headlam group plc

Annual Report and Accounts 2006

Headlam has a clear and focused strategy based on the creation of a diverse and autonomous structure. The group operates through 47 separate businesses in the UK and a further three in Continental Europe.

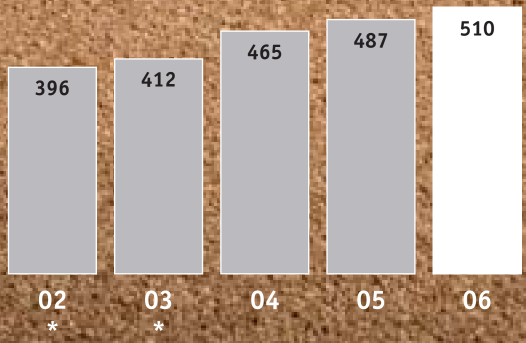
A key factor contributing to the group's success is the individuality of experienced management teams who are responsible for the market presence, development and ultimate profitability of their businesses.

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

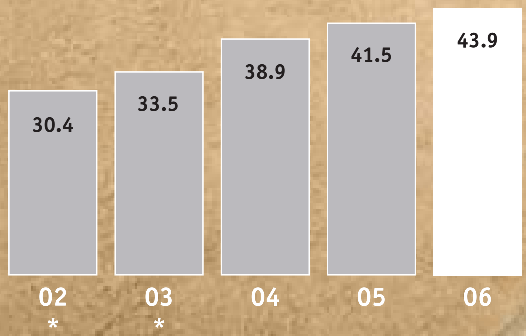
Sales (£m)

+4.8%



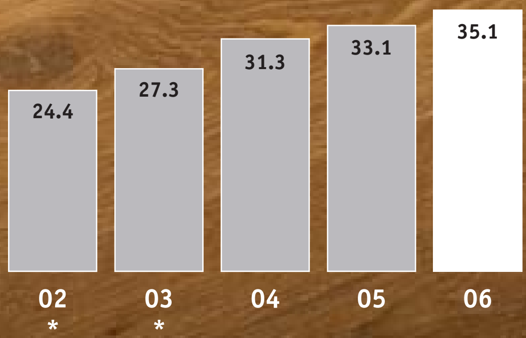
Operating Profit (£m)

+2.4m



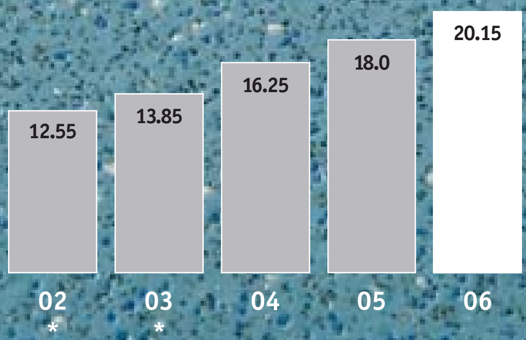
Earnings Per Share (p)

+6.0%



Proposed Dividends (p)

+11.9%



* not restated for IFRS

Market Presence

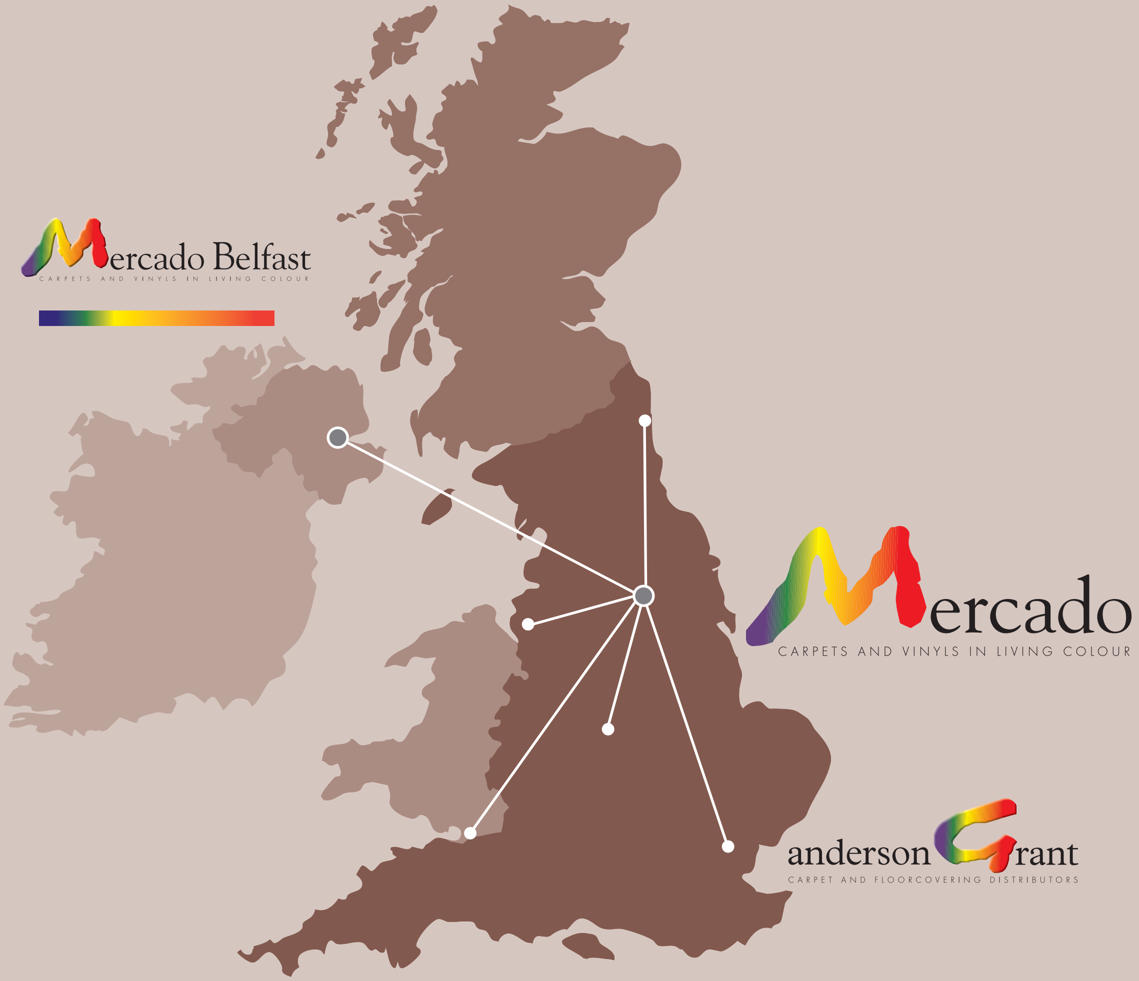
The UK operating structure is based on five business sectors each aimed at maximising market penetration and supporting different aspects of the floorcovering market. Our Regional and National multi-product businesses provide a comprehensive residential and commercial product range and extensive geographical coverage. The Regional commercial businesses focus on strong relationships with suppliers and a high level of localised service for their customers. Our Residential specialist businesses supply medium to premium residential carpet on a national basis and the Commercial specialist businesses, which have a national presence, provide a range of products servicing various aspects of the commercial market.

Our business in France operates from two distribution centres and 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.

Market Presence continued

Regional Multi-Product Distribution

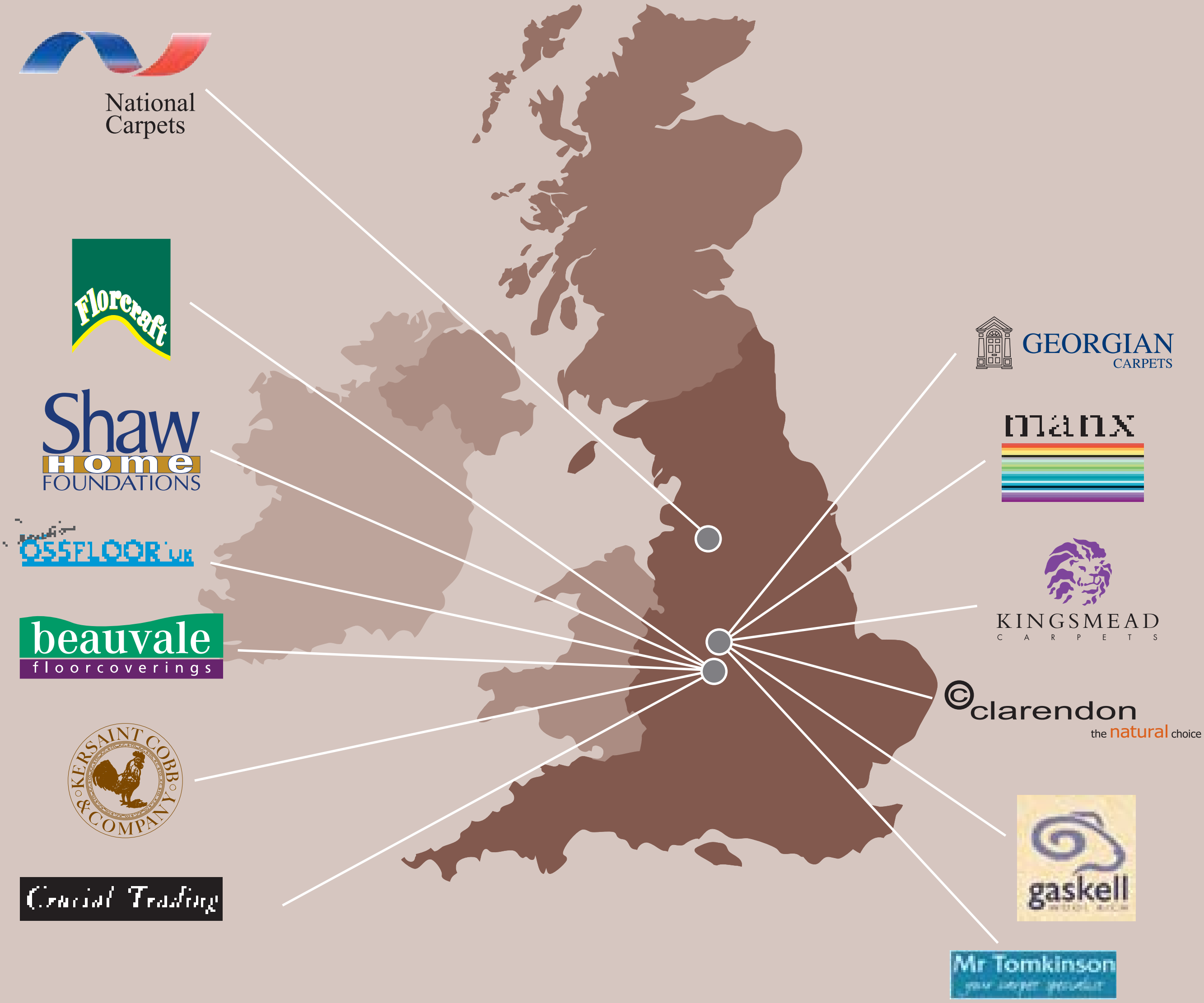
National Multi-Product Distribution Network



Market Presence continued

Regional Commercial Distribution

National Residential Specialist Products



Market Presence continued

National Commercial Specialist Products

European Multi-Product Distribution

Chairman's Statement

The group is committed to being the leading distributor of floorcoverings in the UK and Continental Europe

During 2006, market conditions in the UK, in both residential and particularly commercial floorcoverings, have been favourable. Increased contributions across each of our business sectors and all product categories have enabled the group to achieve another record year in revenue and profitability.

Revenue from the group's activities amounted to £509.9 million, an increase of 4.8% on last year and profit before tax increased by 6.7% to £43.6 million.

Earnings and dividend

Basic earnings per share increased by 6.0% from 33.1p to 35.1p. Your board is recommending a final dividend of 15.30p per share, an increase of 12.5% on last year. This increases the total dividend for the year by 11.9% from 18.00p to 20.15p. If approved by shareholders at the forthcoming Annual General Meeting, the final dividend will be paid on 2 July 2007 to shareholders on the register at 8 June 2007.

Strategy

The group is committed to being the leading distributor of floorcoverings in the UK and Continental Europe. During the ongoing development of our businesses, it is not our intention to diversify away from our focus on floorcovering distribution.

To retain our position as the leading distributor of floorcoverings in Europe, we will continue to invest in the infrastructure of the business. Over the last twelve years we have invested in eleven new facilities, giving our businesses increased capacity and the latest floorcovering material handling technology keeping us at the forefront of the floorcovering industry.

Operations

We continue to develop and maintain our close relationship with the leading worldwide floorcovering manufacturers. Our 47 businesses in the UK operate in five clearly defined business sectors, working closely with these suppliers and subsequently with our customers. We employ 320 external sales people who are positioning new product into the independent retailer and flooring contractor on a daily basis. This ensures that our customers have the latest product offering which is supported by a next day delivery service through our fleet of 420 commercial vehicles. Whilst encouraging the autonomy of individual business operations, they each operate to a specific strategy relevant to their own market position and also comply with consistent operational procedures and financial disciplines.

The management teams of these individual businesses are working to clearly defined budgets and specific objectives. They are measured and incentivised on the performance of their individual business responsibility. We believe this autonomous business structure is a major strength that allows us to manage our market position and thereby removes a large element of risk within our business.

The improvements we have made in our three Continental European businesses in France, Switzerland and the Netherlands have resulted in a further increase in revenue and profitability.

Employees

We wish to thank all management and employees for their contribution to the group's ongoing success. The autonomous structure of our business operations has developed a culture of individuality, whilst benefiting from opportunities throughout the group. We have had many instances over a number of years where employees have developed into senior sales and management roles. This policy of internal promotion wherever possible, gives all employees the opportunity for significant career development within the group.

Outlook

Through our clearly focused structure, which exists in each of our five business sectors, we are confident that our individual management teams and the autonomous businesses, for which they are responsible, will continue to exceed market conditions.

The group has made a positive start to 2007 in both the UK and Continental Europe and is well positioned to achieve its objectives for the year.

Graham Waldron, Chairman

Business Review

We continue to actively invest in sales and marketing initiatives throughout our businesses in the UK and Continental Europe

Conditions in the UK floorcovering market during 2006 in both residential and particularly commercial flooring were positive. This enabled us to grow our UK businesses by 4.1% on a like for like basis and total sales by 4.6%.

Our businesses in Continental Europe prospered with solid performances from France and Switzerland and a particularly strong performance from the Netherlands. These businesses achieved a collective like for like sales increase of 5.6%.

