONTINUED

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

	Group		Company	
	2005	2004	**2005**	2004
	%	%	**%**	%
Discount rate	**5.00**	5.50	**5.00**	5.50
Future salary increases	**4.90**	4.90	**4.90**	4.90
Future pension increases	**2.90**	2.90	**2.90**	2.90
Inflation rate	**2.90**	2.90	**2.90**	2.90
Expected rate of return on plan assets	**6.12**	6.62	**6.12**	6.62

History of plans

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

Balance sheet

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
Present value of defined benefit obligation	**(64,750)**	(54,729)	**(64,750)**	(54,729)
Fair value of plan assets	**44,524**	36,815	**44,524**	36,815
Deficit	**(20,226)**	(17,914)	**(20,226)**	(17,914)

Experience adjustments

	Group		Company	
	2005	2004	**2005**	2004
	£000	£000	**£000**	£000
Experience adjustments on plan liabilities	**6,711**	4,786	**6,711**	4,786
Experience adjustments on plan assets	**4,134**	1,030	**4,134**	1,030
Experience adjustment as a percentage of plan liabilities	**10.4%**	8.7%	**10.4%**	8.7%
Experience adjustment as a percentage of plan assets	**9.3%**	2.8%	**9.3%**	2.8%

The group and company expect to contribute approximately £2,063,000 to defined benefit plans in the next financial year.

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

Share-based payments – Group
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 company'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 that of the General Index of Retail Prices, all items, over the relevant period.

Options granted under the 1996 and 1998 unapproved schemes are normally exercisable between the third and seventh anniversaries of their date of grant, subject to the movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices, all items, by 2% per annum and 3% per annum respectively over the relevant period.

Additionally, the company operates a savings related share option scheme which is open to all UK employees subject to eligibility criteria determined by the directors prior to each option grant. The most recent grant was on 28 October 2002 where all employees with over one year's service were invited to participate. As this savings related share option 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.

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – 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 2005	2004	Vesting conditions	Contractual life of options
Unapproved 1998 scheme grant to key management 14 December 1998	**–**	50,000	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices by 3% pa over the relevant period	14/12/01 – 14/12/05
Approved 1988 scheme grant to key management 10 January 2001	**35,500**	102,500	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices over the relevant period	10/01/04 – 10/01/11
Unapproved 1998 scheme grant to key management 10 January 2001	**–**	274,063	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices by 3% pa over the relevant period	10/01/04 – 10/01/08
Three year sharesave scheme granted to other employees 28 October 2002	**203,679**	212,009	One year's service	01/01/06 – 30/06/06
Five year sharesave scheme granted to other employees 28 October 2002	**401,152**	426,495	One year's service	01/01/08 – 30/06/08
Approved 1998 scheme grant to key management 14 April 2003	**382,112**	382,112	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices over the relevant period	14/04/06 – 14/04/13
Unapproved 1998 scheme grant to key management 14 April 2003	**84,888**	84,888	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices over the relevant period	14/04/06 – 14/04/10
Unapproved 1998 scheme grant to key management 22 August 2005	**1,242,864**	–	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices by 3%-5% pa over the relevant period	22/04/08 – 22/08/12
Approved 1998 scheme grant to key management 22 August 2005	**57,136**	–	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices by 2% pa over the relevant period	22/04/08 – 22/08/15
Total share options	**2,407,331**	1,532,067		

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

Share-based payments – Group – continued
The number and weighted average exercise prices of share options are as follows:

	Weighted average exercise price 2005	**Number of options 2005**	Weighted average exercise price 2004	Number of options 2004
Outstanding at the beginning of the year	**186.5**	**1,532,067**	166.5	3,417,356
Exercised during the year	**141.9**	**(401,417)**	149.6	(1,846,098)
Granted during the year	**420.0**	**1,300,000**	–	–
Lapsed during the year	**197.0**	**(23,319)**	179.3	(39,191)
Outstanding at the end of the year	**319.9**	**2,407,331**	186.5	1,532,067
Exercisable at the end of the year	**128.0**	**35,500**	139.4	426,563

Options were exercised on a regular basis during the year. The average share price during the year was 432.0p (2004: 415.0p).

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 6.8 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.

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

	2005	2004
Fair value at measurement date	**89.01p**	37.13p
Weighted average share price	**432p**	415p
Exercise price	**420p**	215p
Expected volatility (expressed as weighted average volatility used in the modelling under the Black-Scholes model)	**31.84**	26.68
Option life (expressed as weighted average life used in the modelling under the Black-Scholes model)	**3 years**	3 years
Expected dividends	**3.6%**	3.3%
Risk-free interest rate (based on UK Gilts)	**4.3%**	4.0%

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

	2005 £000	2004 £000
Share options granted in 2003 under the approved 1998 scheme	**47**	47
Share options granted in 2003 under the unapproved 1998 scheme	**10**	10
Share options granted in 2005 under the approved 1998 scheme	**6**	–
Share options granted in 2005 under the unapproved 1998 scheme	**133**	–
Total carrying amount of liabilities	**196**	57

Share-based payments – 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 that of the General Index of Retail Prices, all items, over the relevant period.

Options granted under the 1996 and 1998 unapproved schemes are normally exercisable between the third and seventh anniversaries of their date of grant, subject to the movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices, all items, by 2% per annum and 3% per annum respectively over the relevant period.

Additionally, the company operates a savings related share option scheme which is open to employees subject to eligibility criteria determined by the directors prior to each option grant. The most recent grant was on 28 October 2002 where employees with over one year's service were invited to participate. As this savings related share option 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.

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – 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 2005	2004	Vesting conditions	Contractual life of options
Unapproved 1998 scheme grant to key management 14 December 1998	**–**	50,000	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices by 3% pa over the relevant period	14/12/01 – 14/12/05
Unapproved 1998 scheme grant to key management 10 January 2001	**–**	100,000	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices by 3% pa over the relevant period	10/01/04 – 10/01/08
Five year sharesave scheme granted to other employees 28 October 2002	**38,144**	38,144	One year's service	01/01/08 – 30/08/08
Approved 1998 scheme grant to key management 14 April 2003	**15,000**	15,000	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices over the relevant period	14/04/06 – 14/04/13
Unapproved 1998 scheme grant to key management 22 August 2005	**628,574**	–	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices by 3%-5% pa over the relevant period	22/04/08 – 22/08/12
Approved 1998 scheme grant to key management 22 August 2005	**21,426**	–	Movement of the group's basic earnings per share exceeding that of the General Index of Retail Prices by 2% pa over the relevant period	22/04/08 – 22/08/15
Total share options	**703,144**	203,144		

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

Share-based payments – Company – continued
The number and weighted average exercise prices of share options are as follows:

	Weighted average exercise price 2005	**Number of options 2005**	Weighted average exercise price 2004	Number of options 2004
Outstanding at the beginning of the year	**171.4**	**203,144**	192.5	745,644
Exercised during the year	**160.5**	**(150,000)**	200.4	(542,500)
Granted during the year	**420.0**	**650,000**	–	–
Outstanding at the end of the year	**403.5**	**703,144**	171.4	203,144
Exercisable at the end of the year	**–**	**–**	160.5	150,000

The weighted average share price at the date of exercise of share options exercised during the period was 403.0p (2004: 399.0).

