headlam group plc

Annual Report and Accounts 2012

Europe's leading **floorcovering distributor**

About Us

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

The group's operational strategy is aimed at providing its customers with a comprehensive and up to date range of competitively priced floorcovering products supported by a next day delivery service.

The implementation of this strategy provides Headlam's suppliers with an opportunity to achieve unparalleled market access backed by cost effective distribution.

In order to provide this level of service, Headlam has developed a diverse and autonomous operating structure which includes 52 businesses across the UK and a further five in continental Europe.

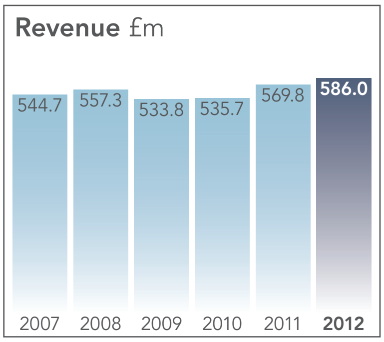
The autonomous operating structure is a key contributor to the group's success since it provides an opportunity for experienced management teams to develop the individual identity, market presence and profitability of the business for which they are responsible.

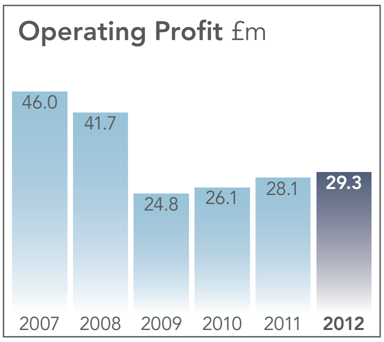
Each business is supported by the group's continuing commitment to investment in people, product, operating facilities and IT. This commitment has underpinned the group's overall development and enabled it to grow into Europe's leading floorcovering distributor.

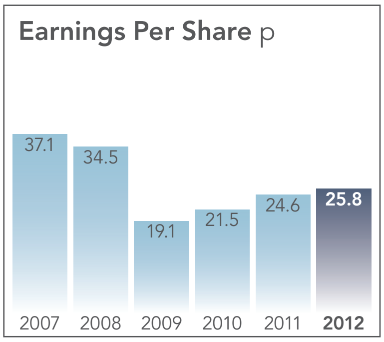
In this report

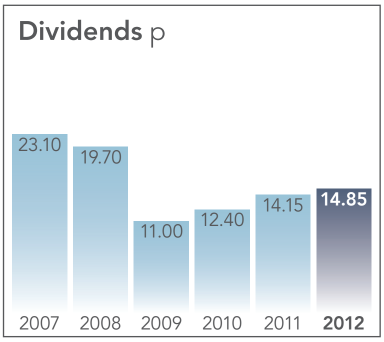
Our Performance

Financial highlights









Operational highlights

Further market share gains in the UK with like for like revenues increase by 5.3%

Continental European markets more difficult and on a like for like basis, revenues decline by 3.3%

Construction commenced on the enlargement of the Coleshill distribution centre. The first phase will be ready for handover in March 2013 and the total project will be completed by January 2014

The group is investing in external training programmes to further develop the management, motivation and selling skills of its management teams and sales representatives

The sophistication of the customer relationship management system used on the iPad continues to evolve and improve and the enhancements introduced during 2012 will be augmented by further features in 2013

Revenue £m

£586.0 2011: £569.8

Operating Profit £m

£29.3 2011: £28.1

Earnings Per Share p

25.8 2011: 24.6

Dividends p

14.85 2011: 14.15

For further detail on our business please visit:
www.headlam.com

Clear Business Model and Strategy

generating revenue for the long term

Headlam distributes a wide range of products, sourced from a variety of floorcovering suppliers around the globe, to its customer base who, in the main, are independent floorcovering retailers and contractors. In fulfilling this role, Headlam forms an essential link that enables suppliers of floorcovering products to gain extensive access to a number of markets located in Western Europe.

Headlam operates through a number of individual and diverse businesses located in the UK, France, Switzerland and the Netherlands. Each business has its own trading identity and is operated on an autonomous basis by a local management team, who are empowered with the responsibility for developing their businesses' market presence and profitability.

This decentralised approach, set within a well developed and consistently applied framework of operational and financial control, provides a broad access to floorcovering markets allowing the group to manage the risks inherent in challenging trading environments and react swiftly to emerging market opportunities.

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

The group's strategy remains focused on the development of its floorcovering distribution businesses in the UK and continental Europe and the continued improvement of the services provided to independent floorcovering retailers and contractors. The group's operations are based upon a well defined operating structure that delivers sustained product development and marketing and distribution services aimed at supporting and enhancing its customers' market position.

The group's structure, built upon over many years, has allowed the group to continually outperform the floorcovering market through various economic cycles, which has been very evident in recent years when conditions have proved to be particularly challenging and during which time the group has maintained its **ability to increase its market share.**

Supply chain (see page 22)...

Executed simply and effectively…

1 Ordering

Serving a large number of customers, the majority of whom are independent retailers and floorcovering retailers.

For more detail see page 4

2 Selection

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

For more detail see page 6

3 Processing

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

For more detail see page 8

4 Deliveries

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

For more detail see page 10

Clear Business Model and Strategy continued

1 Ordering

The group serves a large number of customers the majority of which are independent retailers and floorcovering contractors.

All of our sales force use iPads with a bespoke CRM system as an app.

Orders placed in the UK

3,973,351

2011: 3,877,835

Active customer accounts in the UK

44,086

2011: 43,347

Fast, efficient service

Each of the businesses utilise an internal sales team who form the initial contact point for customers wanting to place their orders. The internal sales team ensure that our customer's requirements are properly recorded for subsequent processing.

Clear Business Model and Strategy continued

Reliable order tracking

The distribution centres maintain substantial investment in products to ensure that customers' orders are swiftly processed and their delivery expectations fully satisfied. At the end of 2012 our inventory was valued at £115.3 million compared with £114.2 million for 2011.

2 Selection

The group has invested in 18 distribution centres across the UK and four on the continent.