UK operations

We have previously categorised our businesses into four specific sectors. However, due to the growing importance of our Regional multi-product commercial operations, we have now increased our business sectors to five:

Regional multi-product:
We have 20 businesses throughout the UK which provide a comprehensive product offering of both residential and commercial floorcovering. Through close liaison with our manufacturers and local relationships with customers, these businesses create a substantial market presence and endeavour to provide an excellent service. During 2006, the businesses increased their sales by 3.7%.

National multi-product:
Mercado has a comprehensive distribution network enabling it to supply residential and commercial flooring throughout England, Wales and Northern Ireland. Through its experienced sales team, substantial stock holding and delivery infrastructure, Mercado increased its business by 5.8%.

Regional commercial:
The newly formed sector, developed through the emergence of existing businesses and also recent acquisitions, now has nine locations throughout England and Northern Ireland. The businesses benefit from strong relationships in the commercial flooring market, with both manufacturers and particularly with flooring contractors. Whilst they were able to increase their business by 7.9% in 2006, there are significant opportunities to increase the geographical coverage both through acquisition and organic growth.

The sales and marketing activities are supported by our comprehensive distribution network

Business Review continued

Residential specialist:
These 12 businesses supply medium to premium end carpet products. Through their product innovation and additional marketing initiatives they were able to increase their business by 6.0%. Through further investment in sales and marketing we can substantially increase the presence of these businesses in the premium sector.

Commercial specialist:
These three businesses are focused in specific areas of the commercial flooring market, principally healthcare, education and government installations. All three businesses performed to expectations in 2006 and were able to grow their business by 8.7%.

Customers

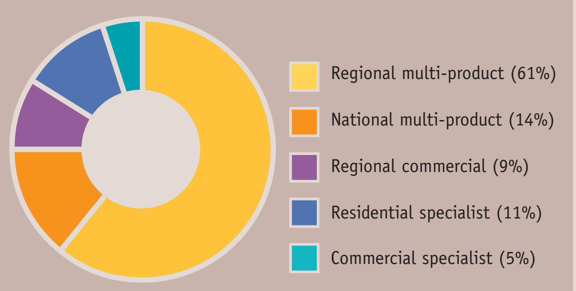
Customers, who are principally independent floorcovering retailers and contractors, continue to prosper. With the benefit of our distribution network, extensive product range and sales and marketing initiatives we have increased the number of active accounts to 36,225 (2005: 35,748).

The management teams of these individual businesses are clearly focused on delivering the objectives before them

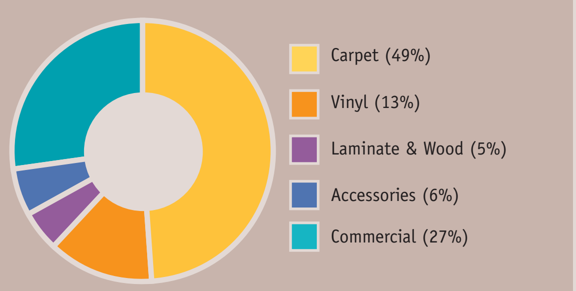
Products

Carpet is still our largest product group, representing 49% of UK sales. During the year we launched 2,690 (2005: 2,486) new products supported by 665,000 (2005: 626,482) point of sale items positioned in independent retailers. This ongoing activity enabled us to increase sales by 1.1%. Sales of carpet in the UK are dominated by plain product consisting of twist pile in either polypropylene or wool and loop pile natural effects, again in polypropylene or wool.

Business Sectors



Proportion by Product



Residential vinyl business, which accounts for 13% of UK sales, increased by 4.2%. During the year we placed 132,000 (2005: 167,360) new point of sale items to support the launch of 622 (2005: 693) new products. The residential vinyl market in the UK has moved significantly towards slip resistant products. This gives the benefit of both safety and an enhanced reproduction of various types of natural flooring. We believe this improved product has increased our sales of residential vinyl, particularly through the independent retail sector.

Wood and laminate, which contribute 5% to the UK sales, have seen a recovery during the year, increasing by 10.2%. We believe there are still extensive opportunities to increase our market presence not only in laminate flooring, but also in engineered and solid wood.

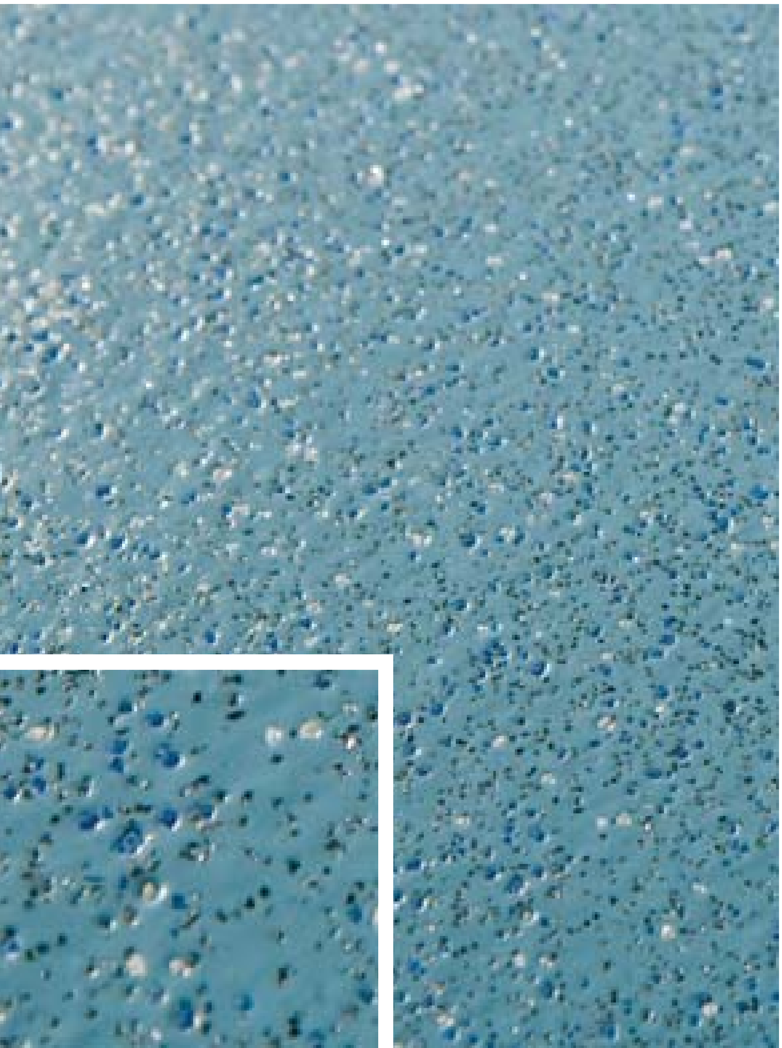
Commercial Flooring represents 27% of UK sales. Through the various activities of our regional and national multi-product businesses and also the regional commercial and commercial specialist businesses, we were able to increase sales of commercial products by 10.2% during 2006. Market information would suggest that this particular sector has been fairly buoyant, but we believe our increase will have outperformed the market and consequently increased our market share.

Information Technology and Material Handling

We continue to enhance our software and invest in the latest hardware to position our businesses at the forefront of technology, both operationally and financially. As previously reported, with the introduction of our IT platform into the French business in 2006, we now operate all businesses in the UK and Continental Europe from the same platform which gives both operational consistency and standardised financial disciplines.

Business Review continued

New facilities will incorporate the despatch sortation system which significantly enhances material handling



We made a major step forward in material handling during 2005 with the introduction of the despatch sortation system at Tamworth. This system was incorporated into the construction of the new facility for Wilkies in Leeds which became operational in October 2006. We also installed a sortation system into the Coleshill distribution centre in the first quarter of 2007. We envisage that our new facilities will incorporate this system which significantly enhances material handling capability and improves cost effectiveness.

Investments

During 2006 we completed the construction of the 105,000 square foot purpose built freehold distribution facility for Wilkies, our regional multi-product business based in Leeds. This facility became operational in October 2006 and we anticipate that Wilkies will be able to significantly develop their residential and commercial business in the north of England over the coming years.

Following the appropriate planning permission, we have now purchased land in Bridgend, South Wales to enable us to re-house MCD Wales. This will be constructed during the course of this year and will be operational towards the end of 2007.

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 particularly pleasing that we recorded a continued improvement in all three of our Continental European businesses in France, Switzerland and the Netherlands. This combined performance showed a sales increase of 5.6% and an increase in operating profit of 12.6%.

Each of our businesses has seen improving market conditions progressively during 2006. This, in conjunction with sales, marketing and operational improvements that we have made over previous years, has contributed to this result.

With this improving trend, we have continued to assess other opportunities to enlarge our presence in Continental Europe.

Acquisitions

In October 2006 we acquired the business of Concept (Midlands) Limited, based in West Bromwich. The acquisition of this business, along with the development of other regional commercial operations, has enabled us to increase the structure of our business sectors from four to five.

We continue to evaluate potential acquisitions in both the commercial and residential markets in the UK, in addition to opportunities in Continental Europe. We envisage further additions to the group over the coming months.

Outlook

We continue to actively invest in sales and marketing initiatives throughout our businesses in the UK and Continental Europe, supported by our comprehensive distribution network.

The management teams of these individual businesses are clearly focused on delivering the objectives before them and we look forward to achieving another successful year.

Tony Brewer, Group Chief Executive

Financial Review

The board anticipates achieving a dividend payout ratio of approximately 67% of earnings by the end of 2009

Trading performance
Group revenue increased during the year by 4.8% from £486.6 million to £509.9 million. As already highlighted, like for like improvement from the UK businesses amounted to 4.1% whilst the Continental European businesses achieved a collective like for like increase of 5.6%.

In addition to the like for like increases in the UK, group revenue also includes the first full year revenues amounting to £5.6 million from Clarendon and Gaskell Wool Rich, the two businesses acquired during 2005, and a contribution of £0.6 million from Concept (Midlands), which was acquired during October 2006.

The group's operating profit increased by 5.9% from £41.5 million to £43.9 million with the UK and Continental European businesses achieving increases before unallocated corporate expenses of 4.2% and 12.6% respectively.

Financial income and expense
Net financial expenses decreased from £658,000 to £383,000. This was attributable to a reduction in the net cost of pension plans falling from £510,000 to £363,000 and a decrease in net interest payable from £148,000 to £20,000.

Taxation
The effective rate of taxation reduced marginally from 30.2% to 30.0%. The rate reflects the group's current mix of business and it is anticipated that the effective tax rate should remain at these levels for the foreseeable future.

Earnings and dividends per share
During the year, basic earnings per share increased by 6.0% from 33.1 pence per share to 35.1 pence per share.

Dividends per share increased by 11.9% from 18.00 pence to 20.15 pence which represents a payout ratio of 57.4% of basic earnings per share compared with 54.4% for the previous year. The board anticipates maintaining a progressive dividend increase over the next three years with the intention of achieving a payout ratio of approximately 67.0% of earnings by the end of 2009.

Shareholder returns
The board recognises that it has a responsibility to shareholders to ensure that the group generates a sustainable return on shareholders funds and maintains investment in the business to support future growth.

The board recognises that it has a responsibility to shareholders to ensure that the group generates a sustainable return on shareholders funds

Financial Review continued

Total shareholder return, being the increase in the share price plus reinvested dividends, has been 182.8% over the last five years compared to the FTSE Mid 250 average of 122.8%. Over the last three years, it has been 106.0% compared with the FTSE Mid 250 average of 111.9% and during the last year, 47.6% compared with the FTSE Mid 250 average of 32.1%.

Return on average shareholders funds during 2006 amounted to 30.2% compared with 31.6% for the previous year. The modest dilution during the year is a result of the significant investment in new and extended facilities undertaken during the last few years. As highlighted in the Chairman's Statement, this commitment to investing in modern, efficient facilities has maintained our position as the leading European floorcoverings distributor. However, whilst this activity brings medium to long term benefits, the immediate consequence is an increase in the cost base since the new facilities are generally larger than the ones they replace. Depending on the level of investment undertaken, this increase in the cost base can give rise to short term dilution in the return on average shareholders funds.

Cash flows and net funds

Cash generated from operating activities

Net cash generated from operating activities during the year was £30.1 million, a net increase of £7.4 million compared with last year. The two significant movement's year on year were; the reduced investment in working capital amounting to £9.0 million and the increase in additional pension fund contributions of £3.2 million.

During 2006 net working capital investment, £1.8 million, reduced to more normal levels compared with the exceptional amount, £10.7 million, invested during the previous year. Expenditure in 2005 reached this level because of the increased inventory requirement created by the significant additional capacity from the new and extended facilities. Generally, when one new facility becomes operational during the year, the additional working capital requirements can be managed without any material increase.

Additional contributions to the defined benefit pension plan during the year amounted to £3.9 million compared with £0.7 million during the previous year.

Cash flows from investing activities

Net cash outflows from investing activities totalled £10.4 million compared with £9.5 million during 2005. Investment in property, plant and equipment amounted to £12.9 million compared with £11.0 million for 2005. The largest item of expenditure was £8.9 million incurred on the completion of the Wilkies property bringing the total cost of this facility to £10.9 million. In addition, £1.5 million was expended on acquiring the freehold interest in the property occupied by our business in the Netherlands and £2.5 million on capital maintenance projects. Subject to planning approval, we anticipate the level of expenditure during 2007 to be no greater than £12.9 million.

Changes in net funds

Group net funds increased from £35.5 million to £40.6 million during the year as detailed in the table below.

However, over the course of the year, the group's net funds, as was the case for 2005, remained in a position that was very close to neutral.

Employee benefits

During the year, the net deficit relating to the defined benefit pension plans, as measured under IAS 19, decreased by £3.3 million from £20.5 million to £17.2 million. The two key drivers contributing to the reduction were the continued revival in equity values and the additional contribution of £3.9 million referred to above. Additional contributions during 2007 are expected to be £1.1 million.

Stephen Wilson, Group Finance Director

	At 1 January 2006 £000	Cash flows £000	Acquisitions excluding cash and overdrafts £000	Translation differences £000	At 31 December 2006 £000
Cash at bank and in hand	36,193	5,725	–	(57)	41,861
Bank overdraft	–	(1,022)	–	12	(1,010)
	36,193	4,703	–	(45)	40,851
Finance leases and similar hire purchase contracts	(738)	497	(26)	–	(267)
	35,455	5,200	(26)	(45)	40,584

Directors, Officers and Advisors

BOARD OF DIRECTORS

G Waldron ❇
Executive Chairman
Graham was appointed an executive director in June 1991 becoming Chairman later that year until 31 December 1999. On the resignation of Trevor Larman on 1 June 2006 he was re-appointed Chairman for a short period whilst his successor is sought. He has 54 years experience in the floorcovering industry. He is the non-executive Chairman of Tandem Group plc. Age 76.