The options outstanding at the year end have an exercise price in the range of 197.0p to 420.0p and a weighted average contractual life of 9.1 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.

	2005	2004
Fair value at measurement date	**89.01**	37.13p
Weighted average share price	**432p**	415p
Exercise price	**420p**	215p
Expected volatility (expressed as weighted average volatility used in the modelling under the Black-Scholes model)	**31.84**	26.68
Option life (expressed as weighted average life used in the modelling under the Black-Scholes model)	**3 years**	3 years
Expected dividends	**3.6%**	3.3%
Risk-free interest rate (based on UK Gilts)	**4.3%**	4.0%

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

Share-based payments – Company – continued
The total expenses recognised for the year arising from share based payments are as follows:

	2005 £000	2004 £000
Share options granted in 2003 under the approved 1998 scheme	**2**	2
Share options granted in 2005 under the approved 1998 scheme	**2**	–
Share options granted in 2005 under the unapproved 1998 scheme	**67**	–
Total carrying amount of liabilities	**71**	2

Share based payments awarded to employees of subsidiary undertakings and recognised as an investment in subsidiary undertakings in the company are as follows:

	2005 £000	2004 £000
Share options granted in 2003 under the approved 1998 scheme	**45**	45
Share options granted in 2003 under the unapproved 1998 scheme	**10**	10
Share options granted in 2005 under the approved 1998 scheme	**4**	–
Share options granted in 2005 under the unapproved 1998 scheme	**66**	–
Total carrying amount of investments	**125**	55

Notes to the Financial Statements continued

21 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.

	Group	
	2005	2004
	£000	£000
Present retirement indemnity obligations	**286**	451

Movements in present value of retirement indemnity obligations

	Group	
	2005	2004
	£000	£000
Current service cost	**(9)**	40
Actuarial (gains)/losses	**(156)**	36
	(165)	76

The current service cost and actuarial gains and losses are recognised in the income statement in administration expenses.

Notes to the Financial Statements continued

22 CAPITAL AND RESERVES

Reconciliation of movement in capital and reserves – group

	Share capital £000	Share premium £000	Translation reserve £000	Cash flow hedging reserve £000	Retained earnings £000	Total equity £000
Balance at 1 January 2004	4,213	49,061	–	–	55,024	108,298
Total recognised income and expense	–	–	(256)	–	24,141	23,885
Equity-settled share based payment transactions, net of tax	–	–	–	–	57	57
Share options exercised by employees	93	2,670	–	–	–	2,763
Deferred tax on Schedule 23 share options (pre Nov 2002)	–	–	–	–	(848)	(848)
Dividends	–	–	–	–	(11,795)	(11,795)
Balance at 31 December 2004	4,306	51,731	(256)	–	66,579	122,360
Balance at 1 January 2005	4,306	51,731	(256)	–	66,579	122,360
Adjustment in respect of adoption of IAS 32 and IAS 39 on 1 January, net of tax	–	–	–	(13)	–	(13)
Total recognised income and expense	–	–	(321)	13	26,827	26,519
Equity-settled share based payment transactions, net of tax	–	–	–	–	196	196
Share options exercised by employees	20	549	–	–	–	569
Deferred tax on Schedule 23 share options (pre November 2002)	–	–	–	–	172	172
Dividends	–	–	–	–	(13,976)	(13,976)
Balance at 31 December 2005	**4,326**	**52,280**	**(577)**	**–**	**79,798**	**135,827**

The aggregate current and deferred tax relating to items that are charged or credited to equity is £7,167,000 (2004: £6,085,000).

Notes to the Financial Statements continued

22 CAPITAL AND RESERVES – CONTINUED

Reconciliation of movement in capital and reserves – company

	Share capital £000	Share premium £000	Translation reserve £000	Special reserve £000	Retained earnings £000	Total parent equity £000
Balance at 1 January 2004	4,213	49,061	–	20,578	32,500	106,352
Total recognised income and expense	–	–	(1,759)	–	18,360	16,601
Equity-settled share based payment transactions, net of tax	–	–	–	–	57	57
Share options exercised by employees	93	2,670	–	–	–	2,763
Deferred tax on Schedule 23 share options (pre Nov 2002)	–	–	–	–	(27)	(27)
Dividends	–	–	–	–	(11,795)	(11,795)
Balance at 31 December 2004	4,306	51,731	(1,759)	20,578	39,095	113,951
Balance at 1 January 2005	4,306	51,731	(1,759)	20,578	39,095	113,951
Total recognised income and expense	–	–	–	–	37,691	37,691
Equity-settled share based payment transactions, net of tax	–	–	–	–	196	196
Share options exercised by employees	20	549	–	–	–	569
Deferred tax on Schedule 23 share options (pre Nov 2002)	–	–	–	–	(173)	(173)
Dividends	–	–	–	–	(13,976)	(13,976)
Balance at 31 December 2005	**4,326**	**52,280**	**(1,759)**	**20,578**	**62,833**	**138,258**

The aggregate current and deferred tax relating to items that are charged or credited to equity is £6,066,000 (2004: £5,329,000).

Notes to the Financial Statements continued

22 CAPITAL AND RESERVES – CONTINUED

Share capital

	5.6% cumulative preference shares of £1 each		Ordinary shares	
	2005	2004	**2005**	2004
In thousands of shares				
On issue at 1 January	**–**	–	**86,111.437**	84,265,339
Allotted under share option scheme	**–**	–	**401,417**	1,846,098
On issue at 31 December – fully paid	**–**	–	**86,512,854**	86,111,437

	2005	2004
	£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	**4,326**	4,306
5.6% cumulative preference shares of £1 each	**–**	–
	4,326	4,306
Shares classified as liabilities	**–**	–
Shares classified in shareholders funds	**4,326**	4,306
	4,326	4,306

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.

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.

Notes to the Financial Statements continued

22 CAPITAL AND RESERVES – CONTINUED

Translation reserve

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

Cash flow hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Dividends

	2005 **£000**	2004 £000
Interim dividend for 2004 of 4.0p paid 3 January 2005	**3,421**	–
Final dividend for 2004 of 12.25p paid 4 July 2005	**10,555**	–
Interim dividend for 2003 of 3.56p paid 5 January 2004	**–**	3,030
Final dividend for 2003 of 10.25p paid 1 July 2004	**–**	8,765
	13,976	11,795

The final proposed dividend of 13.6p per share (2004: £12.25p per share) will not be provided for until authorised by shareholders at the forthcoming AGM.

Interim dividends of 4.4p per share (2004: 4.0p per share) are provided for when the dividend is paid.

The total value of dividends proposed but not recognised at 31 December 2005 is £15,582,000 (2004: £13,976,000).

23 FINANCIAL INSTRUMENTS

The main risks arising in the normal course of the group's business are credit 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 over a certain amount and these are frequently reviewed by management to limit exposure. The group does not require collateral in respect of financial assets.