UK warehouse capacity

53.5 million ft^3

2011: 52 million ft^3

Clear Business Model and Strategy continued

Efficient materials processing

Bar code labelling and scanning equipment enable us to use a system of random location, which maximises the capacity of the distribution centres.

3
Processing

Whilst the scale of our inventory investment enables us to support customers' requirements, we would not be able to achieve the high levels of service if we did not employ reliable and accurate tracking systems. These systems facilitate the location and retrieval of individual product lines on an efficient and consistent basis.

UK cut length processing per week

35,322

2011: 34,328

Clear Business Model and Strategy continued

4 Deliveries

Virtually all our deliveries to customers are made on group vehicles.

UK deliveries during 2012

1,170,219

2011: 1,143,860

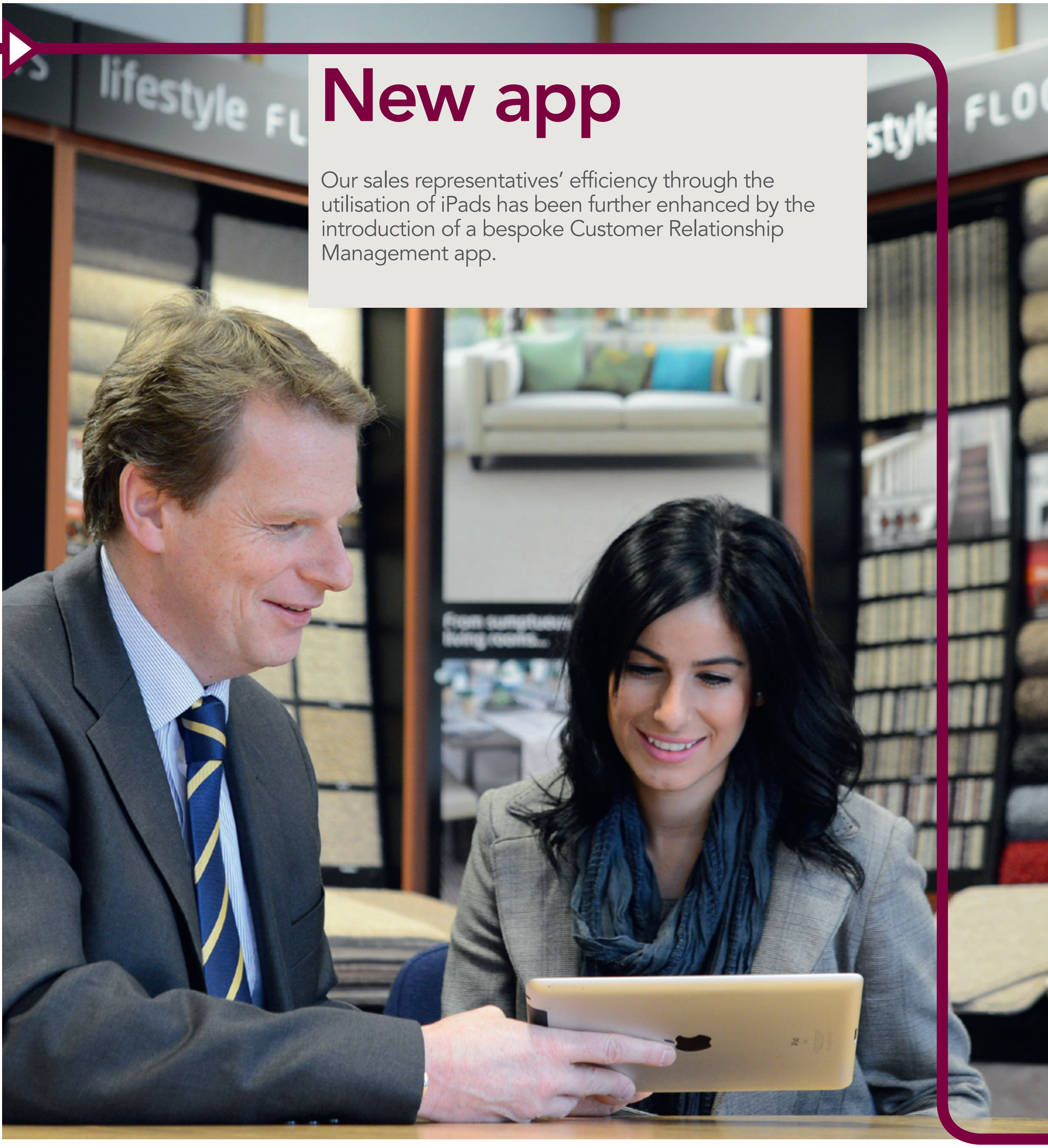
Next day deliveries

The fleet is completely updated over a five year period in order to maintain a constant improvement in operating efficiency and reduced operating costs and vehicle emissions.

Strongly Developing our Marketplace

New app

Our sales representatives' efficiency through the utilisation of iPads has been further enhanced by the introduction of a bespoke Customer Relationship Management app.



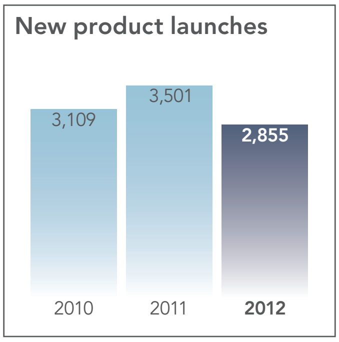
Our external sales representatives are positioning new product with customers on a daily basis.

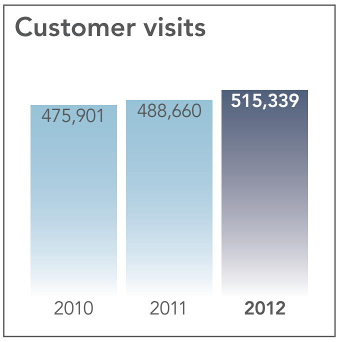
The bespoke Customer Relationship Management app, ("CRM"), facilitates constant and immediate access to customer data. Therefore, the representatives' objectives can be fully prepared prior to making a customer visit and, following the visit, they can record their achievements and note topics requiring future consideration. In addition, the CRM provides instant communication to the representatives' sales manager and internal sales support.