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 29 years experience in the floorcovering industry. Age 46.

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 52.

T J Anderson ◆●■
Senior Independent Director
Tom was appointed a non-executive director in August 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 68.

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 52.

M K O'Leary ◆●■
Non-executive Director
Mike was appointed a non-executive director in March 2006. He was formerly a director of MISYS plc and chief executive of Marlborough Stirling plc. Mike has worked in domestic and international markets and brings a wealth of general management experience to the company. Age 54.

COMPANY SECRETARY

G M Duggan
Geoff joined the company in April 1998. He is an associate of the Institute of Chartered Secretaries and Administrators and a fellow of the Chartered Institute of Management Accountants. Age 46.

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 34 years experience in the floorcovering industry. Age 54.

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 43.

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 26 years experience in the floorcovering industry. Age 42.

K R Yates ▲
Managing Director, Mercado
Keith joined Mercado in April 1983 and was subsequently appointed its Managing Director in 1996. Keith has 24 years experience in the floorcovering industry. Age 51.

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

ADVISERS

Auditors
KPMG Audit Plc
2 Cornwall Street
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Taxation Advisers
Deloitte & Touche
Four Brindleyplace
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The Royal Bank of Scotland plc
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Birmingham B3 2RB

Stockbrokers
Arden Partners Limited
Arden House
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Birmingham B15 3DU

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

Financial Calendar

Group Results

Annual General Meeting	25 May 2007
Interim results announced	September 2007
Full year results announced	March 2008

Dividend Dates

Final dividend for 2006, if approved, payable to qualifying shareholders on the register as at 8 June 2007	2 July 2007
Interim dividend for 2007 announced	September 2007
Interim dividend for 2007 payable	January 2008

Directors' Report

The directors present their annual report on the affairs of the group, together with the audited financial statements and auditors' report, for the year ended 31 December 2006.

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 100.

Review of the business

The company is required to set out in this report a fair view of the business of the group during the financial year ended 31 December 2006, the position of the group at the end of the financial year and a description of the principal risks and uncertainties facing the group. The information that fulfils these requirements includes a business review on pages 12 to 17, a financial review on pages 18 to 21, risks and uncertainties on pages 25 to 27 and corporate social responsibility on pages 41 to 43, which are incorporated into this report by reference.

Dividends

An interim dividend of 4.85p per share (2005: 4.40p) was paid on 2 January 2007 and your board is recommending a final dividend of 15.30p per share (2005: 13.60p), making a total dividend of 20.15p per share for the year (2005: 18.00p). The final dividend, if approved by shareholders at the Annual General Meeting ("AGM"), will be payable on 2 July 2007 to shareholders whose names appear on the register at the close of business on 8 June 2007.

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. At the AGM of the company held on 1 June 2006, the shareholders approved a resolution for the company to make purchases of its own shares up to a maximum number of 13,007,600 ordinary shares of 5 pence each. The resolution remains valid until either it is substituted by the granting of a new authority to make market purchases at this year's AGM or the conclusion of this year's AGM. No shares were bought back under this authority during the year and at present the company does not hold any shares in treasury.

Substantial shareholdings

As at the last date prior to posting these report and accounts, the company had been notified in accordance with Chapter 5 of the Disclosure and Transparency Rules, the following interests in the voting rights attached to the ordinary share capital of the company.

	Ordinary shares of 5p each	% of issued share capital
Schroders plc	8,289,262	9.52
AXA SA	7,003,815	8.04
Aberforth Partners LLP	6,989,439	8.03
Aviva plc	6,847,352	7.86
Lloyds TSB Group plc	5,816,182	6.68
Aegon UK Group of Companies	4,347,020	4.99
Legal & General Group Plc	3,354,498	3.85

Directors and their interests

The names of the directors of the company at the date of this report and biographical details are given on page 22. A complete list of directors who served during the year is shown within the remuneration report on page 38. No other person has acted as a director of the company during the financial year ended 31 December 2006. 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, Graham Waldron and Steve Wilson retire by rotation and being eligible, offer themselves for re-election at the forthcoming AGM. In proposing their re-election, the board confirms to shareholders that following a formal performance evaluation, each of these individual's performance continues to be effective and they have expressed a willingness to continue in their roles.

Tom Anderson retires from the board at the conclusion of the forthcoming AGM having served nine years as a non-executive director. The directors thank Tom for his contribution to the continuing success of the business. He will be succeeded as Senior Independent Director by Mike O'Leary.

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

Directors' Report continued

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 plans.

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.

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

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

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

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

Periods of recession, low consumer confidence or changes in trends and preferences have the potential to affect market

Directors' Report continued

activity and therefore demand for products supplied by the group. However, market activity is monitored in each individual business and at group level on a daily basis which enables a rapid response to any factors adversely affecting trading.

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

Competitor risk

The group operates in four different geographical markets which generally share similar trading characteristics.

Within each market, the group competes with a variety of regional and national distributors, manufacturers selling directly to our customer base and indirectly with multiple retail chains.

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

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

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

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

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

Credit risk

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

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

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

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

Infrastructure

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

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

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

Systems

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

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

Transport

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

Directors' Report continued

People

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

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

Pension

The cost of funding the group's defined benefit plans may increase due to a decline in investment returns, movement in interest rates and longer life expectancy.

As a result of the triennial actuarial valuation of the UK plan, the group agreed to make an additional payment of approximately £1.5 million every year until 2016.

The results of future scheme valuations could result in this commitment increasing.

Government legislation

The group's operations are affected by a variety of laws and regulations covering health and safety, environmental, employment, legal, financial and tax.

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

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

Donations

The group's Charities Committee considers requests for charitable donations within a set criteria. The group contributed charitable donations of £54,661 (2005: £36,289) during the year. The board has maintained its policy of not making political donations.

Supplier payment policy

The group's policy with regard to the payment of suppliers is to agree the terms of payment as part of the conditions of supply of goods and services. The group seeks to strictly comply with these payment terms whenever it is satisfied that the supplier has provided the goods and services in accordance with the agreed terms and conditions. The payment policy has been and will continue to be developed to meet the group's specific requirements and is not based on any particular code or standard relating to payment practice. The number of creditor days of the company at 31 December 2006 was 40 days (2005: 41 days).

Auditors

KPMG Audit Plc has expressed its willingness to continue in office as auditor of the company and in accordance with the provisions of section 385 of the Companies Act 1985, a resolution for its re-appointment and to authorise the directors to agree its remuneration will be proposed at the forthcoming AGM. Auditors remuneration and fees paid during the year to 31 December 2006 are set out in note 3 to the financial statements.

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

Resolutions

Authority to allot shares

The Companies Act 1985 provides that directors shall only allot unissued shares with the authority of shareholders in general meeting. Resolution 8 will be proposed as an ordinary resolution for the renewal of the director's general authority to issue relevant securities up to an aggregate nominal amount of £1,035,000, representing approximately 23.8% of the current issued share capital of the company. The authority sought will be in substitution for the previous authority taken at last year's AGM, and this authority will expire at the conclusion of the next AGM, or 25 August 2008 if later. The directors have no present intention of exercising this authority other than in respect of shares which may be issued pursuant to the Company's share option schemes.

Disapplication of pre-emption rights

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 9 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 open offer or other pre-emptive offer to shareholders and other persons entitled to participate to

Directors' Report continued

shareholders and authorises other allotments of up to a maximum aggregate nominal amount of £217,775 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.

Purchase of own shares

Resolution 10 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 13,066,500 ordinary shares, representing approximately 15% 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 repurchased. This power will only be used if the directors consider that to do so would be in the best interests of shareholders generally. As at 1 April 2007 (being the latest practicable date before publication of this report), there were 2,209,691 options to subscribe for ordinary shares in the company outstanding which represent 2.5% of the company's current issued share capital. If the authority to purchase shares were to be used in full, these outstanding share options would represent 3.0% of the company's issued share capital (excluding any shares then held in treasury).

AGM

The notice of the fifty ninth AGM to be held at 10.00am on 25 May 2007 at the group's distribution facility in Coleshill, Warwickshire has been mailed to shareholders with this Annual Report.

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
20 March 2007

Corporate Governance

The company is committed to good standards of corporate governance and, save as set out on page 34, has complied throughout the year with the principles of corporate governance as set out in the Combined Code on Corporate Governance which is appended to the the Listing Rules of the Financial Services Authority ("the Code"). The following paragraphs, together with the report on directors' remuneration on pages 35 to 40, provide a description of how the group has applied the principles of good governance set out in section 1 of the Code, including both the main and supporting principles.

Directors' and board effectiveness

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

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

The directors' responsibility for the preparation of accounts is explained on page 44. The directors confirmation that they consider it appropriate to prepare the accounts for 2006 on a going concern basis is given on page 28.

Further details of the board's role in relation to the group's systems of internal control and risk management are given on pages 33 and 34. Descriptions of the specific responsibilities which have been delegated to the principal board committees are given on pages 30 to 32.

At the end of 2006 the board comprised three executive directors, including the Chairman, and three non-executive directors. Biographical details of the directors are given on page 22. 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 judgment of any director.

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 Group Chief Executive

The roles of Chairman and Group 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 22 and the board is satisfied that his existing commitments do not unduly restrict his availability to the group.

Corporate Governance continued

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, attendance by certain directors at courses run by professional bodies and solicitors, attendance at external training sessions and seminars on matters relevant to members of the audit and remuneration committees and workshops run by external bodies on various commercial and regulatory matters.

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 December. No actions were considered necessary as a result of the evaluations. The board intends to conduct a further evaluation of its performance during 2007.

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

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.

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 operates under the chairmanship of Dick Peters. 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

Corporate Governance continued

meets at least twice a year, including meetings before the annual and interim results announcements.

Members' attendance record at meetings of the committee in 2006 is given on page 32. 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, Chairman, 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.

During the 2006 financial period, the audit committee discharged its responsibilities by:

- reviewing the group's draft 2005 preliminary annual results announcement and financial statements and 2006 interim results statement prior to board approval, including consideration of the significant accounting judgments contained therein, and reviewing the external auditors' detailed reports thereon.

- reviewing the group's trading update announcement prior to release at the AGM.

- reviewing the consistency of and any changes to the group's accounting policies, the application of appropriate accounting standards and methods used to account for significant or unusual transactions.

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

- reviewing the effectiveness of the 2005 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 2005.

- reviewing the external auditors' plan for the audit of the group's 2006 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 2005 (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 30) 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 which operated under the chairmanship of Tom Anderson until 15 March 2007 and subsequently his successor Mike O'Leary. 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.

Corporate Governance continued

The committee meets periodically when required. Members' attendance record at meetings of the committee in 2006 is given below. Only the members of the committee are entitled to be present at meetings however the Chairman, 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 38.

Nominations Committee

The nominations committee consists of the non-executive directors and the Group Chief Executive under the Chairmanship of Mike O'Leary 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 2006 is given below. Only members of the committee are entitled to be present at meetings but others may be invited by the committee to attend. The board has agreed the procedures to be followed by the nominations committee in making appointments to the various positions on the board and as Company Secretary. The committee has access to such information and advice both from within the group and externally, at the cost of the company, as it deems necessary. This may include the appointment of external executive search consultants, where appropriate. The procedures referred to above were used in the appointment during 2006 of Mike O'Leary 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.

Directors' attendance record

The attendance of directors at relevant meetings of the board and of the remuneration, audit and nominations committees held during 2006 was as follows:

	Scheduled board (9 meetings)	Remuneration committee (4 meetings)	Audit committee (3 meetings)	Nominations committee (2 meetings)
Non-executive director				
Trevor Larman (Chairman) (resigned as director and chairman 1 June 2006)	4/4#	2/2#	1/1#	1/1#
Executive directors				
Graham Waldron (Chairman) (appointed Chairman on 1 June 2006)	9	*	*	*
Tony Brewer (Group Chief Executive)	9	*	*	2
Stephen Wilson (Group Finance Director)	9	*	*	*
Non-executive directors				
Tom Anderson (Senior Independent Director)	9	4	3	2
Dick Peters	9	4	3	2
Mike O'Leary (appointed director on 10 March 2006)	8/8#	4	3	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.

Corporate Governance continued

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

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

The group operates a comprehensive planning system, including detailed reviews at all subsidiary undertakings, together with formal reviews and approval of annual plans by the board. Actual performance is reported on a monthly basis measured against plan and prior year including a detailed explanation of major variances. The company and its subsidiary undertakings have implemented control procedures designed to ensure complete and accurate accounting for financial transactions and to limit the potential exposure to fraud. The group has clearly defined guidelines for capital expenditure and investment appraisal. These include annual plans, detailed appraisal and review procedures, levels of authority and due diligence requirements when businesses are acquired. Any acquisition or disposal of a business needs formal board approval. The board reports that full procedures are in place to achieve compliance with the internal control aspects of the Code for the next financial period.

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

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

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

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

Corporate Governance continued

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.

Compliance with the Combined Code
The group was in compliance with the relevant provisions of the Code throughout 2006, except with regard to the following aspects:

The Code provision A3.2 states that except for smaller companies, at least half of the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. The Code provisions B2.1 and C3.1 state that the board should establish both an audit and a remuneration committee of at least three, or in the case of smaller companies, two members, who should all be independent non-executive directors. The group complied with these provisions following the appointment of Mike O'Leary as a non-executive director in March 2006 and who became a member of each of the remuneration, audit and nominations 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 full year results. Meetings are also held as deemed necessary throughout the period.

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

Geoff Duggan
Company Secretary
20 March 2007

Remuneration Report

Composition and role of the remuneration committee
The board's remuneration committee comprises the independent non-executive directors. Tom Anderson, Chairman, and Dick Peters were members of the committee throughout 2006, Trevor Larman until June 2006 when he resigned from the board and Mike O'Leary became a member when he joined the board in March 2006. Tom Anderson was succeeded as Chairman by Mike O'Leary on 15 March 2007.

Within formal terms of reference, the committee makes recommendations to the board on the policy and framework of executive remuneration and its cost to the company. The committee is also responsible for the implementation of the group's 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 2006 the committee sought information from a wide variety of 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 related 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.