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, including derivative financial instruments, in the balance sheet.

Interest rate risk

The group and company are exposed to interest rate fluctuations on its borrowings and cash deposits. It borrows principally in sterling, euros and Swiss francs at both fixed and floating rates and places cash on deposit in sterling and euros at floating rates. During the year, with the exception of a fixed term facility amounting to £nil (2004: £687,000) denominated in Swiss francs, the group maintained its policy of borrowing at floating rates.

Notes to the Financial Statements continued

23 FINANCIAL INSTRUMENTS – CONTINUED

Effective interest rates and repricing analysis – group
In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they mature or, if earlier, are repriced.

	2005				2004				
	Effective interest rate %	**Total £000**	**0 to <1years £000**	**1 to <2years £000**	Effective interest rate %	Total £000	0 to <1years £000	1 to <2years £000	2 to <5 years £000
Cash and cash equivalents	**4.57**	**36,193**	**36,193**	**–**	4.59	37,747	37,747	–	–
Finance lease liabilities	**6.00**	**(738)**	**(471)**	**(267)**	6.00	(1,175)	(437)	(471)	(267)
Unsecured Swiss franc bank loan	**–**	**–**	**–**	**–**	1.98	(687)	(687)	–	–
Bank overdrafts	**–**	**–**	**–**	**–**	2.49	(278)	(278)	–	–
		35,455	**35,722**	**(267)**		35,607	36,345	(471)	(267)

The unsecured Swiss franc bank loan incurred interest at a fixed rate.

Comparative information for 2004 is provided in accordance with previous GAAP.

Effective interest rates and repricing analysis – company
In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they mature or, if earlier, are repriced.

	2005				2004				
	Effective interest rate %	**Total £000**	**0 to <1years £000**	**1 to <2years £000**	Effective interest rate %	Total £000	0 to <1years £000	1 to <2years £000	2 to <5years £000
Cash and cash equivalents	**4.57**	**31,265**	**31,265**	**–**	4.59	5,473	5,473	–	–
Finance lease liabilities	**6.00**	**(738)**	**(471)**	**(267)**	6.00	(1,168)	(430)	(471)	(267)
		30,527	**30,794**	**(267)**		4,305	5,043	(471)	(267)

Comparative information for 2004 is provided in accordance with previous GAAP.

Notes to the Financial Statements continued

23 FINANCIAL INSTRUMENTS – CONTINUED

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.

For the twelve month period to 31 December 2005, 4.4% (2004: 4.4%) of the group's operating profit was derived from overseas subsidiaries and at 31 December 2005, 8.5% (2004: 8.5%) 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 uses forward exchange contracts to hedge its foreign currency transactional risk. All forward exchange contracts have maturities of less than one year after the balance sheet date.

Gains and losses on currency contracts recognised as a liability as at 31 December 2005 amounted to £43,000 (2004: £13,000).

Unrecognised gains and losses on currency contracts and the movements during the year based on previous GAAP were as follows:

		2004	
	Gains	Losses	Total net losses
	£000	£000	£000
Unrecognised gains and losses at 1 January	–	(1)	(1)
Gains and losses arising in previous years that were recognised in the year	–	1	1
Gains and losses arising before 1 January that were not recognised in the year	–	–	–
Gains and losses arising in the year that were not recognised in the year	–	–	–
Unrecognised gains and losses on currency contracts at 31 December	–	(13)	(13)
Gains and losses expected to be recognised in the next financial year	–	(13)	(13)

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

Sensitivity analysis
In managing interest rate and currency risks the company and group aims 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 would have an impact on the consolidated income statement.

Notes to the Financial Statements continued

23 FINANCIAL INSTRUMENTS – CONTINUED

Fair values
The fair values together with the carrying amounts shown in the balance sheet are as follows:

	Group		Company	
	Carrying amount 2005 £000	Fair value 2005 £000	Carrying amount 2005 £000	Fair value 2005 £000
Assets				
Cash and cash equivalent	36,193	36,193	36,193	36,193
Trade and other receivables	84,275	84,275	2,320	2,320
	120,468	120,468	38,513	38,513
Liabilities				
Trade and other payables	141,529	141,529	5,532	5,532
Borrowings				
Current	471	471	471	471
Non-current	267	267	267	267
	142,267	142,267	6,270	6,270

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.

Notes to the Financial Statements continued

23 FINANCIAL INSTRUMENTS – CONTINUED

The main functional currencies of the group are sterling, euros, Swiss francs and US dollars. The following analysis of net monetary assets and liabilities shows the group's currency exposures after the effects of forward contracts used to manage currency exposure.

The amount shown represents the transactional exposures which give rise to the net currency gains and losses recognised in the consolidated income statement. Such exposures comprise the monetary assets and monetary liabilities of the group which are not denominated in the operating currency of the operating unit involved.

		2005		
	Sterling amount £000	**Euro value £000**	**US Dollar amount £000**	**value £000**
Sterling	**–**	**141**	**–**	**141**
Other European	**3**	**29**	**–**	**32**
Total	**3**	**170**	**–**	**173**

		2004		
	Sterling amount £000	Euro value £000	US Dollar amount £000	value £000
Sterling	–	536	38	574
Other European	–	69	–	69
Total	–	605	38	643

Notes to the Financial Statements continued

24 ACQUISITIONS OF SUBSIDIARIES

On 1 April 2005, the group acquired the trade and assets of the retail division of Gaskell Flooring Limited, trading as Gaskell Wool Rich and Tomkinson Carpets, for £425,596, satisfied in cash. The business supplies residential carpets to independent floorcovering retailers and department stores within the UK. In the nine months to 31 December 2005, the business contributed net profit of £161,000 to the consolidated net profit for the year. If the acquisition had occurred on 1 January 2005, contribution to the group revenue would have been an estimated £3,029,000 and net profit would have been an estimated £175,000.

Effect of acquisitions
The acquisitions had the following effect on the group's assets and liabilities:

	Acquiree's book values £000	Fair value adjustments £000	Acquisition amounts £000
Acquiree's net assets at the acquisition date:			
Inventories	426	–	426
Net identifiable assets and liabilities	426	–	426
Goodwill on acquisition			–
Consideration paid			(426)
Net cash outflow			(426)

No goodwill has arisen on the acquisition of the retail division of Gaskell Flooring Limited and no value has been attributed to the trade names or customer lists.

Notes to the Financial Statements continued

24 ACQUISITIONS OF SUBSIDIARIES – CONTINUED

Acquisitions completed during 2004 had the following effect on the group's assets and liabilities:

	Acquiree's book values £000	Fair value adjustments £000	Acquisition amounts £000
Acquiree's net assets at the acquisition date:			
Plant and equipment	255	–	255
Inventories	1,977	–	1,977
Trade and other receivables	4,795	–	4,795
Cash and cash equivalents	69	–	69
Trade and other payables	(4,320)	–	(4,320)
Net identifiable assets and liabilities	2,776	–	2,776
Intangible asset on acquisition			1,672
Consideration paid			(4,448)
Satisfied by:			
Cash			3,788
Deferred consideration			600
Acquisition costs capitalised			60
			4,448
Analysis of cash flows:			
On completion			(3,788)
Costs of acquisition			(60)
Cash and cash equivalents			69
			(3,779)

The acquisitions during 2004 relate to the purchase of N.C.G. Limited, completed on 30 April 2004 and Kingsmead Carpets which was completed on 17 September 2004.