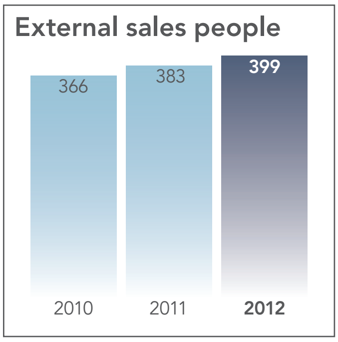
The iPad also allows representatives to view stock and place orders on the mainstream operating system at any time. Furthermore, the iPad contains all the required marketing and point of sale material for presentation to customers.

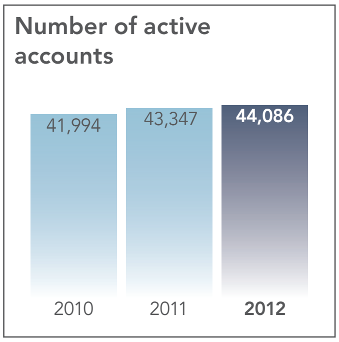
The iPad, incorporating the CRM, has streamlined the representatives' working practices, time management and efficiency and has ultimately enabled them to provide an improved service to our customers.

Each of these features within the iPad is intended to maximise the performance of our representatives and allow them to achieve their daily and monthly objectives.









Our Market Presence

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

Our Regional and National Multi-product businesses provide a comprehensive residential and commercial product range and extensive geographical coverage.

The Regional commercial businesses focus on strong relationships with suppliers and a high level of localised service for their customers.

Our Residential specialist businesses supply medium to premium residential carpet on a national basis and the Commercial specialist businesses, which have a national presence, provide a range of products servicing various aspects of the commercial market.

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

Regional Multi-product Distribution

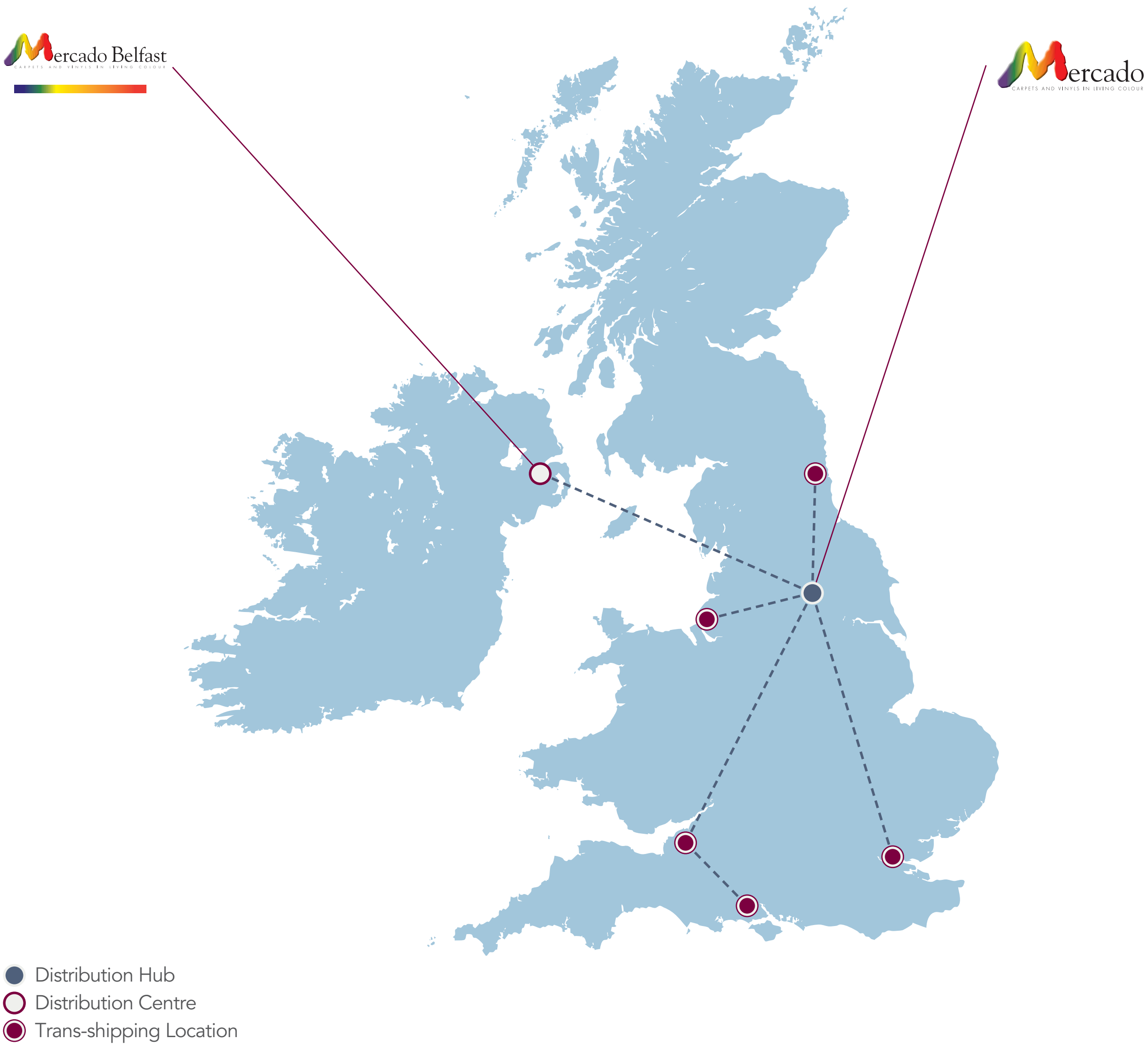
These 21 businesses, operating in both the residential and commercial markets, collectively provide a comprehensive national coverage.

1

Our Market Presence continued

National Multi-product Distribution

Operating principally under the Mercado trade brand, these businesses offer a national service for residential and commercial floorcovering throughout England, Wales and Northern Ireland.



Regional Commercial Distribution

Our Regional Commercial Distribution currently includes 23 operations based in 5 distribution and 18 service centres.

3

Our Market Presence continued

4

National Residential Specialist Products

These 14 businesses operate principally in the middle to premium quality carpet market.