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

The executive share option scheme (ESOS) 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. Recent practice has been, when deemed appropriate, to make conditional awards every three to five years up to a maximum of 200% of gross earnings.

Executive directors participate in a non-contributory final salary pension plan, details of which are given on page 40.

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 2007 and succeeding years.

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

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

Remuneration Report continued

Annual performance bonus

The committee reviews the bonus scheme at the beginning of each year to ensure that it remains competitive in the marketplace, continues to incentivise the executive directors and other senior executives 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 38.

Executive share option schemes (ESOS)

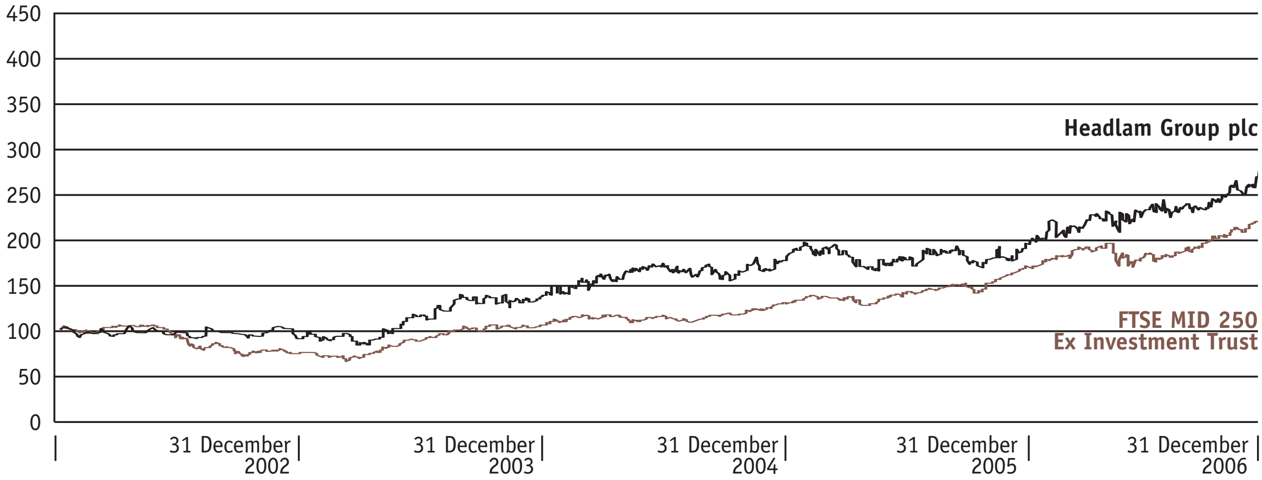
Subject to the extent that performance conditions are satisfied, options granted under the ESOS become exercisable three years after the date of grant and remain so until the tenth anniversary of grant in respect of the approved scheme and the seventh anniversary of grant in respect of the unapproved 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. No new options were granted in 2006. Details of options granted to executive directors are shown on page 39. 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 2006



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 2006 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

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

Other employment benefits

In common with other senior management, executive directors are entitled to a range of benefits, including a company car, 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.

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

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 2006 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 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 22. Their fees are approved by the board.

In 2006 the board conducted a review of non-executive directors' fees. 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 Combined Code, and the fees paid by other companies. The board received survey and other information from a variety of sources. As a result of this review, their annual fees were increased from £31,500 to £33,500, with an additional £5,000 being paid to the respective chairmen of the audit and remuneration committees. The non-executive directors do not participate in any of the company's share schemes, incentive plans or pension schemes.

The remuneration report from page 35 to page 38 up to this statement, with the exception of the performance graph on page 37, has not been audited. With the exception of directors' interests in shares on page 39, from this point until the end of the report on page 40 the disclosures have been audited by the company's auditors, KPMG.

Directors' emoluments
Details of directors' emoluments for the year ended 31 December 2006 are set out below.

	Salary and fees		Benefits		Performance related pay		Total	
	2006	2005	**2006**	2005	**2006**	2005	**2006**	2005
	£000	£000	**£000**	£000	**£000**	£000	**£000**	£000
Executive								
Tony Brewer	**450**	425	**26**	27	**644**	465	**1,120**	917
Steve Wilson	**325**	310	**46**	31	**476**	350	**847**	691
Graham Waldron	**100**	80	**21**	21	**—**	—	**121**	101
Non-executive								
Trevor Larman (i)	**31**	70	**—**	—	**—**	—	**31**	70
Tom Anderson	**37**	35	**—**	—	**—**	—	**37**	35
Roger Dickens (ii)	**3**	35	**—**	—	**—**	—	**3**	35
Dick Peters	**37**	3	**—**	—	**—**	—	**37**	3
Mike O'Leary (iii)	**26**	—	**—**	—	**—**	—	**26**	—
	1,009	958	**93**	79	**1,120**	815	**2,222**	1,852

(i) resigned 1 June 2006
(ii) resigned 29 January 2006
(iii) appointed 10 March 2006

Benefits are in respect of all taxable benefits arising from employment by the company including the provision of a company car, life assurance and private medical care. Pension benefits and gains made by executive directors in respect of share options are excluded from the table above. The aggregate amount of gains made by executive directors on the exercise of share options was £11,714 (2005: £363,750).

Remuneration Report continued

Directors' Interests in Shares
The following tables below 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 in the company's share schemes of the executive directors who served during the year:

	Shareholdings at 31 December 2006	Shareholdings at 31 December 2005
Executive Directors		
Graham Waldron	**481,463**	471,667
Tony Brewer	**443,874**	443,874
Steve Wilson	**336,433**	336,433
Non-executive Directors		
Trevor Larman, (resigned 1 June 2006)	**—**	6,944
Dick Peters	**5,000**	—
Tom Anderson	**4,000**	4,000

Directors' interests in share option schemes
Executive schemes
During the year an option held under the 2002 savings related share option scheme was exercised, details of which are shown under gains on share options.

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

	Options held at 1 January 2006	Options granted during the year	Options exercised during the year	Options held at 31 December 2006	Exercise price (pence)	Date from which exercisable	Expiry date
Tony Brewer							
1998 USOS (i)	342,858	—	—	342,858	420.00	Aug 2008	Aug 2012
1998 ESOS (ii)	7,142	—	—	7,142	420.00	Aug 2008	Aug 2015
Sharesave (iii)	8,337	—	—	8,337	197.00	Jan 2008	Jun 2008
Steve Wilson							
1998 USOS (ii)	242,858	—	—	242,858	420.00	Aug 2008	Aug 2012
1998 ESOS (ii)	7,142	—	—	7,142	420.00	Aug 2008	Aug 2015
Sharesave (iii)	8,337	—	—	8,337	197.00	Jan 2008	Jun 2008
Graham Waldron							
Sharesave (iv)	4,796	—	4,796	—	197.00	Jan 2006	Jun 2006
Sharesave (iii)	—	2,331	—	2,331	401.00	July 2009	Jan 2010

(i) Headlam Group Unapproved Executive share option scheme 1998 (1998 USOS)
Details of the operation of the scheme are provided on page 36.
(ii) Headlam Group Approved Executive share option scheme 1998 (1998 ESOS)
Details of the operation of the scheme are provided on page 36.
(iii) Headlam Group Sharesave scheme 2002 (Sharesave)
The company operates an Inland Revenue-approved all-employee savings-related share option scheme in the UK. The scheme is designed to provide a long-term savings and investment opportunity for employees and is described on page 37.
(iv) Exercise of share options
The market price of shares on 5 January 2006 when the option was exercised was 441.25 pence.

The closing price of a Headlam Group plc ordinary share on the last trading day of 2006 (31 December) was 615.00 pence. The range during the year was 615.00 pence (high) and 432.00 pence (low).

Remuneration Report continued

Pension Benefits
Tony Brewer and Steve Wilson participate in the group's defined benefit pension scheme which provides benefits at a normal retirement age of fifty five based upon pensionable service and basic pay, bonus being excluded. The maximum pension payable under the scheme is two-thirds of final pensionable pay subject to Inland Revenue limits. There are four times earnings lump sum death-in-service benefits and pension provisions for members' dependents. During 2006, the company reviewed its pension policy as a result of the 2004 Pensions Act and the 2004 Finance Act.

Details of executive directors' pension benefits for the year ended 31 December 2006 are shown below

	Increase in accrued pension during the year £000pa	**Transfer value of increase £000**	**Accumulated accrued pension at 31 December 2006 £000pa**	**Change in accrued pension over the year £000pa**	Accumulated accrued pension at 31 December 2005 £000pa
Tony Brewer	**12**	**196**	**49**	**13**	35
Steve Wilson	**19**	**397**	**64**	**20**	44

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 2006 £000	**Change in value over the year £000pa**	Transfer value of accrued pension at 31 December 2005 £000
Tony Brewer	**783**	**344**	439
Steve Wilson	**1,350**	**661**	689

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

Geoff Duggan
Company Secretary
20 March 2007

Corporate and social responsibility

Introduction
Our commitment to Corporate Social Responsibility (“CSR”) is included within our group procedures manual which sets out our undertaking to act ethically and responsibly in all of our business dealings with stakeholders. We are committed to continuous improvements in all aspects of CSR – our policies, our systems, our performance and our reporting. Our management structure allows the consideration of social and environmental factors by both individual businesses within the group and also at a group level. Our links with external stakeholders continue to grow including improved customer liaison and community involvement.

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

Our policy
Our policy sets out the framework for the development and implementation of CSR activities across the group.

We will conduct all our business activities in a fair and balanced manner, respecting and responding to legal, social and ethical issues arising from our commercial activities.

We are committed across the group to continued progress in the following areas:

- improving the quality of our products, processes and services.
- becoming an employer of choice.
- improving our health and safety performance.
- working with the local communities around our businesses.
- protecting the environment.
- 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 CSR programme develops.

Improving the quality of our products, processes and services
We aim to increase awareness and communication of the environmental strategy and commitments through a programme of employee training.

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

- increase the use of environmental specification.
- increase the volume of certified sustainable natural products.
- reduce the amount of 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 motor vehicles that we operate replacing them every five and three years respectively, so improving operational efficiencies and reducing operating costs and vehicle emissions. Obligations placed on manufacturers have resulted in the production of more efficient and less polluting vehicles. Replacement of Euro 2 compliant commercial vehicles with new Euro 4 compliant models, according to manufacturers statistics, has resulted in significant savings in all regulated exhaust emissions: a 62.5% reduction in carbon monoxide, a 58.8% reduction in hydrocarbons, a 50% reduction in nitrous oxides and a 86.6% reduction in particulate matter or soot. Efficiencies achieved in motor vehicles have been less notable with CO_2 emissions for the majority of the motor vehicles operated reducing from 159g to 157g following the introduction of Euro 4 compliant models.

Our operations predominantly create waste materials in the form of protective plastic wrapping, cardboard and wooden pallets. Increasingly we collect the plastic and cardboard in discreet types and, with the use of baler units that we have invested in over the last few years, despatch these to specialist re-processing agents.

Corporate and social responsibility continued

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.

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 in the directors' report in the section on employment, training and development.

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

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

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

Further details are given in the directors report in the section on health and safety.

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

Corporate and social responsibility continued

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 continue to investigate the benefits from using green specification guides and modify our strategy accordingly. We shall continue to work with suppliers to ensure products are supplied from renewable sources and that their manufacturing processes fairly reward employees and do not seek to exploit. We shall continue to work with our suppliers to investigate the potential for improvements in product design.

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, the site for our new facility in Bridgend being reclaimed land.

This report is not subject to audit by KPMG.

Statement of Directors' Responsibilities

in respect of the Annual Report and the financial statements

The directors are responsible for preparing the Annual Report and the group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

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

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

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

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

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

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 2006 which comprise the Consolidated Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statements of Recognised Income and Expenses and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 44.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors’ Report includes that specific information presented in the Chairman’s Statement, Business Review and Financial Review that is cross referenced from the Review of the Business section of the Directors’ Report. In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance statement reflects the company's compliance with the nine provisions of the 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 the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Independent Auditors' Report

to the Members of Headlam Group plc - continued

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

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

Opinion
In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2006;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor

2 Cornwall Street
Birmingham
B3 2DL

20 March 2007

Consolidated Income Statement

for the year ended 31 December 2006

	Note	2006 £000	2005 £000
Revenue	2	**509,899**	486,635
Cost of sales		**(350,506)**	(336,570)
Gross profit		**159,393**	150,065
Distribution expenses		**(81,623)**	(77,507)
Administrative expenses		**(33,829)**	(31,060)
Operating profit	2	**43,941**	41,498
Financial income	6	**4,926**	3,893
Financial expenses	6	**(5,309)**	(4,551)
Net financing costs		**(383)**	(658)
Profit before tax	3	**43,558**	40,840
Taxation	7	**(13,067)**	(12,352)
Profit for the year attributable to the equity shareholders		**30,491**	28,488
Dividend paid per share	22	**18.00p**	16.25p
Earnings per share			
Basic	9	**35.1p**	33.1p
Diluted	9	**34.8p**	32.8p

All group operations during the financial years were continuing operations.