Deferred consideration relates to the acquisition of N.C.G. Limited. £300,000 was paid on 29 April 2005 and £300,000 will be paid on 28 April 2006.

The intangible asset relates to customer lists purchased with N.C.G. Limited and has been amortised in full during 2004 and 2005.

Notes to the Financial Statements continued

25 ANALYSIS OF CHANGES IN NET FUNDS

	At 1 January 2005 £000	**Cash flows £000**	**Translation differences £000**	**At 31 December 2005 £000**
Cash at bank and in hand	37,747	**(1,527)**	**(27)**	**36,193**
Bank overdraft	(279)	**269**	**10**	**–**
	37,468	**(1,258)**	**(17)**	**36,193**
Debt due after one year	(687)	**662**	**25**	**–**
Finance leases and similar hire purchase contracts	(1,176)	**438**	**–**	**(738)**
	35,605	**(158)**	**8**	**35,455**

Notes to the Financial Statements continued

26 OPERATING LEASES

Non-cancellable operating lease rentals are payable as follows:

Group

	2005			2004		
	Land and buildings £000	**Plant and machinery £000**	**Total £000**	Land and buildings £000	Plant and machinery £000	Total £000
Less than one year	**–**	**1,596**	**1,596**	–	1,672	1,672
Between one and five years	**–**	**16,829**	**16,829**	–	17,385	17,385
More than five years	**2,741**	**1,762**	**4,503**	3,302	596	3,898
	2,741	**20,187**	**22,928**	3,302	19,653	22,955

Company

	2005			2004		
	Land and buildings £000	**Plant and machinery £000**	**Total £000**	Land and buildings £000	Plant and machinery £000	Total £000
Less than one year	**–**	**2**	**2**	–	6	6
Between one and five years	**–**	**42**	**42**	–	18	18
	–	**44**	**44**	–	24	24

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 2005, £9,076,000 was recognised as an expense in the consolidated income statement in respect of operating leases (2004: £8,663,000).

Notes to the Financial Statements continued

27 CAPITAL COMMITMENTS

Group
During the year ended 31 December 2005, the group entered into contracts to purchase property, plant and equipment for £8,448,000 (2004: £4,085,000). These commitments are expected to be settled in the following financial year.

Company
During the year ended 31 December 2005, the company entered into contracts to purchase property, plant and equipment for £8,448,000 (2004: £nil). These commitments are expected to be settled in the following financial year.

28 CONTINGENCIES

	Group		Company	
	2005	2004	**2005**	2004
Third party guarantees	**460**	240	**–**	–

29 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 2005, directors of the company and their immediate relatives controlled 1.6 per cent of the voting shares of the company.

Key management personnel are considered to be the directors and their remuneration is disclosed within the Directors' remuneration report on page 41.

Notes to the Financial Statements continued

29 RELATED PARTIES – CONTINUED

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 2005, directors of the company and their immediate relatives control 1.6 per cent of the voting shares of the company.

Key management are considered to be the directors and their remuneration is disclosed within the remuneration report on page 41.

Transactions with other group companies

	Highest during the year £000	**Balance at 31 December 2005 £000**	Highest during the year £000	Balance at 31 December 2004 £000
Amounts due from subsidiary undertakings	**25,163**	**23,272**	29,340	25,163
Amounts due to subsidiary undertakings	**(50,587)**	**(50,587)**	(50,682)	(48,930)

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

	For year ended 31 December 2005 £000	For year ended 31 December 2004 £000
Rental income	**4,752**	4,036
Dividends received	**39,911**	18,345
Management charges	**1,910**	2,186
Interest expense	**(1,254)**	(117)

Notes to the Financial Statements continued

30 SUBSEQUENT EVENTS

With the exception of changes in directors, noted in the director's report, there have been no events after the balance sheet date that require disclosure.

31 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 2005. 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 2005.

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 dependant on the group's ability to generate sufficient future taxable profits.

Non-current assets classified as held for sale
The inclusion of assets within non-current assets classified as held for sale and the realisation of the expected proceeds is based on the assumption that contracts will complete during the financial year.

Employee benefits
The deficit relating to the group's defined benefit pension 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.

Notes to the Financial Statements continued

32 EXPLANATION OF TRANSITION TO IFRS – GROUP

As stated in note 1, these are the company's and group's first consolidated financial statements prepared in accordance with IFRS.

The accounting policies set out in note 1 have been applied in preparing the financial statements for the year ended 31 December 2005, the comparative information presented in these financial statements for the year ended 31 December 2004 and in the preparation of an opening IFRS balance sheet at 1 January 2004, the company's and group's date of transition.

In preparing its opening IFRS balance sheet, the company and group have adjusted amounts reported previously in financial statements prepared in accordance with UK GAAP, its former basis of accounting. An explanation of how the transition from UK GAAP to IFRS has affected the group's financial performance and the company and group financial position and cash flows is set out in the following tables and the notes that accompany the tables.

Reconciliation of profit for year ended 31 December 2004

	UKGAAP £000	Effect of transition to IFRS £000	IFRS £000
Revenue	464,789	-	464,789
Cost of sales	(323,924)	-	(323,924)
Gross profit	140,865	-	140,865
Net operating expenses	(102,465)	524	(101,941)
Operating profit	38,400	524	38,924
Net financing costs	(59)	(381)	(440)
Profit before tax	38,341	143	38,484
Taxation	(11,975)	237	(11,738)
Profit for the year	26,366	380	26,746

Notes to the Financial Statements continued

32 EXPLANATION OF TRANSITION TO IFRS – GROUP – CONTINUED

Reconciliation of equity	1 January 2004			**31 December 2004**		
	UK GAAP £000	Effect of transition to IFRS £000	IFRS £000	**UK GAAP £000**	**Effect of transition to IFRS £000**	**IFRS £000**
Non-current assets						
Property, plant and equipment	64,236	(2,612)	61,624	**75,256**	**(3,502)**	**71,754**
Intangible assets	13,210	–	13,210	**13,964**	**82**	**14,046**
Deferred tax assets	1,226	6,232	7,458	**1,390**	**6,777**	**8,167**
	78,672	3,620	82,292	**90,610**	**3,357**	**93,967**
Current assets						
Inventories	73,889	–	73,889	**79,692**	**–**	**79,692**
Trade and other receivables	72,877	260	73,137	**85,293**	**257**	**85,550**
Cash and cash equivalents	32,336	–	32,336	**37,747**	**–**	**37,747**
Assets classified as held for sale	1,042	(892)	150	**3,975**	**(3,772)**	**203**
	180,144	(632)	179,512	**206,707**	**(3,515)**	**203,192**
Total assets	258,816	2,988	261,804	**297,317**	**(158)**	**297,159**
Current liabilities						
Short term borrowings	(2,045)	–	(2,045)	**(279)**	**–**	**(279)**
Current portion of long term borrowings	(499)	–	(499)	**(1,124)**	**–**	**(1,124)**
Trade and other payables	(135,209)	11,658	(123,551)	**(156,046)**	**14,018**	**(142,028)**
Employee benefits	–	–	–	**–**	**(722)**	**(722)**
Tax payable	(9,625)	–	(9,625)	**(11,053)**	**–**	**(11,053)**
	(147,378)	11,658	(135,720)	**(168,502)**	**13,296**	**(155,206)**