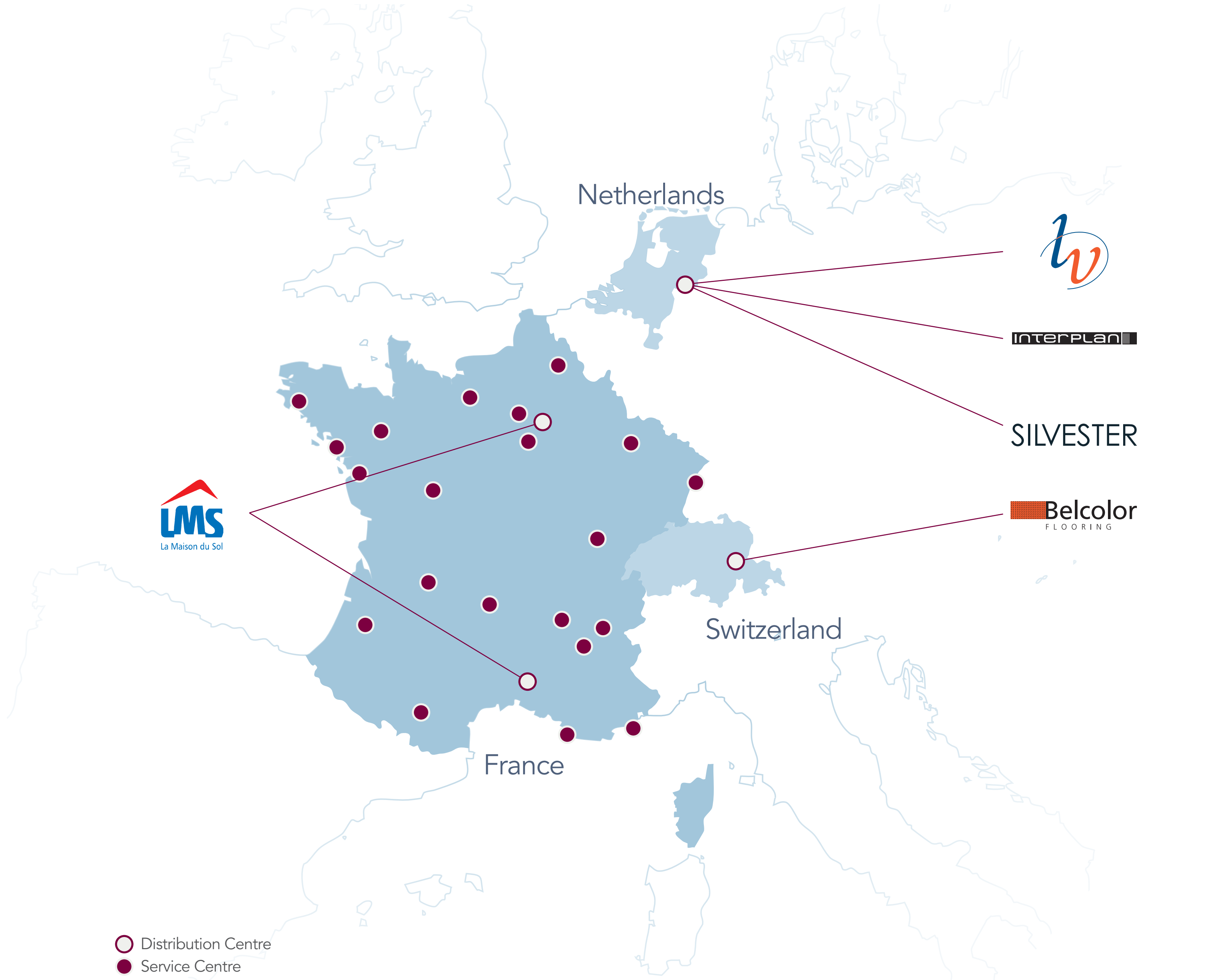
National Commercial Specialist Products

These two businesses operate throughout the commercial markets but have a primary focus in the healthcare and education sectors.

5

European Multi-product Distribution

Our continental European operations incorporate five businesses. In the Netherlands our three businesses are located in one distribution centre. In France our single business operates from two distribution centres and 21 service centres and our business in Switzerland operates from one distribution centre.



Chairman's Statement

"We enter 2013 with the confidence that the various initiatives implemented across our businesses will deliver performance improvement"

I am pleased to report that the group has achieved another year of progress with revenue and profit showing improvement on 2011. This was despite the very challenging market conditions that continued to persist throughout the 12 months and which, whilst difficult in the UK, were far more acute in some of the group's continental markets.

However, notwithstanding market constraint, various indicators would suggest that we have continued to achieve further gains in market share.

Overview

The fact that the group has continued to outperform in these difficult markets suggests that our long term operational strategy is delivering the right results, albeit, at a slightly slower pace than we anticipated.

The board remains convinced that our structure and business diversity are still appropriate but recognises, that during periods of severe market constraint, it is difficult to achieve optimal performance. However, when markets resume growth, the group will be in a prime position to capitalise and take advantage of the upturn as a result of retaining its structure.

During the year we maintained our investment activities in a number of areas across the business to improve our quality and market position. These include comprehensive marketing initiatives such as Lifestyle Floors, the continuing optimisation of our Customer Relationship Management system to improve our customer service offering and the extensive introduction of further training programmes to elevate the knowledge and professionalism of our managers and employees.

Each of these investments, in conjunction with the extension of our geographical reach through the opening of further service centres in the UK, are all intended to maintain and extend the group's position as the leading floorcovering distributor in Europe.

Dividend (p)

14.85

2011: 14.15

Earnings and dividend

Profit before tax increased by 3.2% from £27.6 million to £28.5 million and earnings per share improved by 4.9% from 24.6p to 25.8p. The board is proposing to increase the final dividend by 3.6% from 9.85p to 10.20p resulting in a total dividend for the year of 14.85p, up 4.9% on 2011. The final dividend, if approved by shareholders at the Annual General Meeting ("AGM"), will be paid on 1 July 2013 to shareholders on the register at close of business on 7 June 2013.