Statements of Recognised Income and Expense

for year ended 31 December 2006

	Note	Group 2006 £000	Group 2005 £000	Company 2006 £000	Company 2005 £000
Foreign exchange translation differences arising on translation of overseas operations		**(419)**	(321)	**–**	–
Recycling of cash flow hedging reserve balance		**–**	13	**–**	–
Actuarial gains and losses on defined benefit pension plans		**(173)**	(2,571)	**(261)**	(2,571)
Tax recognised on income and expenses recognised directly in equity		**1,057**	910	**383**	910
Net income/(expense) recognised directly in equity		**465**	(1,969)	**122**	(1,661)
Profit for the year		**30,491**	28,488	**32,237**	39,352
Total recognised income and expense attributable to the equity shareholders	22	**30,956**	26,519	**32,359**	37,691

Balance Sheets

at 31 December 2006

	Note	Group 2006 £000	Group 2005 £000	Company 2006 £000	Company 2005 £000
Non-current assets					
Property, plant and equipment	10	**85,032**	74,640	**66,773**	58,665
Investments in subsidiary undertakings	12	**–**	–	**84,247**	94,835
Intangible assets	11	**13,210**	13,210	**–**	–
Deferred tax assets	13	**9,182**	8,199	**6,480**	6,629
		107,424	96,049	**157,500**	160,129
Current assets					
Inventories	14	**94,217**	91,160	**–**	–
Trade and other receivables	15	**91,284**	84,275	**21,899**	25,592
Cash and cash equivalents	16	**41,861**	36,193	**40,221**	31,265
		227,362	211,628	**62,120**	56,857
Non-current assets classified as held for sale	17	**–**	3,471	**–**	3,471
Total assets		**334,786**	311,148	**219,620**	220,457
Current liabilities					
Bank overdraft	16	**(1,010)**	–	**–**	–
Other interest-bearing loans and borrowings	18	**(267)**	(471)	**(267)**	(471)
Trade and other payables	19	**(149,422)**	(141,529)	**(40,663)**	(6,387)
Employee benefits	20	**(1,102)**	(1,080)	**(1,102)**	(1,080)
Income tax payable	8	**(10,184)**	(11,139)	**(2,324)**	(3,500)
		(161,985)	(154,219)	**(44,356)**	(11,438)
Non-current liabilities					
Other interest-bearing loans and borrowings	18	**–**	(267)	**–**	(267)
Other payables	19	**–**	–	**–**	(49,732)
Employee benefits	20	**(16,124)**	(19,432)	**(15,930)**	(19,146)
Deferred tax liabilities	13	**(3,665)**	(1,403)	**(2,627)**	(1,616)
		(19,789)	(21,102)	**(18,557)**	(70,761)
Total liabilities		**(181,774)**	(175,321)	**(62,913)**	(82,199)
Net assets		**153,012**	135,827	**156,707**	138,258

Balance Sheets continued

at 31 December 2006

		Group		Company	
	Note	**2006**	2005	**2006**	2005
		£000	£000	**£000**	£000
Equity attributable to equity holders of the parent					
Share capital	22	**4,354**	4,326	**4,354**	4,326
Share premium	22	**53,428**	52,280	**53,428**	52,280
Special reserve	22	**–**	–	**20,578**	20,578
Translation reserves	22	**(616)**	(577)	**–**	(1,759)
Retained earnings	22	**95,846**	79,798	**78,347**	62,833
Total equity		**153,012**	135,827	**156,707**	138,258

These financial statements were approved by the board of directors on 20 March 2007 and were signed on its behalf by:

Tony Brewer
Director

Stephen Wilson
Director

Cash Flow Statements

for year ended 31 December 2006

	Note	Group 2006 £000	Group 2005 £000	Company 2006 £000	Company 2005 £000
Cash flows from operating activities					
Profit/(loss) before tax for the year		**43,558**	40,840	**(1,684)**	135
Adjustments for:					
Depreciation, amortisation and impairment		**4,974**	5,133	**1,066**	1,249
Financial income		**(4,926)**	(3,893)	**(5,825)**	(1,280)
Financial expense		**5,309**	4,551	**4,452**	2,035
Loss/(profit) on sale of property, plant and equipment		**10**	(228)	**17**	(206)
Equity settled share-based payment expenses		**472**	196	**196**	71
Operating profit/(loss) before changes in working capital and provisions		**49,397**	46,599	**(1,778)**	2,004
(Increase)/decrease in trade and other receivables		**(6,810)**	1,699	**(460)**	1,801
Increase in inventories		**(2,930)**	(11,335)	**–**	–
Increase/(decrease) in trade and other payables		**7,987**	(1,085)	**(1,423)**	832
Cash generated from the operations		**47,644**	35,878	**(3,661)**	4,637
Interest paid		**(2,023)**	(1,456)	**(133)**	(1,518)
Tax (paid)/received		**(11,622)**	(10,994)	**1,885**	843
Additional contributions to defined benefit pension plans		**(3,927)**	(722)	**(2,080)**	(722)
Net cash from operating activities		**30,072**	22,706	**(3,989)**	3,240
Cash flows from investing activities					
Proceeds from sale of property, plant and equipment		**1,816**	597	**1,729**	445
Interest received		**2,001**	1,335	**1,878**	1,154
Dividends received		**–**	–	**34,775**	39,910
Acquisition of subsidiary, net of cash acquired		**(1,369)**	(426)	**(1,747)**	–
Additional investment in subsidiary		**–**	–	**(1,336)**	–
Acquisition of property, plant and equipment		**(12,884)**	(10,964)	**(7,447)**	(5,121)
Net cash from investing activities		**(10,436)**	(9,458)	**27,852**	36,388
Cash flows from financing activities					
Proceeds from the issue of share capital		**1,176**	570	**1,176**	570
Repayment of borrowings		**–**	(662)	**–**	–
Payment of finance lease liabilities		**(497)**	(438)	**(471)**	(430)
Dividends paid		**(15,612)**	(13,976)	**(15,612)**	(13,976)
Net cash from financing activities		**(14,933)**	(14,506)	**(14,907)**	(13,836)
Net increase/(decrease) in cash and cash equivalents		**4,703**	(1,258)	**8,956**	25,792
Cash and cash equivalents at 1 January		**36,193**	37,468	**31,265**	5,473
Effect of exchange rate fluctuations of cash held		**(45)**	(17)	**–**	–
Cash and cash equivalents at 31 December	16	**40,851**	36,193	**40,221**	31,265

Notes to the Financial Statements

1 ACCOUNTING POLICIES
Headlam Group Plc (the "company") is a company incorporated in the UK.

The principal accounting policies applied in the preparation of these financial statements and the financial statements of the company are set out below. These policies have been applied consistently to all years presented, unless otherwise stated.

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

Both the company's financial statements and the group's financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards as adopted by the EU ("IFRS"). On publishing the company's 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. The principal exception is that the directors have changed the accounting policies in respect of the following matters:

- Amendment to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts - Financial Guarantee Contracts: Where the group enters into financial guarantee contracts to guarantee the indebtedness between group companies, these are considered to be insurance arrangements, and each group company accounts for them as such. In this respect, the group treats the guarantee contract as a contingent liability until such time as it becomes probable that the applicable group company will be required to make a payment under the guarantee.
- Amendment to IAS 39 Financial Instruments: Cash Flow Hedge Accounting of Forecast Intragroup Transactions.
- Amendment to IAS 39 Financial Instruments: The Fair Value Options.
- IFRIC 4: Determining whether an Arrangement Contains a Lease.

The implementation of the changes noted above has not had a significant effect on either the profit or the net assets of the group for the period commencing 1 January 2006.

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 29.

IFRS not yet applied
The following IFRSs 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. The application of IFRS 7 in the year to 31 December 2006 would not have affected the balance sheets or income statement as the standard is concerned only with disclosure. The group plans to adopt it during 2007.

- IFRIC 8 'Scope of IFRS 2 Share based payments: Applicable for the years commencing on or after 1 May 2006.
- IFRIC 9 'Reassessment of embedded derivatives: Applicable for years commencing on or after 1 June 2006.
- IFRIC 10 'Interim financial reporting and impairment: Applicable for years commencing on or after 1 November 2006.

The application of these IFRIC statements would not have affected the balance sheets or income statement for the year ended 31 December 2006 and the group plans to adopt them during 2007.

Following initial adoption, the directors have decided not to apply the hedge accounting requirements of IAS 39 'Financial instruments: Recognition and Measurement'. Consequently, all movements in the fair value of the hedge are recognised immediately in the income statement, within financial income or expense.

Measurement convention
The company and group financial statements are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, financial instruments classified as fair value through profit or loss and assets available for sale. 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 company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

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

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

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

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

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

Classification of financial instruments issued by the group
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 or 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 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 company's financial statements, the excess of the fair value of the consideration of shares issued over the nominal value is credited to the special reserve.

Derivative financial instruments and hedging
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

Notes to the Financial Statements continued

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.

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.

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

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

Expenditure on research activities is recognised in the income statement as an expense as incurred.

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 of customer lists are deemed to be between 1-24 months.

Trade and other receivables
Trade and other receivables are stated at their fair value, 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

Notes to the Financial Statements continued

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 assets 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.

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.

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

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

Notes to the Financial Statements continued

Interest-bearing borrowings
Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

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

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

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

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

All actuarial gains and losses that arise in calculating the group's obligation in respect of a scheme are recognised immediately in reserves and reported in the statement of recognised income and expense (SORIE).

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

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

Share-based payment transactions
The company and group operate various equity settled share option schemes under the approved and unapproved executive schemes and savings related schemes.

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

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

Unapproved
These share options, depending on the value of the grant, are subject to the movement of the group earnings per share exceeding RPI between 3% and 5% per annum.

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

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

Notes to the Financial Statements continued

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, returns and allowances. Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods are transferred to the buyer, the amount of revenue can be reliably measured and it is probable that the economic benefits associated with the transaction will flow to the group.

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

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

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

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

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

Taxation
Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

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

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

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	
	2006 £000	2005 £000	**2006 £000**	2005 £000	**2006 £000**	2005 £000
Revenue						
External sales	**434,321**	415,038	**75,578**	71,597	**509,899**	486,635
Result						
Segment result	**43,670**	41,905	**2,044**	1,815	**45,714**	43,720
Unallocated corporate expenses					**(1,773)**	(2,222)
Operating profit					**43,941**	41,498
Financial income					**4,926**	3,893
Financial expense					**(5,309)**	(4,551)
Taxation					**(13,067)**	(12,352)
Profit for the year					**30,491**	28,488
Other information						
Segment assets	**293,280**	271,074	**32,324**	28,404	**325,604**	299,478
Unallocated assets					**9,182**	11,670
Consolidated total assets					**334,786**	311,148
Segment liabilities	**(133,493)**	(127,258)	**(17,206)**	(15,009)	**(150,699)**	(142,267)
Unallocated liabilities					**(31,075)**	(33,054)
Consolidated total liabilities					**(181,774)**	(175,321)
Capital expenditure	**10,882**	10,461	**2,002**	503	**12,884**	10,964
Depreciation	**3,610**	3,451	**674**	631	**4,284**	4,082
Amortisation	**690**	836	**–**	–	**690**	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.

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

Notes to the Financial Statements continued

3 PROFIT BEFORE TAX

The following are included in profit before tax:

	2006 £000	2005 £000
Depreciation on property, plant and equipment	**4,284**	4,082
Amortisation of intangible assets	**690**	836
Impairment loss on property, plant and equipment	**–**	215
Loss/(profit) on sale of property, plant and equipment	**10**	(228)
Equity settled share-based payment expenses	**472**	196
Operating lease rentals		
Plant and machinery	**7,926**	7,369
Land and buildings	**1,831**	1,707

Auditors' remuneration:

	2006 £000	2005 £000
Audit of these financial statements	**54**	59
Amounts received by the auditors and their associates in respect of:		
Audit of financial statements of subsidiaries pursuant to legislation	**121**	122
All other services	**8**	63
	183	244

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	
	2006	2005	**2006**	2005
By sector:				
Floorcoverings	**2,053**	2,025	**–**	–
Central operations	**9**	9	**9**	9
	2,062	2,034	**9**	9
By function:				
Sales and distribution	**1,891**	1,853	**–**	–
Administration	**171**	181	**9**	9
	2,062	2,034	**9**	9

The aggregate payroll costs were as follows:

	£000	£000	**£000**	£000
Wages and salaries	**53,089**	49,617	**2,496**	2,603
Equity settled transactions	**472**	196	**196**	71
Social security costs	**6,632**	6,437	**312**	324
Contributions to defined contribution plans	**1,307**	1,307	**15**	8
Increase in liability for defined benefit plans	**1,768**	1,644	**590**	1,644
	63,268	59,201	**3,609**	4,650

5 DIRECTORS' EMOLUMENTS

	2006	2005
	£000	£000
Directors' emoluments	**2,222**	1,852
Gains made on share options	**12**	364
Company contributions to defined contribution plan	**–**	7

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

Notes to the Financial Statements continued

6 FINANCE INCOME AND EXPENSE

	2006 £000	2005 £000
Interest income		
Bank interest	**1,823**	1,329
Other	**124**	87
Return on defined benefit plan assets	**2,979**	2,477
Financial income	**4,926**	3,893
Interest expense		
Bank loans, overdrafts and other financial expenses	**(1,862)**	(1,503)
Interest on defined benefit plan obligation	**(3,342)**	(2,987)
Finance leases and similar hire purchase contracts	**(36)**	(61)
Other	**(69)**	–
Financial expenses	**(5,309)**	(4,551)

7 TAXATION

Recognised in the income statement

	2006 £000	2005 £000
Current tax expense		
Current year	**13,302**	12,764
Adjustments for prior years	**(826)**	(1,652)
	12,476	11,112
Deferred tax expense		
Origination and reversal of temporary differences	**(40)**	(101)
Adjustments for prior years	**631**	1,341
	591	1,240
Total tax in income statement	**13,067**	12,352

	2006 £000	2005 £000
Tax relating to items credited/(charged) to equity		
Current tax		
Current tax on income and expenses recognised directly in equity	**1,938**	–
Deferred tax		
Deferred tax on share options	**193**	172
Deferred tax on income and expenses recognised directly in equity	**(881)**	910
Tax credit reported directly in reserves	**1,250**	1,082

Notes to the Financial Statements continued

7 TAXATION – CONTINUED

Reconciliation of effective tax rate

	2006 %	2006 £000	2005 %	2005 £000
Profit before tax		**43,558**		40,840
Tax using the UK corporation tax rate	**30.0%**	**13,067**	30.0%	12,252
Non-deductible expenses	**0.4%**	**186**	0.9%	362
Effect of tax rates in foreign jurisdictions	**0.0%**	**9**	(0.1%)	(38)
Losses not recognised	**–**	**–**	0.2%	87
Over provided in prior years	**(0.4%)**	**(195)**	(0.8%)	(311)
Total tax in income statement	**30.0%**	**13,067**	30.2%	12,352

During 2006, certain computations under enquiry with HM Revenue and Customs were finalised and agreed. The current position has been reconciled to date, giving a net prior year credit of £195,000. This is made up of a current tax credit of £826,000 which, to a large extent, is matched with a corresponding deferred tax charge of £631,000.

8 CURRENT TAX LIABILITIES

The group current tax liability of £10,184,000 *(2005: £11,139,000)* represents the amount of income payable in respect of current and prior year periods which exceed any amounts recoverable. The company current tax liability of £2,324,000 (2005: £3,500,000) represents the amount of income tax payable in respect of current and prior year periods which exceed any amounts recoverable.