Notes to the Financial Statements continued

32 EXPLANATION OF TRANSITION TO IFRS – GROUP – CONTINUED

	1 January 2004 UK GAAP £000	1 January 2004 Effect of transition to IFRS £000	1 January 2004 IFRS £000	**31 December 2004 UK GAAP £000**	**31 December 2004 Effect of transition to IFRS £000**	**31 December 2004 IFRS £000**
Non-current assets						
Other interest-bearing loans and borrowings	(1,175)	–	(1,175)	**(738)**	**–**	**(738)**
Employee benefits	(375)	(14,166)	(14,541)	**(451)**	**(17,192)**	**(17,643)**
Deferred tax liabilities	(1,628)	(442)	(2,070)	**(758)**	**(454)**	**(1,212)**
	(3,178)	(14,608)	(17,786)	**(1,947)**	**(17,646)**	**(19,593)**
Total liabilities	(150,556)	(2,950)	(153,506)	**(170,449)**	**(4,350)**	**(174,799)**
Net assets	108,260	38	108,298	**126,868**	**(4,508)**	**122,360**
Equity attributable to equity holders of the parent						
Share capital	4,213	-	4,213	**4,306**	**–**	**4,306**
Share premium	49,061	-	49,061	**51,731**	**–**	**51,731**
Revaluation reserve	2,844	(2,844)	-	**6,615**	**(6,615)**	**–**
Retained earnings	52,142	2,882	55,024	**64,216**	**2,107**	**66,323**
Total equity	108,260	38	108,298	**126,868**	**(4,508)**	**122,360**

Notes

Removal of property revaluation

As a result of opting to restate land and buildings back to their depreciated historical cost, property reported as a non-current asset has reduced because the revaluation surplus has been eliminated and depreciation charged in the twelve month periods has also decreased.

Goodwill amortisation

Goodwill represents the excess of the cost of acquisition over the fair value of the identifiable net assets of the acquired subsidiary undertakings at the date of acquisition and is included on the balance sheet as a non-current asset. Under UK GAAP, goodwill was amortised on a straight line basis over a period of 20 years representing the estimated useful economic life. This changes under IFRS as goodwill is not amortised but tested at least annually for impairment. Goodwill is then held in the balance sheet at cost less any accumulated impairment losses. Goodwill amortised in the twelve month periods under UK GAAP has therefore been reversed and the amount reported under non-current assets is now subject to an annual impairment review.

Notes to the Financial Statements continued

32 EXPLANATION OF TRANSITION TO IFRS – GROUP – CONTINUED

Non-current assets held for sale
Under IFRS, a non-current asset held for sale must, at the balance sheet date, be available for immediate sale in its present condition and the sale must be highly probable and expected to be completed within one year. As a result, some of the properties that were previously shown as assets held for resale within current assets under UK GAAP have been reclassified to property, plant and equipment under non-current assets. These properties had a net book value of £623,000 at 1 January 2004 and £4,302,000 at 31 December 2004. IFRS 5 has been adopted early and hence reflected at 31 December 2004.

Share based payments
Under UK GAAP, the expense of granting employee share options was the difference between the exercise price and market price at the date the option was granted.

Under IFRS, the expense is based upon the fair value of the option, as spread over the vesting period and adjusted for non-market conditions. The fair value of the share options granted after 7 November 2002 is calculated using an appropriate pricing model and the expense is recognised in the consolidated income statement.

The charge for the group has been calculated using the Black-Scholes option pricing model. In accordance with the transitional provisions of IFRS 2, no income statement expense has been recorded in respect of grants of share options made prior to 7 November 2002. There is no impact to net assets or distributable reserves as a result of this adjustment which is credited directly to equity.

Retirement benefit obligations
Under UK GAAP, the cost of the group's defined benefit plan was reported by reference to SSAP 24 and further disclosures were provided in accordance with FRS 17. These two standards have now been replaced by IAS 19.

Cumulative actuarial gains and losses have been recognised within equity as at 1 January 2004 in respect of the group's defined benefit plans as per the transitional exemption allowed by IFRS 1. This gives rise to a defined benefit scheme plan of £14,541,000 at 1 January 2004 and a liability of £18,365,000 at 31 December 2004.

Deferred tax
Under UK GAAP, with the exception of permanent differences, deferred tax should be recognised on all timing differences that have originated but not reversed by the balance sheet date. Non-reversing permanent differences fall outside the scope of deferred tax.

Under IFRS, deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying value in the financial statements. Deferred tax is recognised in the consolidated income statement except if it relates to an item that is recognised directly in equity, in which case it is dealt with in the consolidated statement of changes in equity.

The group's transitional balance sheet at 1 January 2004 includes additional deferred tax assets and liabilities amounting to £6,232,000 and £442,000 respectively. The deferred tax assets principally relate to the tax provided on the defined benefit plan liability and the need to provide for the tax on the gains arising on share based payments. The additional deferred tax liabilities occur because of depreciating properties, acquired as part of a business combination, which are not eligible for tax relief.

The consolidated income statement for the twelve month period ended 31 December 2004 contains an additional deferred tax credit of £237,000 because of the tax effects associated with the amortisation of intangibles assets and the recognition of additional costs relating to the defined benefit plan.

Notes to the Financial Statements continued

32 EXPLANATION OF TRANSITION TO IFRS – GROUP – CONTINUED

Events after balance sheet date
Under UK GAAP, equity dividends were recognised in the year to which they related and were an adjustable post balance sheet event.

Under IFRS, final equity dividends proposed by the board are recognised only when approved by the shareholders at the AGM. Interim dividends are recognised when paid or when they are approved by the shareholders. Dividends are shown as a movement in equity and not on the face of the consolidated income statement.

Property leases
Under IFRS, property leases should be divided into two components with land and buildings considered as separate elements. Land is normally classified as an operating lease unless title passes to the lessee at the end of the lease term. The building is classified as an operating or finance lease by applying classification criteria in IAS 17 – Leases.

At 1 January 2004, one property has been reclassified. Land amounting to £300,000 has been treated as an operating lease and has been transferred from property, plant and equipment under non-current assets and shown within other current assets in current assets. The value attributed to the land is being amortised over the life of the lease term and recognised in the consolidated income statement and, in the twelve month period to 31 December 2004, gives rise to an additional charge of £3,000.

There are no other material differences between the cash flow statement presented under IFRS and the cash flow statement presented under UK GAAP.

Cash flow
There are no material differences between the cash flow statement for the group presented under IFRS and the cash flow statement presented under UK GAAP.