Employees

The board would like to thank all employees for their efforts and contribution to the ongoing success of the group. It is due to the endeavours of our management teams and employees that we manage to maintain our forward momentum.

Headlam's business is based on lasting relationships with customers and suppliers. It is a cornerstone of the group's business ethos, without which it would be impossible to deliver progress. The hard work and commitment from our teams around the group are focused on strengthening these relationships and building for the future.

Board and governance

Excellent governance has its foundation in an effective board. At Headlam, we seek to foster a culture of openness and transparency in an environment which encourages participation and contribution from all of the board members. Strong governance creates high standards and in turn creates confidence amongst our investors, management, employees, suppliers and customers.

Outlook

Floorcovering markets remain very challenging and the attendant uncertainty is reducing trading visibility for the immediate future. However, we enter 2013 with the confidence that the various initiatives implemented across our businesses will deliver performance improvements, particularly when assisted by more buoyant markets, and the group's long term business strategy will ultimately enable us to achieve further progress.

Graham Waldron
Chairman
8 March 2013

Chief Executive's Review

"The collaborative effort that exists between our senior and individual management teams and suppliers, is aimed at ensuring that our businesses remain at the forefront of all new products introduced into our particular markets."

Strategy

Maintaining a clear focus on the continuing development of our floorcovering business in the UK and continental Europe is a fundamental component of the group's long term operating strategy. It's the board's current intention that any future investments or acquisitions will continue to be for the purpose of enlarging and improving our floorcovering distribution businesses.

Our business structure, particularly in the UK, reaches a substantial proportion of the floorcovering market and provides a distribution channel for suppliers, whether UK, European or worldwide, requiring the sales, marketing and distribution of their products into the markets we serve. This allows a wide range of appropriate products to be available through a number of our businesses into the retail and commercial sectors.

Operating our businesses on an autonomous basis, and encouraging our managers to develop their own individual style, has enabled the group to be active in a significant proportion of the floorcovering market and provided a degree of protection against the downside risk arising from particularly competitive markets. Furthermore, the investment in our structure and development of our businesses has enabled us to bring together the benefits of market facing culture, delivering the latest sales and marketing product initiatives with a comprehensive and sophisticated logistics operation.

This strategy has formed the foundation that has permitted the group to outperform the overall market during the challenging environment of the last few years.

Market sectors

Following the acquisition of Flooring Accessories, which is located in Cardiff and C.K. Davie, located in Aberdeen and Dundee, the group now has 52 businesses in the UK. Each of the businesses, depending on their product offering and geographical presence, are positioned in one of five market sectors, which are; *regional multi-product, national multi-product, regional commercial, residential specialist* and *commercial specialist.*

These businesses are supported by 18 distribution centres and 23 service centres, which provide a comprehensive stockholding and logistics service to their relevant customers.

Relationship and supply chain

A key ingredient of the group's ongoing success is its strong relationships with suppliers, which have developed over many years, at both senior level and within each of our operating businesses.

Domotex, the principal worldwide flooring exhibition, which takes place in Germany during January, represents an excellent opportunity and venue for the management of Headlam's

New product launches

2,855

2011: 3,501

businesses to meet with the majority of their suppliers to review and order new products. It is also an ideal time for the businesses to discuss their business plans and objectives with suppliers for the year ahead.

The collaborative effort that exists between our senior and individual management teams and suppliers, is aimed at ensuring that our businesses remain at the forefront of all new products introduced into our particular markets. This has resulted in 2,855 new product launches during the year, which were supported by 625,114 point of sale items being positioned with our customers.

Despite particularly challenging market conditions, these new products and point of sale items have contributed to the revenue from our residential and commercial product categories increasing against the corresponding period in 2011. Overall, the mix between residential and commercial flooring in the UK has remained broadly the same compared with 2011 at respectively 69% and 31%.

Lifestyle Floors is now very much established as a trade brand within the floorcovering industry and has been important to the revenue growth through our regional and national multi-product businesses. We will continue to build on this market presence and further strengthen our position. As part of this initiative, we have invested in 16 merchandisers to support the brand's display stands within independent flooring retailers.

Customers

Although markets remain challenging, our customers continue to perform positively, as reflected in the group's overall increase in revenue. Credit taken by UK customers at 41.3 days, (2011: 40.9), demonstrates that they continue to pay us to terms. The cost of bad debts decreased compared with last year.

During the year, our sales representatives collectively visited our customers 515,339 times, (2011: 488,660), ensuring that we are able to cater for our customers' needs. This direct contact with our customers is supported by the service provided by our telesales people, a comprehensive stockholding and a logistics service which allows orders taken up until 16:00 to be delivered to the customer's premises the following working day. During 2012, we received 3,973,351 orders (2011: 3,877,835) and increased the number of active accounts from 43,347 to 44,086.

Continental Europe

Our businesses in continental Europe have experienced particularly difficult market conditions again during 2012. Notwithstanding these challenges, LMS in France and Lethem Vergeer in the Netherlands achieved creditable results, whilst Belcolor in Switzerland delivered a satisfactory performance.

Chief Executive's Review continued

Coleshill total capacity by January 2014

283,800sq. ft.

Management and employees

Of key importance to the ongoing success of the group are the individual management teams of the autonomous businesses. These teams operate their business on a day-to-day basis and have primary responsibility for maintaining their relationships with suppliers and customers.

To further improve the effectiveness of management teams, we are in the process of undertaking external training programmes to develop their management, motivation and selling skills. This process is also intended to improve the productivity and selling techniques of our sales representatives. We believe this can be an on-going investment, which will assist in developing the careers of individuals to the benefit of the group as a whole.

Investments

The group made two investments with the acquisition of Flooring Accessories Limited in August and the business and certain assets of C.K. Davie in December, to enlarge our presence in South Wales and the north east of Scotland respectively.

The group announced on Friday 22 February, that it had entered into an agreement to acquire the business and certain assets of Hall's Floorings Limited, with completion anticipated to occur on Thursday 28 March 2013. Hall's Floorings, a distributor of residential floorcovering based in Edmonton, north London, is a supplier to independent floorcovering retailers throughout most of England.