9 EARNINGS PER SHARE

	2006 £000	2005 £000
Earnings		
Earnings for the purposes of basic earnings per share being profit attributable to equity holders of the parent	**30,491**	28,488

	2006	2005
Number of shares		
Issued ordinary shares at 1 January	**86,512,854**	86,111,437
Effect of shares issued during the period	**416,237**	86,272
Weighted average number of ordinary shares for the purposes of basic earnings per share	**86,929,091**	86,197,709
Effect of diluted potential ordinary shares:		
Weighted average number of ordinary shares at 31 December	**86,929,091**	86,197,709
Share options	**2,046,461**	2,407,331
Number of shares that would have been issued at fair value	**(1,422,270)**	(1,813,602)
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**87,553,282**	86,791,438

Notes to the Financial Statements continued

10 PROPERTY, PLANT AND EQUIPMENT – GROUP AND COMPANY

Group

	Land & buildings £000	Plant & equipment £000	Under construction £000	Total £000
Cost				
Balance at 1 January 2005	54,220	14,898	11,946	81,064
Additions	3,240	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	65,086	18,814	2,001	85,901
Balance at 1 January 2006	65,086	18,814	2,001	85,901
Acquisition	248	92	–	340
Additions	2,005	3,866	7,013	12,884
Transfer from non-current assets held for sale	1,890	–	–	1,890
Disposals	–	(1,583)	–	(1,583)
Effect of movements in foreign exchange	(254)	(119)	–	(373)
Reclassification	8,292	–	(8,292)	–
Balance at 31 December 2006	77,267	21,070	722	99,059
Depreciation				
Balance at 1 January 2005	4,636	4,674	–	9,310
Depreciation charge for the year	1,262	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	5,397	5,864	–	11,261
Balance at 1 January 2006	5,397	5,864	–	11,261
Depreciation charge for the year	1,335	2,949	–	4,284
Transfer from non-current assets held for sale	120	–	–	120
Disposals	–	(1,457)	–	(1,457)
Effect of movements in foreign exchange	(95)	(86)	–	(181)
Balance at 31 December 2006	6,757	7,270	–	14,027
Net book value				
At 1 January 2005	49,584	10,224	11,946	71,754
At 31 December 2005 and 1 January 2006	59,689	12,950	2,001	74,640
At 31 December 2006	**70,510**	**13,800**	**722**	**85,032**

Notes to the Financial Statements continued

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

Asset impairment

The asset impairment provision in the year ended 31 December 2005 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 £000	Plant & equipment £000	Under construction £000	Total £000
Cost				
Balance at 1 January 2005	49,329	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	60,155	558	2,001	62,714
Balance at 1 January 2006	60,155	558	2,001	62,714
Additions	138	52	7,013	7,203
Transfer to non-current assets held for sale	1,890	–	–	1,890
Disposals	–	(51)	–	(51)
Transfer from group companies	245	–	–	245
Reclassification	8,292	–	(8,292)	–
Balance at 31 December 2006	70,720	559	722	72,001
Depreciation				
Balance at 1 January 2005	3,037	491	–	3,528
Depreciation charge for the year	1,004	30	–	1,034
Transfer to non-current assets held for sale	(441)	–	–	(441)
Disposals	–	(72)	–	(72)
Balance at 31 December 2005	3,600	449	–	4,049
Balance at 1 January 2006	3,600	449	–	4,049
Depreciation charge for the year	1,036	30	–	1,066
Transfer to non-current assets held for sale	120	–	–	120
Disposals	–	(7)	–	(7)
Balance at 31 December 2006	4,756	472	–	5,228
Net book value				
At 1 January 2005	46,292	62	11,946	58,300
At 31 December 2005 and 1 January 2006	56,555	109	2,001	58,665
At 31 December 2006	**65,964**	**87**	**722**	**66,773**

Notes to the Financial Statements continued

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

Property, plant and equipment under construction

During the year ended 31 December 2006, the group acquired land in Wales 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 £722,000.

Assets held under finance leases

The carrying value of assets held under finance leases amounts to £1,936,000 (2005: £1,985,000). The carrying value of the land element totalling £300,000 (2005: £300,000) is included within other debtors.

Notes to the Financial Statements continued

11 INTANGIBLE ASSETS – GROUP

	Goodwill £000	Customer lists £000	Total £000
Cost			
Balance at 1 January 2005 and 31 December 2005	13,210	1,672	14,882
Balance at 1 January 2006	13,210	1,672	14,882
Addition	–	690	690
Balance at 31 December 2006	13,210	2,362	15,572
Amortisation			
Balance at 1 January 2005	–	836	836
Amortisation for the year	–	836	836
Balance at 31 December 2005	–	1,672	1,672
Balance at 1 January 2006	–	1,672	1,672
Amortisation for the year	–	690	690
Balance at 31 December 2006	–	2,362	2,362
Net book value			
At 1 January 2005	13,210	836	14,046
At 31 December 2005 and 1 January 2006	13,210	–	13,210
At 31 December 2006	**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:

	2006 £000	2005 £000
UK	**6,671**	6,671
Continental Europe	**6,539**	6,539
	13,210	13,210

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

Goodwill by geographical segments has been separately identified and measured for impairment. The recoverable amount of each cash-generating unit has been assessed on a value in use basis using the operating profit of each geographical segment for 2006 and extrapolating forward assuming forecast inflationary growth rates of 3% for the territories in which the cash-generating units are located. The group has applied a discount rate of 9.1% when measuring for impairment.

Notes to the Financial Statements continued

12 INVESTMENTS IN SUBSIDIARIES

Summary information on investments in subsidiary undertakings is as follows:

	Shares £000	Loans £000	Total £000
Cost			
At 1 January 2006	118,268	28,437	146,705
Share options granted to employees of subsidiary undertakings	276	–	276
Additions during the period	3,083	–	3,083
Disposals during the period	(65,046)	(81)	(65,127)
At 31 December 2006	56,581	28,356	84,937
Provisions			
At 1 January 2006	51,870	–	51,870
Disposals during the period	(51,870)	–	(51,870)
Impairment during the period	690	–	690
At 31 December 2006	690	–	690
At 31 December 2005	66,398	28,437	94,835
Carrying value			
At 31 December 2006	**55,891**	**28,356**	**84,247**

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

Disposals during the year ended 31 December 2006 relate to the striking-off and liquidation of non-trading subsidiaries.

The principal trading subsidiaries are listed on page 100.

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	
	2006 £000	2005 £000	**2006 £000**	2005 £000	**2006 £000**	2005 £000
Property, plant and equipment	**–**	–	**3,665**	1,403	**3,665**	1,403
Intangible assets	**(551)**	(539)	**–**	–	**(551)**	(539)
Employee benefits	**(6,640)**	(7,047)	**–**	–	**(6,640)**	(7,047)
Provisions	**(1,265)**	(377)	**–**	–	**(1,265)**	(377)
Other items	**(726)**	(236)	**–**	–	**(726)**	(236)
Tax (assets)/liabilities	**(9,182)**	(8,199)	**3,665**	1,403	**(5,517)**	(6,796)

Movement in deferred tax during the year

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

Movement in deferred tax during the prior 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)

Unrecognised deferred tax assets and liabilities

At the balance sheet date the group has unused capital losses of £9,555,000 (2005: £14,651,000) available for offset against future chargeable gains. No deferred tax asset has been recognised in respect of this amount as the group does not anticipate incurring significant chargeable gains in the foreseeable future.

Notes to the Financial Statements continued

13 DEFERRED TAX ASSETS AND LIABILITIES – COMPANY

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2006 £000	2005 £000	**2006 £000**	2005 £000	**2006 £000**	2005 £000
Property, plant and equipment	**–**	–	**2,627**	1,616	**2,627**	1,616
Employee benefits	**(5,898)**	(6,480)	**–**	–	**(5,898)**	(6,480)
Provisions	**(582)**	(149)	**–**	–	**(582)**	(149)
Tax (assets)/liabilities	**(6,480)**	(6,629)	**2,627**	1,616	**(3,853)**	(5,013)

Movement in deferred tax during the year

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

Movement in deferred tax during the prior 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)

Unrecognised deferred tax assets and liabilities

At the balance sheet date the company has unused capital losses of £9,555,000 (2005:£11,350,000) available for offset against future chargeable gains. No deferred tax asset has been recognised in respect of this amount as the company does not anticipate incurring significant chargeable gains in the foreseeable future.

Notes to the Financial Statements continued

14 INVENTORIES

	Group		Company	
	2006	2005	**2006**	2005
	£000	£000	**£000**	£000
Finished goods and goods held for resale	**94,217**	91,160	**–**	–

Cost of sales consists of the following:

	Group		Company	
	2006	2005	**2006**	2005
	£000	£000	**£000**	£000
Material cost	**343,603**	330,147	**–**	–
Processing cost	**4,282**	3,616	**–**	–
Other	**2,621**	2,807	**–**	–
	350,506	336,570	**–**	–

15 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2006	2005	**2006**	2005
	£000	£000	**£000**	£000
Trade receivables	**71,505**	66,602	**22**	217
Prepayments and accrued income	**3,858**	3,480	**55**	420
Other receivables	**15,921**	14,193	**1,983**	1,683
Amounts due from subsidiary undertakings	**–**	–	**19,839**	23,272
	91,284	84,275	**21,899**	25,592

£1,298,000 (2005: £974,000) was recognised as an impairment loss in the consolidated income statement in respect of trade receivables. Included within trade and other receivables is £nil (2005: £1,500,000) for the group and £nil (2005: £1,500,000) for the company expected to be recovered in more than twelve months.

16 CASH, CASH EQUIVALENTS AND BANK OVERDRAFTS

	Group		Company	
	2006	2005	**2006**	2005
	£000	£000	**£000**	£000
Cash and cash equivalents per balance sheet	**41,861**	36,193	**40,221**	31,265
Bank overdrafts	**(1,010)**	–	**–**	–
Cash and cash equivalents per cash flow statements	**40,851**	36,193	**40,221**	31,265

Notes to the Financial Statements continued

17 NON-CURRENT ASSETS HELD FOR SALE

	Group		Company	
	2006	2005	**2006**	2005
	£000	£000	**£000**	£000
Assets classified as held for sale:				
Property, plant and equipment	**–**	3,471	**–**	3,471

At 31 December 2006, there were no assets classified as held for sale. At 31 December 2005, a property in Glossop was held for sale with a carrying value of £1,701,000 and on 15 August 2006, it was subsequently sold for proceeds of £1,688,000 net of costs totalling £20,000, creating a loss on disposal of £13,000. There was no gain or loss on initial classification of this asset. A property in Leeds that had been classified as held for sale at 31 December 2005 no longer met the criteria at 31 December 2006 and has been subsequently transferred from the held for sale category into tangible fixed assets.

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 risks, see note 23.

	Group		Company	
	2006	2005	**2006**	2005
	£000	£000	**£000**	£000
Non-current liabilities				
Finance lease liabilities	**–**	267	**–**	267
	–	267	**–**	267
Current liabilities				
Finance lease liabilities	**267**	471	**267**	471
	267	471	**267**	471

The group has undrawn borrowing facilities expiring in one year or less which, at 31 December 2006, amounted to £50,536,000 (2005: £51,802,000). The facility conditions for drawdown had been met during the period. The borrowing is unsecured and there is a cross guarantee in place between the company and its UK subsidiaries. There is a downstream guarantee from the company in relation to its borrowing facility in the Netherlands.

Notes to the Financial Statements continued

18 OTHER INTEREST-BEARING LOANS AND BORROWINGS – CONTINUED

The undrawn borrowing facilities are as follows:

	Interest rate %	**2006 £000**	Interest rate %	2005 £000
UK	**6.0**	**46,000**	5.5	46,500
Netherlands	**4.7**	**337**	3.3	1,031
France	**4.1**	**2,022**	2.8	2,061
Switzerland	**3.2**	**2,177**	2.3	2,210
		50,536		51,802

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

Finance lease liabilities
Finance lease liabilities are payable as follows:

Group	**Minimum lease payments 2006 £000**	**Interest 2006 £000**	**Principal 2006 £000**	Minimum lease payments 2005 £000	Interest 2005 £000	Principal 2005 £000
Less than one year	**267**	**–**	**267**	516	(45)	471
Between one and five years	**–**	**–**	**–**	267	–	267
	267	**–**	**267**	783	(45)	738

Company	**Minimum lease payments 2006 £000**	**Interest 2006 £000**	**Principal 2006 £000**	Minimum lease payments 2005 £000	Interest 2005 £000	Principal 2005 £000
Less than one year	**267**	**–**	**267**	516	(45)	471
Between one and five years	**–**	**–**	**–**	267	–	267
	267	**–**	**267**	783	(45)	738

19 TRADE AND OTHER PAYABLES

	Group		**Company**	
Current	**2006 £000**	2005 £000	**2006 £000**	2005 £000
Trade payables	**114,555**	109,765	**281**	192
Taxation and social security	**10,857**	10,585	**1,326**	365
Non-trade payables and accrued expenses	**24,010**	21,179	**6,886**	4,975
Amounts due to subsidiary undertakings	**–**	–	**32,170**	855
	149,422	141,529	**40,663**	6,387

Non-current				
Amounts due to subsidiary undertakings	**–**	–	**–**	49,732

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS

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

The total group cost of operating the plans during the year was £3,075,000 (2005: £2,951,000) and, at 31 December 2006, there was an amount of £319,000 (2005: £156,000) owed to the plans and included in creditors, being employer and employee contributions due for December 2006 but not received by 31 December 2006.

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 (2005: £1,307,000). Contributions amounting to £88,000 (2005: £76,000) were payable to the scheme at 31 December 2006.

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

	Group		Company	
	2006	2005	**2006**	2005
	£000	£000	**£000**	£000
Present value of funded defined benefit obligations	**(73,160)**	(64,750)	**(69,736)**	(64,750)
Fair value of plan assets	**56,220**	44,524	**52,704**	44,524
Net obligations	**(16,940)**	(20,226)	**(17,032)**	(20,226)
Recognised liability for defined benefit obligations	**(16,940)**	(20,226)	**(17,032)**	(20,226)
Other long term employee benefits (note 21)	**(286)**	(286)	**–**	–
Total employee benefits	**(17,226)**	(20,512)	**(17,032)**	(20,226)
Split:				
Current liabilities	**(1,102)**	(1,080)	**(1,102)**	(1,080)
Non-current liabilities	**(16,124)**	(19,432)	**(15,930)**	(19,146)
Total employee benefits	**(17,226)**	(20,512)	**(17,032)**	(20,226)

The employee benefits recognised as a current liability represent committed additional group and company contributions.

The group and company expect to contribute approximately £2,415,000 (2005: £2,063,000) to defined benefit plans in the next financial year.