Notes to the Financial Statements continued

32 EXPLANATION OF TRANSITION TO IFRS – COMPANY

Reconciliation of equity	1 January 2004 UK GAAP £000	1 January 2004 Effect of transition to IFRS £000	1 January 2004 IFRS £000	**31 December 2004 UK GAAP £000**	**31 December 2004 Effect of transition to IFRS £000**	**31 December 2004 IFRS £000**
Non-current assets						
Property, plant and equipment	50,365	(2,612)	47,753	**61,802**	**(3,502)**	**58,300**
Investments in subsidiary undertakings	90,112	41	90,153	**94,614**	**96**	**94,710**
Deferred tax assets	–	4,608	4,608	**285**	**5,419**	**5,704**
	140,477	2,037	142,514	**156,701**	**2,013**	**158,714**
Current assets						
Trade and other receivables	1,825	257	2,082	**2,421**	**257**	**2,678**
Amounts due from subsidiary undertakings	47,682	(18,342)	29,340	**49,574**	**(24,411)**	**25,163**
Cash and cash equivalents	6,875	–	6,875	**5,473**	**–**	**5,473**
Assets classified as held for sale	1,042	(892)	150	**3,975**	**(3,772)**	**203**
	57,424	(18,977)	38,447	**61,443**	**(27,926)**	**33,517**
Total assets	197,901	(16,940)	180,961	**218,144**	**(25,913)**	**192,231**
Current liabilities						
Other interest-bearing loans and borrowings	(393)	–	(393)	**(430)**	**–**	**(430)**
Amount due to subsidiary undertakings	(915)	–	(915)	**–**	**–**	**–**
Trade and other payables	(14,757)	11,658	(3,100)	**(19,350)**	**14,019**	**(5,331)**
Employee benefits	–	–	–	**–**	**(722)**	**(722)**
Tax payable	(3,805)	–	(3,805)	**(4,841)**	**–**	**(4,841)**
	(19,870)	11,658	(8,212)	**(24,621)**	**13,297**	**(11,324)**

Notes to the Financial Statements continued

32 EXPLANATION OF TRANSITION TO IFRS – COMPANY – CONTINUED

	1 January 2004			31 December 2004		
	UK GAAP £000	Effect of transition to IFRS £000	IFRS £000	**UK GAAP £000**	**Effect of transition to IFRS £000**	**IFRS £000**
Non-current liabilities						
Other interest-bearing loans and borrowings	(1,168)	–	(1,168)	**(738)**	**–**	**(738)**
Amounts due to subsidiary undertakings	(49,766)	–	(49,766)	**(48,930)**	**–**	**(48,930)**
Employee benefits	–	(14,166)	(14,166)	**–**	**(17,192)**	**(17,192)**
Deferred tax liabilities	(903)	(394)	(1,297)	**–**	**(96)**	**(96)**
	(51,837)	(14,560)	(66,397)	**(49,668)**	**(17,288)**	**(66,956)**
Total liabilities	(71,707)	(2,902)	(74,609)	**(74,289)**	**(3,991)**	**(78,280)**
Net assets	126,194	(19,842)	106,352	**143,855**	**(29,904)**	**113,951**
Equity attributable to equity holders of the parent						
Share capital	4,213	–	4,213	**4,306**	**–**	**4,306**
Share premium	49,061	–	49,061	**51,731**	**–**	**51,731**
Special reserve	20,578	–	20,578	**20,578**		**20,578**
Revaluation reserve	2,844	(2,844)	–	**6,615**	**(6,615)**	**–**
Retained earnings	49,498	(16,998)	32,500	**60,625**	**(23,289)**	**37,336**
Total equity	126,194	(19,842)	106,352	**143,855**	**(29,904)**	**113,951**

Notes

The IFRS adjustments relating to the company are in principal the same as those affecting the group. Therefore, the explanations given above for the group are the same for the company with the exception of the following:

Goodwill amortisation

There is no corresponding adjustment in the company.

Events after the balance sheet date

Under UK GAAP, equity dividends receivable from subsidiary undertakings were recognised in the year and were an adjustable post balance sheet event. Under IFRS, equity dividends are only recognised when the cash has been received from subsidiary undertakings. Dividends are shown as a movement in equity.

Cash flow

There are no material differences between the cash flow statement for the company presented under IFRS and the cash flow statement prepared under UK GAAP.

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 subsidiary undertakings comprises ordinary share capital and loans.

Financial Record

	2001 £000	2002 £000	2003 £000	2004 £000	**2005** **£000**
Trading results					
Revenue	434,122	395,723	412,295	464,789	**486,653**
Operating profit before goodwill amortisation	32,111	30,362	33,514	38,924	**41,498**
Goodwill amortisation	(783)	(825)	(835)	—	**—**
Operating profit	31,328	29,537	32,679	38,924	**41,498**
Loss on sale of land and buildings	(434)	—	—	—	**—**
(Loss)/profit on disposal of discontinued operations	(18,811)	861	—	—	**—**
Profit before net financing costs	12,083	30,398	32,679	38,924	**41,498**
Net financing costs	(3,403)	(521)	(86)	(440)	**(658)**
Profit on ordinary activities before tax	8,680	29,877	32,593	38,484	**40,840**
Taxation	(9,188)	(9,335)	(10,464)	(11,738)	**(12,352)**
(Loss)/profit on ordinary activities after taxation	(508)	20,542	22,129	26,746	**28,488**
Dividends	(9,558)	(10,550)	(11,657)	—	**—**
(Loss)/profit for the year	(10,066)	9,992	10,472	26,746	**28,488**
Proposed dividend per share	11.40p	12.55p	13.85p	16.25p	**18.0p**
Earnings per share	23.3p	24.4p	27.3p	31.3p	**33.1p**
Net assets					
Non-current assets					
Property, plant and equipment	37,913	44,607	64,236	71,754	**74,640**
Intangible assets	12,741	13,767	13,210	14,046	**13,210**
Deferred tax assets	—	—	—	8,167	**8,199**
	50,654	58,374	77,446	93,967	**96,049**
Current assets					
Inventories	70,742	66,951	73,889	79,692	**91,160**
Trade and other receivables	74,163	67,605	72,877	85,550	**84,275**
Cash and cash equivalents	44,464	35,522	32,336	37,747	**36,193**
	189,369	170,078	179,102	202,989	**211,628**
Non-current assets classified as held for sale	7,025	6,591	1,042	203	**3,471**
Total assets	247,048	235,043	257,590	297,159	**311,148**
Current liabilities					
Bank overdraft	(1,695)	(635)	(216)	(279)	**—**
Other interest-bearing loans and borrowings	(25,914)	(3,342)	(2,328)	(1,124)	**(471)**
Trade and other payables	(120,622)	(123,805)	(135,209)	(142,028)	**(141,529)**
Employee benefits	—	—	—	(722)	**(1,080)**
Income tax payable	(5,572)	(7,505)	(9,625)	(11,053)	**(11,139)**
	(153,803)	(135,287)	(147,378)	(155,206)	**(154,219)**
Non-current liabilities					
Other interest-bearing loans and borrowings	(4,498)	(1,670)	(1,175)	(738)	**(267)**
Employee benefits	—	—	—	(17,643)	**(19,432)**
Other payables	(107)	(379)	(375)	—	**—**
Deferred tax liabilities	(375)	(297)	(402)	(1,212)	**(1,403)**
	(4,980)	(2,346)	(1,952)	(19,593)	**(21,102)**
Total liabilities	(158,783)	(137,633)	(149,330)	(174,799)	**(175,321)**
Net assets	88,265	97,410	108,260	122,360	**135,827**

The earnings per share for the years 2001 to 2003 is calculated by reference to operating profit before goodwill amortisation and exceptional items.