We will continue to evaluate similar opportunities to enlarge and complement the group's geographical or product coverage.

We have now completed the extension to the Tamworth distribution centre. The entire 160,200 square feet site is now fully operational and will allow our Residential and Commercial specialist businesses to further develop their activities in the middle to higher market sectors they serve.

Construction has commenced to significantly enlarge the Coleshill distribution centre. The first phase will be ready for handover in March 2013 and the total project will be completed by January 2014, giving Coleshill a total capacity of 283,800 square feet. The increased capacity will enable us to extend our product offering.

The protracted discussions with regard to the planned investment in Ipswich continue, where we are still waiting for the current landowner and local authority to conclude their negotiations.

During 2012, the group invested in additional service centres in Middlesbrough, Liverpool, Sheffield and Coventry and we have recently concluded an agreement to open a service centre in Trafford Park, Manchester. During 2013, it is our intention to carefully increase the number of service centres in strategic geographical locations, to enlarge our commercial presence.

"The iPad, launched to our sales teams in 2011, continues to contribute to improved working practices and enhanced customer information."

For further detail on our business please visit:

www.headlam.com

Innovations

The iPad, launched to our sales teams in 2011, continues to contribute to improved working practices and enhanced customer information. The device allows each of our sales people to be fully prepared before making their visits and as productive as possible whilst engaging with their customer. The sophistication of the Customer Relationship Management system used on the iPad will continue to evolve and improve, with the enhancements introduced during 2012 being augmented by further features planned for 2013.

Another example how the group has taken advantage of new technology is the utilisation of the iPad within our distribution centres, where it is used to improve the efficiency of the picking process for palletised goods such as carpet tiles, laminate and adhesives.

The group will continue to monitor developments in technology to ensure that whenever appropriate, investments will be made to keep us at the forefront of sales and marketing techniques, along with streamlined logistics.

Outlook

The continued challenging market conditions combined with unfavourable weather has culminated in a slightly disappointing start to 2013.

Notwithstanding this, the board are confident that the operating strategy and group structure will enable the business to continue to deliver progress in its respective markets over the longer term.

Tony Brewer
Chief Executive
8 March 2013

Financial Review

Revenue and operating profit

Group revenue increased during the year by 2.8% from £569.8 million to £586.0 million. Underlying like for like revenue in the UK increased by 5.3%, whilst the collective like for like performance from the continental European businesses declined by 3.3%.

The group's gross margin was lower during the year compared with the previous year declining to 30.0% compared with 30.8%. A change in product mix and an increasingly intensive competitive environment in the UK contributed to this reduction.

Overheads reduced during the year by £1.3 million, down to £146.4 million compared with £147.7 million in the previous year. As a percentage of revenue, overheads were 25.0% compared with 25.9%.

Operating profit margin improved to 5.0% compared with 4.9% since the dilution in gross margin was compensated for by the reduction in overheads. Operating profit improved by 4.5% on the previous year increasing from £28.1 million to £29.3 million.

Looking forward, the group's operating profit margin should start to register further improvement when floorcovering markets, particularly in the UK, resume growth. Whilst the cost of retaining the group's existing structure has had a diluting impact on profit margin, it has enabled the group to increase its market share and will allow an immediate response to any upturn in market activity.

Net finance costs

Net finance costs increased during the year by £0.4 million compared with 2011, the principal contributors being net bank interest, £0.18 million and £0.26 million attributable to the movement in the cash flow and interest rate hedges.

Taxation

The effective rate of taxation reduced to 24.9% during the year, reflecting the decrease in UK headline corporation tax rate and also the further future reduction already enacted, which impacts upon deferred taxation. The anticipated effective rate for 2013 is expected to reduce to 23.75% due to further UK rate reductions which have been announced but are not yet enacted.

Earnings per share

Basic earnings per share increased by 4.9% from 24.6 pence to 25.8 pence and diluted earnings increased by 5.3%, up from 24.4 pence to 25.7 pence.

Dividends

Total dividends paid and proposed for 2012 have increased by 4.9% from 14.15 pence to 14.85 pence. Dividend cover at 1.7 is broadly consistent with where it has remained in recent years and represents a cover ratio which the board anticipates maintaining for the foreseeable future.

Cash flows

Net cash flow from operating activities

Net cash flow from operating activities increased during the year by £15.9 million from £10.1 million to £26.0 million.

Operating cash flows before changes in working capital and other payables accounted for £1.3 million of the overall increase with the principal contribution coming from the improvement in profit before tax of £0.9 million.

The net investment in working capital reduced by £2.2 million during the year compared with an increase in net investment during the previous year of £12.9 million. Inventory was broadly stable during the year with further investment restricted to £0.5 million and was the main cause behind the modest cash outflow, £0.8 million, relating to trade and other payables. Cash collection during the final quarter of the year in connection with trade and other receivables was particularly impressive resulting in a cash inflow of £3.5 million.
The change in net working capital investment during 2012 compared with 2011 was the main reason for cash generated from operations increasing from £20.9 million to £37.3 million.

The final components in the movement of net cash flow from operating activities are cash payments covering interest, tax and additional pension liabilities. During the year these increased by £0.5 million from £10.8 million to £11.3 million.

Net debt

	At 1 January 2012 £000	Cash flows £000	Non-cash movement £000	Foreign exchange translation £000	At 31 December 2012 £000
Cash at bank and in hand	41,494	**8,476**	–	(172)	**49,798**
Debt due within one year	(30,219)	–	**30,000**	6	**(213)**
Debt due after one year	(3,691)	**213**	**(30,000)**	107	**(33,371)**
	7,584	**8,689**	–	(59)	**16,214**

Funding

Maturity date	Drawn £000	Undrawn £000	Total facility £000
Less than one year	**212**	**43,294**	**43,506**
Over one year and less than five years	**30,636**	**10,000**	**40,636**
Over five and less than seven years	**2,736**	–	**2,736**
	33,584	**53,294**	**86,878**

Cash flows from investing and financing activities

The acquisition of property, plant and equipment amounted to £8.0 million with work on the Tamworth extension completed and work on the development of the Coleshill extension initiated.