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

Pension plans – continued

Movements in present value of defined benefit obligation

	Group		Company	
	2006 £000	2005 £000	**2006 £000**	2005 £000
At 1 January	**64,750**	54,729	**64,750**	54,729
Reclassification of Swiss defined benefit plan	**3,470**	–	**–**	–
Current service cost	**1,405**	1,134	**1,226**	1,134
Interest cost	**3,342**	2,987	**3,240**	2,987
Actuarial losses	**1,689**	6,711	**1,664**	6,711
Benefits paid	**(1,653)**	(1,072)	**(1,394)**	(1,072)
Contributions by members	**347**	261	**250**	261
Effect of movements in foreign exchange	**(190)**	–	**–**	–
At 31 December	**73,160**	64,750	**69,736**	64,750

Movements in fair value of plan assets

	Group		Company	
	2006 £000	2005 £000	**2006 £000**	2005 £000
At 1 January	**44,524**	36,815	**44,524**	36,815
Reclassification of Swiss defined benefit plan	**3,446**	–	**–**	–
Expected return on plan assets	**2,979**	2,477	**2,844**	2,477
Actuarial gains	**1,516**	4,134	**1,403**	4,134
Contributions by employer	**5,249**	1,909	**5,077**	1,909
Contributions by members	**347**	261	**250**	261
Benefits paid	**(1,653)**	(1,072)	**(1,394)**	(1,072)
Effect of movements in foreign exchange	**(188)**	–	**–**	–
At 31 December	**56,220**	44,524	**52,704**	44,524

Following the advice from a professionally qualified actuary the Swiss plan has been reclassified as a defined benefit plan.

Expense recognised in the income statement

	Group	
	2006 £000	2005 £000
Current service cost	**1,405**	1,134
Interest on defined benefit plan obligation	**3,342**	2,987
Expected return on defined benefit plan assets	**(2,979)**	(2,477)
Total	**1,768**	1,644

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	
	2006	2005
	£000	£000
Administrative expenses	**1,405**	1,134
Net financing costs	**363**	510
	1,768	1,644

Cumulative actuarial gains and losses reported in the group's statement of recognised income and expense since 1 January 2004, the transition date to IFRS, are £6,498,000 (2005: £6,325,000). Cumulative actuarial gains and losses reported in the company's statement of recognised income and expense are £6,586,000 (2005: £6,325,000).

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

	Group		Company	
	2006	2005	**2006**	2005
	£000	£000	**£000**	£000
Equities	**37,784**	28,975	**35,263**	28,975
Government debt	**14,311**	11,856	**14,311**	11,856
Annuities	**3,122**	3,195	**3,122**	3,195
Other	**1,003**	498	**8**	498
	56,220	44,524	**52,704**	44,524
Actual return on plan assets	**4,556**	6,611	**4,247**	6,611

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	
	2006	2005	**2006**	2005
	%	%	**%**	%
Discount rate	**5.3**	5.0	**5.4**	5.0
Future salary increases	**5.1**	4.9	**5.3**	4.9
Future pension increases	**3.1**	2.9	**3.3**	2.9
Inflation rate	**3.2**	2.9	**3.3**	2.9
Expected rate of return on plan assets	**6.6**	6.1	**6.7**	6.1
Mortality table assumption - non-pensioners	**PA92 C=2020**	PA92 C=2020	**PA92 C=2020**	PA92 C=2020
Mortality table assumption - pensioners	**PA92 C=2010**	PA92 C=2010	**PA92 C=2010**	PA92 C=2010

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

	Group		Company	
	2006	2005	**2006**	2005
Non-pensioner male	**19.9**	19.9	**19.9**	19.9
Pensioner male	**19.0**	19.0	**19.0**	19.0
Non-pensioner female	**22.8**	22.8	**22.8**	22.8
Pensioner female	**22.0**	22.0	**22.0**	22.0

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

	Group			Company		
	2006	2005	2004	**2006**	2005	2004
	£000	£000	£000	**£000**	£000	£000
Present value of defined benefit obligation	**(73,160)**	(64,750)	(54,729)	**(69,736)**	(64,750)	(54,729)
Fair value of plan assets	**56,220**	44,524	36,815	**52,704**	44,524	36,815
Deficit	**(16,940)**	(20,226)	(17,914)	**(17,032)**	(20,226)	(17,914)

Experience adjustments

	Group			Company		
	2006	2005	2004	**2006**	2005	2004
	£000	£000	£000	**£000**	£000	£000
Experience adjustments on plan liabilities	**1,688**	6,711	4,786	**1,664**	6,711	4,786
Experience adjustments on plan assets	**1,518**	4,134	1,030	**1,403**	4,134	1,030
Experience adjustment as a percentage of plan liabilities	**2.3%**	10.4%	8.7%	**2.4%**	10.4%	8.7%
Experience adjustment as a percentage of plan assets	**2.7%**	9.3%	2.8%	**2.7%**	9.3%	2.8%

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 RPI over the relevant period.

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

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

Notes to the Financial Statements continued

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 shares 2006	Number of shares 2005	Vesting conditions	Contractual life of options
Approved 1998 scheme grant to key management 10 January 2001	**10,000**	35,500	Movement of the group's basic earnings per share exceeding RPI over the relevant period	10/01/04 – 10/01/11
Three year sharesave scheme granted to other employees 28 October 2002	**–**	203,679	One year's service	01/01/06 – 30/06/06
Five year sharesave scheme granted to other employees 28 October 2002	**395,849**	401,152	One year's service	01/01/08 – 30/06/08
Approved 1998 scheme grant to key management 14 April 2003	**70,357**	382,112	Movement of the group's basic earnings per share exceeding RPI over the relevant period	14/04/06 – 14/04/13
Unapproved 1998 scheme grant to key management 14 April 2003	**22,596**	84,888	Movement of the group's basic earnings per share exceeding RPI over the relevant period	14/04/06 – 14/04/10
Unapproved 1998 scheme grant to key management 22 August 2005	**1,242,864**	1,242,864	Movement of the group's basic earnings per share exceeding RPI by 3%-5% pa over the relevant period	22/08/08 – 22/08/12
Approved 1998 scheme grant to key management 22 August 2005	**57,136**	57,136	Movement of the group's basic earnings per share exceeding RPI by 3% pa over the relevant period	22/08/08 – 22/08/15
Three year sharesave scheme granted to other employees 25 May 2006	**231,365**	–	One month's service	01/07/09 – 01/01/10
Five year sharesave scheme granted to other employees 25 May 2006	**179,524**	–	One month's service	01/07/11 – 01/01/12
Total share options	**2,209,691**	2,407,331		

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 2006	**Number of options 2006**	Weighted average exercise price 2005	Number of options 2005
Outstanding at the beginning of the year	**319.9**	**2,407,331**	186.5	1,532,067
Exercised during the year	**207.5**	**(566,667)**	141.9	(401,417)
Granted during the year	**401.0**	**419,436**	420.0	1,300,000
Lapsed during the year	**211.9**	**(50,409)**	197.0	(23,319)
Outstanding at the end of the year	**366.6**	**2,209,691**	319.9	2,407,331
Exercisable at the end of the year	**206.5**	**102,953**	128.0	35,500

Options were exercised on a regular basis during the year. The average share price during the year was 489.4p (2005: 432.0p).

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 6.3 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

	2006	2005
3 year options:		
Fair value at measurement date	**97.4p**	89.0p
Weighted average share price	**615p**	432p
Exercise price	**401p**	420p
Expected volatility (expressed as weighted average volatility used in the modelling under the Black-Scholes model)	**36.8**	31.8
Option life (expressed as weighted average life used in the modelling under the Black-Scholes model)	**3 years**	3 years
Expected dividends	**3.1%**	3.6%
Risk-free interest rate (based on UK Gilts)	**4.6%**	4.3%
5 year options:		
Fair value at measurement date	**105.2p**	–
Weighted average share price	**615p**	–
Exercise price	**401p**	–
Expected volatility (expressed as weighted average volatility used in the modelling under the Black-Scholes model)	**32.1**	–
Option life (expressed as weighted average life used in the modelling under the Black-Scholes model)	**5 years**	–
Expected dividends	**3.1%**	–
Risk-free interest rate (based on UK Gilts)	**4.6%**	–

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

	2006 £000	2005 £000
Share options granted in 2003 under the approved 1998 scheme	**14**	47
Share options granted in 2003 under the unapproved 1998 scheme	**3**	10
Share options granted in 2005 under the approved 1998 scheme	**17**	6
Share options granted in 2005 under the unapproved 1998 scheme	**369**	133
Share options granted in 2006 under the SAYE 3 year scheme	**46**	–
Share options granted in 2006 under the SAYE 5 year scheme	**23**	–
Total expense recognised	**472**	196

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 RPI over the relevant period.

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

Share-based payments – Company – continued
Options granted under the 1996 and 1998 unapproved schemes are normally exercisable between the third and seventh anniversaries of their date of grant, and depending on the value of the grant, are subject to the movement of the group's basic earnings per share exceeding RPI, between 3% and 5% per annum over the relevant period.

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

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 shares 2006	Number of shares 2005	Vesting conditions	Contractual life of options
Three year sharesave scheme granted to other employees 28 October 2002	**–**	4,796	One year's service	01/01/06 – 30/06/06
Five year sharesave scheme granted to other employees 28 October 2002	**33,348**	33,348	One year's service	01/01/08 – 30/08/08
Approved 1998 scheme grant to key management 14 April 2003	**–**	5,000	Movement of the group's basic earnings per share exceeding RPI over the relevant period	14/04/06 – 14/04/13
Unapproved 1998 scheme grant to key management 14 April 2003	**10,000**	10,000	Movement of the group's basic earnings per share exceeding RPI over the relevant period	14/04/06 – 14/04/10
Unapproved 1998 scheme grant to key management 22 August 2005	**628,574**	628,574	Movement of the group's basic earnings per share exceeding RPI by 3% -5% pa over the relevant period	22/08/08 – 22/08/12
Approved 1998 scheme grant to key management 22 August 2005	**21,426**	21,426	Movement of the group's basic earnings per share exceeding RPI by 3% pa over the relevant period	22/08/08 – 22/08/15
Three year sharesave scheme granted to other employees 25 May 2006	**4,662**	–	One month's service	01/07/09 – 01/01/10
Total share options	**698,010**	703,144		

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 2006	**Number of options 2006**	Weighted average exercise price 2005	Number of options 2005
Outstanding at the beginning of the year	**403.5**	**703,144**	171.4	203,144
Exercised during the year	**206.2**	**(9,796)**	160.5	(150,000)
Granted during the year	**401.0**	**4,662**	420.0	650,000
Outstanding at the end of the year	**406.3**	**698,010**	403.5	703,144
Exercisable at the end of the year	**215.0**	**10,000**	–	–

The weighted average share price at the date of exercise of share options exercised during the period was 483.0p (2005: 403.0p).

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 8.2 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.

	2006	2005
3 year options:		
Fair value at measurement date	**97.4p**	89.0p
Weighted average share price	**615p**	432p
Exercise price	**401p**	420p
Expected volatility (expressed as weighted average volatility used in the modelling under the Black-Scholes model)	**36.8**	31.8
Option life (expressed as weighted average life used in the modelling under the Black-Scholes model)	**3 years**	3 years
Expected dividends	**3.1%**	3.6%
Risk-free interest rate (based on UK Gilts)	**4.6%**	4.3%

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS – CONTINUED

	2006	2005
5 year options:		
Fair value at measurement date	**105.2p**	–
Weighted average share price	**615p**	–
Exercise price	**401p**	–
Expected volatility (expressed as weighted average volatility used in the modelling under the Black-Scholes model)	**32.1**	–
Option life (expressed as weighted average life used in the modelling under the Black-Scholes model)	**5 years**	–
Expected dividends	**3.1%**	–
Risk-free interest rate (based on UK Gilts)	**4.6%**	–

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

	2006 £000	2005 £000
Share options granted in 2003 under the approved 1998 scheme	**2**	2
Share options granted in 2005 under the approved 1998 scheme	**6**	2
Share options granted in 2005 under the unapproved 1998 scheme	**187**	67
Share options granted in 2006 under the SAYE 3 year scheme	**1**	–
Total expense recognised	**196**	71

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

	2006 £000	2005 £000
Share options granted in 2003 under the approved 1998 scheme	**14**	47
Share options granted in 2003 under the unapproved 1998 scheme	**1**	8
Share options granted in 2005 under the approved 1998 scheme	**11**	4
Share options granted in 2005 under the unapproved 1998 scheme	**182**	66
Share options granted in 2006 under the SAYE 3 year scheme	**45**	–
Share options granted in 2006 under the SAYE 5 year scheme	**23**	–
Total carrying amount of investments	**276**	125

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 to provide for lump sum cash payments due to employees retiring on their normal retirement date.

	Group	
	2006	2005
	£000	£000
Present retirement indemnity obligations	**286**	286

Movements in present value of retirement indemnity obligations

	Group	
	2006	2005
	£000	£000
Current service cost	**–**	(9)
Actuarial (gains)/losses	**–**	(156)
	–	(165)

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 2005	4,306	51,731	(256)	(13)	66,579	122,347
Total recognised income and expense	–	–	(321)	13	26,827	26,519
Equity-settled share based payment transactions	–	–	–	–	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
Balance at 1 January 2006	4,326	52,280	(577)	–	79,798	135,827
Transfer between reserves	–	–	380	–	(380)	–
Total recognised income and expense	–	–	(419)	–	31,375	30,956
Equity-settled share based payment transactions	–	–	–	–	472	472
Share options exercised by employees	28	1,148	–	–	–	1,176
Deferred tax on Schedule 23 share options (pre November 2002)	–	–	–	–	193	193
Dividends	–	–	–	–	(15,612)	(15,612)
Balance at 31 December 2006	**4,354**	**53,428**	**(616)**	**–**	**95,846**	**153,012**

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 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	–	–	–	–	196	196
Share options exercised by employees	20	549	–	–	–	569
Deferred tax on Schedule 23 share options (pre November 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
Balance at 1 January 2006	4,326	52,280	(1,759)	20,578	62,833	138,258
Transfer between reserves	–	–	1,759	–	(1,759)	–
Total recognised income and expense	–	–	–	–	32,359	32,359
Equity-settled share based payment transactions	–	–	–	–	472	472
Share options exercised by employees	28	1,148	–	–	–	1,176
Deferred tax on Schedule 23 share options (pre November 2002)	–	–	–	–	54	54
Dividends	–	–	–	–	(15,612)	(15,612)
Balance at 31 December 2006	**4,354**	**53,428**	**–**	**20,578**	**78,347**	**156,707**

Notes to the Financial Statements continued

22 CAPITAL AND RESERVES – CONTINUED

Share capital

	Ordinary shares	
	2006	2005
Number of shares		
In issue at 1 January	**86,512,854**	86,111,437
Allotted under share option scheme	**566,667**	401,417
In issue at 31 December – fully paid	**87,079,521**	86,512,854

	2006	2005
	£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	**4,354**	4,326
5.6% cumulative preference shares of £1 each	**–**	–
	4,354	4,326
Shares classified as liabilities	**–**	–
Shares classified in shareholders funds	**4,354**	4,326
	4,354	4,326

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 subsidiaries.