The information relating to the years 2001 to 2003 has not been restated for IFRS.

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of Headlam Group plc will be held at the group's distribution facility located at Gorsey Lane, Coleshill, Birmingham, B46 1LW on Thursday 1 June 2006 at 10.00 a.m. for the following purposes.

As ordinary business

1 To receive, consider and adopt the report of the directors and the financial statements for the year ended 31 December 2005, together with the auditors' report.

2 To declare a final dividend.

3 To re-elect as a director Graham Waldron who retires in accordance with the Articles of Association and is eligible for re-election. Graham Waldron has attained the age of 75, being born on 16 April 1930, therefore this resolution authorising his re-election as a director for a period of twelve months expires at the conclusion of the next AGM.

4 To re-elect as a director Tony Brewer who retires in accordance with the Articles of Association and is eligible for re-election.

5 To elect as a director, Dick Peters who, following his appointment on 1 December 2005, retires in accordance with the Articles of Association and is eligible for election.

6 To elect as a director, Mike O'Leary who, following his appointment on 10 March 2006, retires in accordance with the Articles of Association and is eligible for election.

7 To re-appoint KPMG Audit Plc as auditors of the company until the conclusion of the next AGM.

8 To authorise the directors to agree the remuneration of the independent auditors of the company.

9 That the Remuneration Report set out on pages 38 to 44 of the Report and Accounts for the year ended 31 December 2005 be approved.

As special business

As special business, to consider and, if thought fit, pass the following resolutions, which will be proposed as to resolution 10 as an Ordinary Resolution and as to resolutions 11 to 14 as Special Resolutions:

10 THAT, subject to and in accordance with Article 18 of the Articles of Association of the Company, the Directors be generally and unconditionally authorised in accordance with section 80 of the Companies Act 1985 (the "Act") (in substitution for any existing authority to allot relevant securities) to exercise all the powers of the Company to allot relevant securities (within the meaning of section 80 of the Act) up to a maximum nominal amount of £216,790, provided that such authority shall expire on 30 September 2007, or such earlier time as this authority shall next be revoked or varied by the Company in general meeting, but so that the Company may, before such expiry, make an offer or agreement which would or might require relevant securities to be allotted after such expiry, and the Directors may allot relevant securities in pursuance of such offer or agreement as if the authority conferred by this resolution had not expired.

11 THAT, subject to the passing of resolution 10 as set out in the notice of this meeting, the directors be empowered pursuant to section 95 of the Companies Act 1985 (the "Act") (in substitution for any existing authority to allot equity securities) to allot equity securities (as defined in section 94 of the Act) for cash pursuant to the general authority conferred by resolution 10 as set out in the notice of this meeting and to sell relevant shares (as defined in section 94 of the Act) held by the company as treasury shares (as

Notice of Annual General Meeting continued

defined in section 162A of the Act) for cash, as if section 89(1) of the Act did not apply to such allotment or sale, provided that this power shall be limited to allotments of equity securities and the sale of treasury shares:

(a) in connection with or pursuant to an offer by way of rights, open offer or other pre-emptive offer to the holders of shares in the company and other persons entitled to participate therein in proportion (as nearly as practicable) to their respective holdings, subject to such exclusions or other arrangements as the directors may consider necessary or expedient to deal with fractional entitlements or legal or practical problems under the laws of any territory or the regulations or requirements of any regulatory authority or any stock exchange in any territory; and

(b) otherwise than pursuant to sub-paragraph (a) above, up to an aggregate nominal amount of £216,790; and such power shall expire on 30 September 2007, or such earlier time as this authority shall next be revoked or varied by the company in general meeting, but so that the company may, before such expiry, make an offer or agreement which would or might require equity securities to be allotted or treasury shares to be sold after such expiry, and the directors may allot equity securities or sell treasury shares in pursuance of such offer or agreement as if the power conferred by this resolution had not expired.

12 THAT the company be generally and unconditionally authorised, pursuant to Article 12.2 of the Articles of Association of the company and pursuant to section 166 of the Companies Act 1985 (the "Act"), to make market purchases (as defined in section 163 of the Act) of up to 13,007,600 ordinary shares of 5p each in the capital of the company ("Ordinary Shares") on such terms and in such manner as the directors of the company may from time to time determine, provided that:

(a) the amount paid for each Ordinary Share (exclusive of expenses) shall not be more than five per cent above the average of the middle market quotation for an Ordinary Share as derived from the Daily Official List of London Stock Exchange plc for the five business days before the date on which the contract for the purchase is made and, in any event, not less than 20p per Ordinary Share; and

(b) the authority herein contained shall expire at the conclusion of the Annual General Meeting of the company to be held in 2007 or on 30 September 2007, whichever is earlier, provided that the company may, before such expiry, make a contract to purchase its own shares which would or might be executed wholly or partly after such expiry, and the company may make a purchase of its own shares in pursuance of such contract as if the authority hereby conferred hereby had not expired.

13 That, with effect from the passing of the resolution Article 98 of the Articles of Association of the company be amended such that the aggregate sum of fees payable to non-executive directors in respect of any year be increased by £50,000 to £200,000.

14 That the Articles of Association of the company be amended by the deletion of Article 184 and the insertion of a new Article 184 as follows:

"184. (A) Without prejudice to any indemnity to which he may otherwise be entitled, every person who is or was a director, secretary or other relevant officer of the company shall be indemnified and kept indemnified out of the company's assets against all liability incurred by him as such or as a director, secretary or relevant officer of an associated company:

(a) in defending any proceedings, whether civil or criminal, in respect of alleged negligence, default, breach of duty, breach of trust or otherwise in relation to the company or an associated company or its or their affairs, in which judgement is given in his favour or in which he is acquitted or in defending or settling any such proceedings which are otherwise disposed of on terms previously agreed with the board or on terms otherwise approved by the board without a finding or admission of negligence, default, breach of duty or breach of trust on his part; or

(b) in connection with any application under the statutes in which relief is granted to him by the court provided that this article shall not grant, or entitle any such person to, indemnification to the extent that it would cause this article, or any part of it, to be void under the statutes

Notice of Annual General Meeting continued

(B) Without prejudice to any indemnity to which he may otherwise be entitled (including, for the avoidance of doubt, any indemnity under or pursuant to these articles) and to the extent permitted by the statutes, the board shall have power in the name and on behalf of the company to:

(a) grant on such terms as it sees fit any person who is or was a director, secretary or other relevant officer of the company an indemnity or indemnities out of the assets of the company in respect of any liability incurred by him as such or as a director, secretary or relevant officer of an associated company and to amend, vary or extend the terms of any such indemnity so granted, again on such terms as the board sees fit; and/or

(b) enter into and amend, vary or extend such arrangements as it sees fit:

(i) to provide any person who is or was a director, secretary or other relevant officer of the company with funds to meet expenditure incurred or to be incurred by him in defending any criminal or civil proceedings brought against him as such or as a director, secretary or relevant officer of an associated company or in connection with any application for relief under the statutes; or
(ii) to enable any such person to avoid incurring any such expenditure

(C) For the purposes of this article 184:
(a) a "relevant officer" is any officer of the company or an associated company (other than in either case any person (whether or not an officer of the company or an associated company) engaged by the company or an associated company as auditor);
(b "associated company" has the meaning given to that term in section 309A of the Act; and
(c) a director shall be entitled to vote and to be counted in the quorum at any meeting of the board or a committee of the board at which any indemnity, arrangement or proposal falling within any of the provisions of Articles 184 is to be considered and, for the purposes of article 120, any interest which any director may have in such indemnity, arrangement or proposal shall not be a material interest unless the terms of such indemnity, arrangement or proposal confer upon such director a privilege or benefit not generally available to, or awarded to, any other director. The decision of the chairman of the meeting as to whether the indemnity, arrangement or proposal to be considered at the meeting falls within the provisions of Articles 184 or as to the materiality of any director's interest therein for the purposes of this article and article 120 shall be final and conclusive"

To consider and, if thought fit, pass the following resolution which will be proposed as an ordinary resolution:

By order of the board

Geoff Duggan
Company Secretary
10 April 2006

Registered Office:-
PO Box 1
Gorsey Lane
Coleshill
Birmingham
B46 1LW

Notice of Annual General Meeting continued

Notes

1 Any member entitled to attend and vote at the Annual General Meeting is entitled to appoint one or more proxies (who need not be a member of the company) to attend and, on a poll, to vote instead of the member. A form of proxy for use by members at the meeting is enclosed. Completion and return of a form of proxy will not preclude a member from attending and voting at the meeting in person, should he subsequently decide to do so. In accordance with regulation 34 of the Uncertified Securities Regulations 1995, the company has determined that only those members whose names are entered in the register of members at 10 a.m. on 30 May 2006 shall be entitled to attend and vote at the meeting.

2 In order to be valid, any form of proxy and power of attorney or other authority under which it is signed, or a notarially certified or office copy of such power or authority must reach the Company's Registrars, Capita Registrars of The Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU not less than 48 hours before the time of the meeting or any adjournment thereof.

3 CREST members who wish to appoint a proxy or proxies by utilising the CREST electronic proxy appointment service may do so for the meeting to be held on 1 June 2006 and any adjournment(s) thereof by utilising the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed (a) voting service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.

In order for a proxy appointment made by means of CREST to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with CRESTCo's specifications and must contain the information required for such instructions, as described in the CREST Manual. The message must be transmitted so as to be received by the issuer's agent (ID RAIO) by the latest time for receipt of proxy appointments specified in note 2 above. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Applications Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST.

CREST members and, where applicable, their CREST sponsors or voting service providers should note that CRESTCo does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed (a) voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting service providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

The company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

4 As permitted by Regulation 41 of the Uncertificated Securities Regulations 2001, shareholders who hold shares in uncertificated form must be entered on the company's share register at 6.00 p.m. on 30 May 2006 in order to be entitled to attend and vote at the Annual General Meeting. Such shareholders may only cast votes in respect of shares held at such time. Changes to entries on the relevant register after that time shall be disregarded in determining the rights of any person to attend or vote at the meeting.

5 Copies of the directors' service contracts and, where appropriate, letters of appointment, a summary of the directors' transactions in the company's shares during the year and written terms of reference for each of the remuneration, audit and nomination committees will be available for inspection at the registered office of the company during normal business hours on any weekday (Saturdays, Sundays and public holidays excluded) from the date of this notice until the close of business on the business day preceding the AGM and will also be available for inspection for at least 15 minutes prior to the meeting and throughout the meeting. There are no service agreements between any director and any subsidiary of the company.

Notice of Annual General Meeting continued

Notes - continued

6 Biographical details of each director who is being proposed for re-appointment or re-election by shareholders, including their membership of board committees, are set out in the annual report and accounts posted to shareholders at the same time as this notice.

Explanatory Notes:

Ordinary Business

Section 241A of the Companies Act 1985 requires quoted companies, at each general meeting at which statutory accounts are to be laid, to propose an ordinary resolution approving the directors' remuneration report for the year. Resolution 9 will be proposed as an ordinary resolution for this purpose; a copy of the report is included in the annual report and accounts posted to shareholders at the same time as this notice.

Explanation of Special Business

The Companies Act 1985 provides that directors shall only allot unissued shares with the authority of shareholders in general meeting. Resolution 10 will be proposed as an Ordinary Resolution for the renewal of the directors' general authority to issue relevant securities up to an aggregate nominal amount of £216,790, representing approximately 5% of the current issued share capital of the company. The directors have no present intention of exercising this authority.

The Companies Act 1985 also provides that any allotment of new shares for cash must be made pro rata to individual shareholders' holdings, unless such provisions are disapplied under section 95 of the Companies Act 1985. Resolution 11 will be proposed as a special resolution for the renewal of the directors' authority to allot equity securities for cash, without first offering them to shareholders pro rata to their holdings. This authority facilitates issues made by way of rights to shareholders which are not strictly in accordance with section 89 of the Companies Act, and authorises other allotments of up to a maximum aggregate nominal amount of £216,790 of shares, representing approximately 5% of the current issued share capital of the company. This authority also allows the directors, within the same aggregate limit, to sell for cash shares that may be held by the company in treasury.
The directors have no present intention of exercising this authority.

Resolution 12 will be proposed as a special resolution for the renewal of the company's authority to purchase its own shares in the market for up to 13,007,600 Ordinary Shares, representing approximately 5% of the issued share capital of the company. The price payable shall not be more than 5% above the average price of the middle market quotation as derived from the Daily Official List of London Stock Exchange plc for the Ordinary Shares for the five business days before the purchase is made and in any event not less than 5p per share, being the nominal value of the shares. It is the directors' intention only to exercise the authority to purchase the company's shares where it would increase the earnings per share of those Ordinary Shares that are not re-purchased. This power will only be used if the directors consider that to do so would be in the best interests of shareholders generally.

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)870 1623131, email: shareholder.services@capitaregistrars.com

Frequent shareholder enquires
If you change your address
Please notify Capita in writing. If shares are held in joint names, the notification must be signed by the first-named shareholder.

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 last 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 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

Designed and produced by corporateprm, Edinburgh and London. www.corporateprm.co.uk

Registered office
Headlam Group plc
PO Box 1
Gorsey Lane
Coleshill
Birmingham
B46 1LW

Website
www.headlam.com
E-mail
headlamgroup@headlam.com

Registration
Registered in England and Wales
Number 460129