The acquisition of Flooring Accessories and C.K. Davie gave rise to a further outflow of £0.8 million. These investments were offset by cash received on the sale of two properties of £1.5 million, and interest received of £0.8 million.

Cash outflows from financing activities amounted to £11.0 million compared with £12.1 million for the previous year with the main differences being an increase in dividends of £1.4 million, the absence of share purchases in 2012, which in 2011 amounted to £1.6 million, and the proceeds of £0.9 million on the release of shares from treasury, which were primarily used to support the SAYE awards exercised during the year.

Net debt

Group net funds at the end of the year increased on the previous year by £8.6 million from £7.6 million to £16.2 million as detailed in the table above.

Funding

The group maintains sufficient banking facilities to fund its operations and investments. As illustrated above, at 31 December 2012, 61.3% of the group's facilities were not being utilised.

During March 2012, the group entered into agreements with Barclays Bank and The Royal Bank of Scotland whereby each bank provided a £20.0 million facility with a four year term ending March 2016. Both banks have now agreed to the extension of these facilities for a further 12 months to March 2017.

Employee benefits

As at 31 December 2012, the group's net pension liabilities totalled £17.4 million increasing by £2.9 million on the previous year. The main factor contributing to the increase in the deficit is the 0.5% per annum fall in the discount rate. However, the full impact of the fall has been offset by a slight reduction in expected inflation, better than expected investment returns and the continued payment of additional deficit reduction contributions.

The company has continued to pay additional contributions into the UK plan, as per its agreement with the trustee. The additional deficit reduction contributions amounted to £2.7 million during the year and are expected to rise to £2.8 million for 2013.

Going concern

Having reviewed the group's resources and a range of likely out-turns, the directors believe they have reasonable grounds for stating that the group has adequate resources to continue in operational existence for the foreseeable future and that it is appropriate to adopt the going concern basis in preparing the group's financial accounts.

Steve Wilson

Group Finance Director

8 March 2013

Measuring our Performance

The group uses the following indicators to assist in determining if it is progressing towards its long term strategic objectives.

1

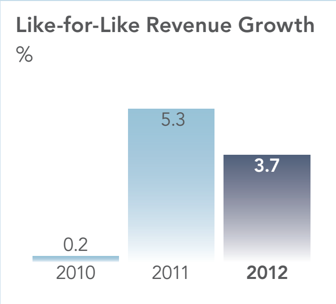
Like for Like Revenue Growth

Measurement

- Like for like revenue growth measures changes in revenue in the current year compared with the previous year. It excludes the effects of acquisitions and the movement in working days and currency.

Why

- The group targets an increase in like for like revenue above anticipated market growth with the objective of maintaining growth in market share.



2

Gross Profit Margin

Measurement

- The ratio of gross profit to revenue.

Why

- Gross profit margin is a primary indicator of business performance and market competitiveness. A movement in gross margin generally reflects a change in the business product mix or market pricing or a combination of both.

3

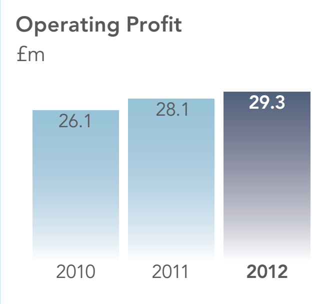
Operating Profit

Measurement

- Operating profit is determined by adding back finance, income and expense to profit before tax.

Why

- The majority of the group's operating costs are fixed and the group therefore obtains a substantial benefit from operational gearing as revenues increase.



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Earnings Per Share

Measurement

- Earnings per share, ("EPS") is calculated by reference to post tax profit divided by the weighted average number of issued shares during the year.

Why

- EPS and EPS growth are widely used measures of company performance. EPS growth forms the basis of the group's current dividend policy since the board anticipates dividend growth to be broadly in line with the growth in EPS.

5

Return on Capital Employed

Measurement

- Return on capital employed is derived from operating profit divided by the simple average of the net assets plus average debt at the start and end of the year.

Why

- Return on capital employed provides an indication of whether the group's performance is creating value for its shareholders.

6

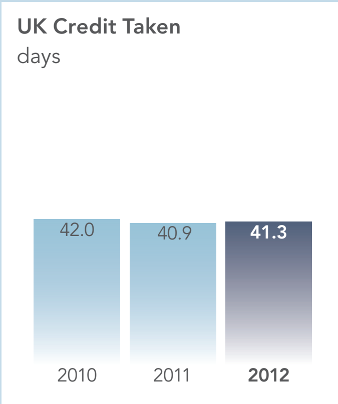
Credit Taken by UK Customers and Bad Debt Percentage

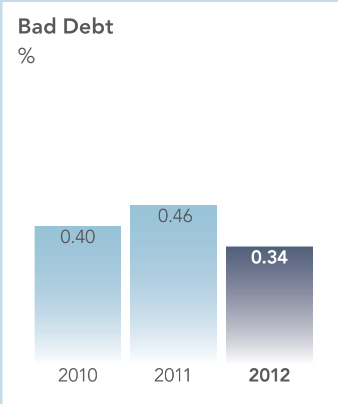
Measurement

- Credit taken is calculated by reference to trade receivables net of impairment provisions expressed as a proportion of current and prior months revenue inclusive of VAT. Bad debts are calculated by expressing the annual impairment loss as a percentage of revenue.

Why

- These two indicators provide an accurate representation of the independent customer's financial health.





Managing our Risk

The group's business, results and financial condition are influenced by a range of risks and uncertainties, a number of which remain beyond the control of the board. The board reviews key risks and controls and, whilst the following highlights some of the key risks, it is not intended to provide an exhaustive analysis of the risks affecting the business.