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

	2006 £000	2005 £000
Interim dividend for 2005 of 4.40p paid 3 January 2006	**3,789**	–
Final dividend for 2005 of 13.60p paid 3 July 2006	**11,823**	–
Interim dividend for 2004 of 4.00p paid 3 January 2005	**–**	3,421
Final dividend for 2004 of 12.25p paid 4 July 2005	**–**	10,555
	15,612	13,976

The final proposed dividend of 15.30p per share (2005: 13.60p per share) will not be provided for until authorised by shareholders at the forthcoming AGM.

Interim dividends of 4.85p per share (2005: 4.40p per share) are provided for when the dividend is paid.

The total value of dividends proposed but not recognised at 31 December 2006 is £17,526,000 (2005: £15,612,000).

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 cover 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 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, 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.

	2006				2005			
	Effective interest rate %	**Total £000**	**0 to <1year £000**	**1 to <2years £000**	Effective interest rate %	Total £000	0 to <1year £000	1 to <2years £000
Cash and cash equivalents	**4.5**	**41,861**	**41,861**	**–**	4.6	36,193	36,193	–
Finance lease liabilities	**6.0**	**(267)**	**(267)**	**–**	6.0	(738)	(471)	(267)
Bank overdrafts	**3.3**	**(1,010)**	**(1,010)**	**–**	–	–	–	–
		40,584	**40,584**	**–**		35,455	35,722	(267)

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.

	2006				2005			
	Effective interest rate %	**Total £000**	**0 to <1year £000**	**1 to <2years £000**	Effective interest rate %	Total £000	0 to <1year £000	1 to <2years £000
Cash and cash equivalents	**4.5**	**40,221**	**40,221**	**–**	4.6	31,265	31,265	–
Finance lease liabilities	**6.0**	**(267)**	**(267)**	**–**	6.0	(738)	(471)	(267)
		39,954	**39,954**	**–**		30,527	30,794	(267)

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

The group and company uses forward exchange contracts to hedge foreign currency transactional risk. A future foreign currency contract would be entered into where there was a known requirement for the currency due to planned imports that are not invoiced in sterling. These forward exchange contracts would have a maturity of less than one year after the balance sheet date. The group also enters into foreign currency contracts at spot rate where the amounts are not frequent or material. Gains and losses on currency contracts recognised as a liability as at 31 December 2006 amounted to £62,000 (2005: £43,000).

Notes to the Financial Statements continued

23 FINANCIAL INSTRUMENTS – CONTINUED

Foreign currency risk – continued
For the twelve month period to 31 December 2006, 4.7% (2005: 4.4%) of the group's operating profit was derived from overseas subsidiaries and at 31 December 2006, 8.6% (2005: 8.5%) of the group's operating assets related to overseas subsidiaries. Hedge accounting, following the adoption of IFRS, has not been applied to these subsidiaries given their relative size and because of the onerous level of compliance required under IAS 39.

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

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 has the potential to impact the consolidated income statement and carrying value of net assets.

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

	Group		Company	
2006	Carrying amount £000	Fair value £000	Carrying amount £000	Fair value £000
Assets				
Cash and cash equivalent	**41,861**	**41,861**	**40,221**	**40,221**
Trade and other receivables	**91,284**	**91,284**	**21,899**	**21,899**
	133,145	**133,145**	**62,120**	**62,120**
Liabilities				
Trade and other payables - Current	**149,422**	**149,422**	**40,663**	**40,663**
Bank overdraft	**1,010**	**1,010**	**–**	**–**
Finance lease liabilities - Current	**267**	**267**	**267**	**267**
	150,699	**150,699**	**40,930**	**40,930**

Notes to the Financial Statements continued

23 FINANCIAL INSTRUMENTS – CONTINUED

Fair values – continued

2005	Group Carrying amount £000	Group Fair value £000	Company Carrying amount £000	Company Fair value £000
Assets				
Cash and cash equivalent	36,193	36,193	31,265	31,265
Trade and other receivables	84,275	84,275	25,592	25,592
	120,468	120,468	56,857	56,857
Liabilities				
Trade and other payables - Current	141,529	141,529	6,387	6,387
- Non-current	–	–	49,732	49,732
Finance lease liabilities - Current	471	471	471	471
- Non-current	267	267	267	267
	142,267	142,267	56,857	56,857

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.

	2006		
	Sterling amount £000	**Euro amount £000**	**Total £000**
Sterling	**–**	**984**	**984**
Other European	**–**	**90**	**90**
Total	**–**	**1,074**	**1,074**

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

Notes to the Financial Statements continued

24 ACQUISITIONS OF SUBSIDIARIES

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

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

No goodwill has arisen on the acquisition of Concept (Midlands) Limited and the intangible asset on acquisition has been attributed to the customer order book.

Notes to the Financial Statements continued

24 ACQUISITIONS OF SUBSIDIARIES – CONTINUED

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 £426,000, 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 group revenue would have been an estimated £487,302,000 and net profit would have been an estimated £28,502,000.

Effect of acquisitions
The acquisitions completed during 2005 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

25 OPERATING LEASES

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

Group

		2006			2005	
	Land and buildings £000	**Plant and machinery £000**	**Total £000**	Land and buildings £000	Plant and machinery £000	Total £000
Less than one year	**730**	**6,142**	**6,872**	1,445	5,041	6,486
Between one and five years	**2,920**	**13,560**	**16,480**	4,885	9,477	14,362
More than five years	**2,747**	**515**	**3,262**	4,212	39	4,251
	6,397	**20,217**	**26,614**	10,542	14,557	25,099

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

Company

		2006			2005	
	Land and buildings £000	**Plant and machinery £000**	**Total £000**	Land and buildings £000	Plant and machinery £000	Total £000
Less than one year	**16**	**15**	**31**	16	15	31
Between one and five years	**65**	**16**	**81**	65	31	96
More than five years	**1,292**	**–**	**1,292**	1,308	–	1,308
	1,373	**31**	**1,404**	1,389	46	1,435

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 2006, £9,757,000 was recognised as an expense in the consolidated income statement in respect of operating leases (2005: £9,076,000).

Notes to the Financial Statements continued

26 CAPITAL COMMITMENTS

Group
During the year ended 31 December 2006, the group entered into contracts to purchase property, plant and equipment for £251,000 (2005: £8,448,000). These commitments are expected to be settled in the following financial year.

Company
During the year ended 31 December 2006, the company entered into contracts to purchase property, plant and equipment for £80,000 (2005: £8,448,000). These commitments are expected to be settled in the following financial year.

27 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 2006, directors of the company and their immediate relatives controlled 1.5 per cent of the voting shares of the company (2005:1.6 per cent).

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

	2006 £000	2005 £000
Short-term employee benefits	**2,222**	1,852
Other long-term benefits	**–**	7
Share based payment	**178**	64
Total	**2,400**	1,923

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

Notes to the Financial Statements continued

27 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 2006, directors of the company and their immediate relatives control 1.5 per cent of the voting shares of the company (2005: 1.6 per cent).

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

	2006 £000	2005 £000
Short-term employee benefits	**2,222**	1,852
Other long-term benefits	**–**	7
Share based payment	**178**	64
Total	**2,400**	1,923

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

Transactions with other group companies

	Highest during the year £000	**Balance at 31 December 2006 £000**	Highest during the year £000	Balance at 31 December 2005 £000
Amounts due from subsidiaries	**23,272**	**19,839**	25,163	23,272
Amounts due to subsidiaries	**(50,587)**	**(32,170)**	(50,587)	(50,587)

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.

Notes to the Financial Statements continued

27 RELATED PARTIES - CONTINUED

Transactions reported in the income statement

	For year ended 31 December 2006 £000	For year ended 31 December 2005 £000
Rental income	**5,095**	4,752
Dividends received	**34,775**	39,911
Management charges	**2,071**	1,910
Interest income/(expense)	**48**	(1,254)
Pension recharge	**1,846**	–

28 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.

29 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 2006. 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 2006.

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 as held for sale and the realisation of the expected proceeds is based on the assumption that contracts will complete during the financial year.

Notes to the Financial Statements continued

29 ACCOUNTING ESTIMATES AND JUDGEMENTS - CONTINUED

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.

Principal Trading Subsidiaries

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

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

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

Group Financial Record

	2002 £000	2003 £000	2004 £000	2005 £000	**2006 £000**
Trading results					
Revenue	395,723	412,295	464,789	486,653	**509,899**
Operating profit before goodwill amortisation	30,362	33,514	38,924	41,498	**43,941**
Goodwill amortisation	(825)	(835)	–	–	**–**
Operating profit	29,537	32,679	38,924	41,498	**43,941**
Profit on disposal of discontinued operations	861	–	–	–	**–**
Profit before net financing costs	30,398	32,679	38,924	41,498	**43,941**
Net financing costs	(521)	(86)	(440)	(658)	**(383)**
Profit on ordinary activities before tax	29,877	32,593	38,484	40,840	**43,558**
Taxation	(9,335)	(10,464)	(11,738)	(12,352)	**(13,067)**
Profit after taxation	20,542	22,129	26,746	28,488	**30,491**
Shareholder value					
Paid dividend per share	11.40p	12.55p	13.85p	16.25p	**18.00p**
Proposed dividend per share	12.55p	13.85p	16.25p	18.00p	**20.15p**
Earnings per share*	24.4p	27.3p	31.3p	33.1p	**35.1p**
Net assets					
Non-current assets					
Property, plant and equipment	44,607	64,236	71,754	74,640	**85,032**
Intangible assets	13,767	13,210	14,046	13,210	**13,210**
Deferred tax assets	–	–	8,167	8,199	**9,182**
	58,374	77,446	93,967	96,049	**107,424**
Current assets					
Inventories	66,951	73,889	79,692	91,160	**94,217**
Trade and other receivables	67,605	72,877	85,550	84,275	**91,284**
Cash and cash equivalents	35,522	32,336	37,747	36,193	**41,861**
	170,078	179,102	202,989	211,628	**227,362**
Non-current assets classified as held for sale	6,591	1,042	203	3,471	**–**
Total assets	235,043	257,590	297,159	311,148	**334,786**
Current liabilities					
Bank overdraft	(635)	(216)	(279)	–	**(1,010)**
Other interest-bearing loans and borrowings	(3,342)	(2,328)	(1,124)	(471)	**(267)**
Trade and other payables	(123,805)	(135,209)	(142,028)	(141,529)	**(149,422)**
Employee benefits	–	–	(722)	(1,080)	**(1,481)**
Income tax payable	(7,505)	(9,625)	(11,053)	(11,139)	**(10,184)**
	(135,287)	(147,378)	(155,206)	(154,219)	**(162,364)**
Non-current liabilities					
Other interest-bearing loans and borrowings	(1,670)	(1,175)	(738)	(267)	**–**
Employee benefits	–	–	(17,643)	(19,432)	**(15,745)**
Other payables	(379)	(375)	–	–	**–**
Deferred tax liabilities	(297)	(402)	(1,212)	(1,403)	**(3,665)**
	(2,346)	(1,952)	(19,593)	(21,102)	**(19,410)**
Total liabilities	(137,633)	(149,330)	(174,799)	(175,321)	**(181,774)**
Net assets	97,410	108,260	122,360	135,827	**(153,012)**

*The earnings per share for the years 2002 to 2003 is calculated by reference to operating profit before goodwill amortisation and exceptional items.

The information relating to the years 2002 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 Friday 25 May 2007 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 2006, together with the auditors' report.

2 To declare a final dividend of 15.3 pence per ordinary share for the financial year ended 31 December 2006.

3 To re-elect as a director Graham Waldron who retires in accordance with the Articles of Association and is eligible for re-election.

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

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

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

7 That the Remuneration Report set out on pages 35 to 40 of the Report and Accounts for the year ended 31 December 2006 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 8 as an Ordinary Resolution and as to resolutions 9 and 10 as Special Resolutions:

8 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 £1,035,000, provided that such authority shall expire on 25 August 2008, 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.

Notice of Annual General Meeting continued

9 That, subject to the passing of resolution 8 as set out in the notice of this meeting, the directors be empowered pursuant to section 95 of 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 8 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 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 £217,775; and such power shall expire on 25 August 2008, 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.

10 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 Act, (in substitution of any existing authority to make market purchases) to make market purchases (as defined in section 163 of the Act) of up to 13,066,500 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 5p per Ordinary Share; and (b) the authority herein contained shall expire at the conclusion of the AGM of the company to be held in 2008 or on 25 August 2008, 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 had not expired.

By order of the board

Geoff Duggan
Company Secretary
20 March 2007

Notice of Annual General Meeting continued

Notes

1 Any member entitled to attend and vote at the AGM 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.

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 address stated on the proxy card, Proxy Processing Centre, Telford Road, Bicester, OX26 4LD, 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 25 May 2007 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 6.00p.m. on 23 May 2007 or, in the event that the meeting is adjourned, 6.00p.m. on the date two days before the date of any adjourned meeting, in order to be entitled to attend and vote at the AGM. 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.

Notice of Annual General Meeting continued

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.

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.

7 Should any shareholder with special needs wish to attend the meeting, please contact the company so that appropriate arrangements can be made.

8 Persons who are not Headlam Group plc shareholders will not be admitted to the meeting unless prior arrangements are made with the company. Investors holding Headlam Group plc shares through nominees (including PEPSs and ISAs) are welcome to attend – please contact your investment manager or bring proof of your holdings with you to the meeting.

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 enquiries
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 least two accounts. This happens when the registration details of separate transactions differ slightly. If you wish to consolidate such multiple accounts, call Capita to request the accounts are consolidated.

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

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

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

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

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

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

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