Area of Risk	Description	Potential Impact	Mitigation
Market demand	A significant proportion of the group's revenue is due to trade with 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 building projects.	Periods of recession that create reduced consumer confidence or contraction in the construction industry and changes in trends and preferences all have the potential to affect market activity and demand for products supplied by the group.	Market activity is monitored daily in each individual business and collectively at group. This visibility allows prompt response to factors adversely affecting trading. Furthermore, since the group's principal activities are supply and distribution, the group has the ability to quickly react to market changes. In addition, the development of a range of regional, national and specialist businesses provides the group with broad market penetration and protection against market contractions.
Competitor risk	The group operates across four geographical markets each of which has similar trading characteristics. Within each market, the group competes directly with a variety of regional and national distributors and manufacturers selling directly to its customer base and indirectly with multiple retail chains.	The emergence of a competitor with a strong business model could undermine the group's growth objectives.	The group seeks to sustain its competitive position by maintaining close relationships with its supplier and customer base. Substantial and continued investment in management and facilities, an extensive product offering, a knowledgeable selling resource, stock availability, IT, efficient material handling and logistics enables the group to continue to improve its market position.
Credit risk	The group trades with a substantial number of its customers on open credit terms and is, therefore, exposed to an ever present risk of certain customers failing to settle their outstanding accounts.	A rise in the number and value of customer defaults can undermine the group's ability to deliver an ongoing improvement in earnings.	The group has standardised credit checking and debt collection procedures in each individual business and a well developed intelligence network that seeks to prevent the escalation of credit risk. Accounts are subject to credit terms and limits and the group's businesses are required to obtain central approval for credit limits that exceed a predefined threshold. The procedures, combined with the local knowledge of the credit control teams, not only help contain the risk of default, but also provide opportunities for customers to trade out of their default position.

Area of Risk	Description	Potential Impact	Mitigation
Technology	The software platform is a vital component of the group's operating strategy underpinning the delivery of operational objectives and providing the framework for the maintenance of financial control.	Given its importance, any prolonged system failure has the potential to adversely affect business performance.	Each business has its own dedicated hardware 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.
People	The group's ability to deliver continued success is very dependent upon its people.	An inadequate pool of suitably qualified and talented people can disrupt business development and undermine the group's ability to deliver sustainable growth.	Recruitment, training and development are aimed at ensuring the group has suitably skilled and qualified people to meet the current and future operational needs of its businesses. Furthermore, the group is committed to creating opportunities for individuals to progress their careers.
Employee benefits	There are ongoing risks that could result in the costs associated with funding the group's defined benefit plans increasing due to a decline in investment returns, movement in interest rates and longer life expectancy.	An increasing deficit in the plans could result in the group having to increase financial support thereby reducing its ability to fund operational investment.	As a result of the triennial actuarial valuation of the UK plan undertaken at 31 March 2011, the group agreed to maintain its deficit reduction contributions until December 2015, at which point the plan deficit should have been removed. The outcome from future scheme valuations, the next being 31 March 2014, could result in the deficit reduction contributions increasing or decreasing.
Legislation and regulation	The group's operations are regulated by a variety of laws and regulations, the principal ones relating to health and safety, the environment, employment, commerce, corporate, financial reporting and taxation.	Failure to comply could lead to serious civil or criminal proceedings causing disruption to the group's operations, financial loss and reputational damage.	The group manages its obligations through a framework of set policies and procedures and, where appropriate, engages the services of competent third party advisers.

Managing Responsibility

1

We are committed to managing the business in a socially responsible way with the aim of consistently improving the social, environmental and economic issues within our control or influence throughout the business and our supply network. We also recognise that the proper management of such matters makes good business sense and can result in strategic, commercial and reputational benefits.

Policy

Our policy towards Corporate Social Responsibility ("CSR") is subject to periodic review to ensure that it continues to meet the needs of the markets and communities in which we operate. In recognising the importance of CSR issues, we seek to encourage and facilitate positive management behaviour in alignment with the group's business strategy. This includes the morale and welfare of our employees, the satisfaction of our customers and our impact on the environment.

Social and environmental factors are considered by individual businesses and at a group level. We manage relationships with stakeholders and communicate with them through a variety of channels. These include the AGM, annual and interim reporting and announcements through a regulatory news service for matters relating to trading and the development of the business, all of which are available on our website at www.headlam.com. Additionally, in order to assist with their understanding of the business and to ensure that the board is aware of their views and concerns, meetings are held with our major institutional shareholders.

People

Equal opportunities

Our policy is that all employees should have access to employment opportunities, irrespective of age, gender, ethnic origin, religion or disability. Consideration is given to applications for employment, having due regard to the particular aptitudes and abilities of the applicants and to our responsibilities under the Disability Discrimination Act. Where practicable, subject to the nature of our activities, employees who develop a disability during employment are given the opportunity to retrain for alternative employment. Our recruitment, training and development processes are designed to ensure that we have suitably skilled and qualified employees to meet the operational needs of the business. We also participate in work experience

2

placement schemes. We are committed to developing the potential of our people, offering opportunities for employees to develop and grow and periodically reviewing succession planning processes. Employee turnover remains low resulting in a stable employee base.

Communications

The continued success of our business relies on good relations and communications with employees and on the provision of a safe and environmentally sound workplace, which complies with applicable laws and regulations, so providing an environment in which people can flourish and succeed. Our employees' wellbeing and professional development is a key element to recruiting and retaining high performing individuals. Our people seek to deliver their best for the business, which, combined with a fair and responsible way of doing business, generates a common ambition to add value. We expect employees to respect confidential information, company time and assets and believe in open and honest communication, fair treatment and equal opportunities, all of which support the fundamental principles of good governance.

We encourage the involvement and participation of employees in matters that affect their interests through formal and informal meetings and value their communication with management, both senior and at the business unit. Employees continue to be informed on matters affecting them and on the various factors affecting the performance of the group. Eligible employees are able to benefit from the group's performance through participation in share schemes, including a savings related share scheme. Considering it important for its employees to make provision for their retirement, the group offers opportunities for participation in retirement plans, also providing death in service benefits through a group life assurance scheme.

Training

Employees are encouraged to take advantage of our training and development opportunities, which is an important part of our strategy for success. Training is delivered through internal resources, a significant proportion of which is on a one to one basis, and external providers. In 2013, we have introduced a bespoke training programme for our managers and sales representatives. Utilising the services of an external trainer, continuing professional competence training for commercial vehicle drivers was undertaken during the year with further training scheduled for 2013.

We require our employees to act ethically and responsibly in accordance with the policies and procedures within our employment handbook, which covers our policies on ethics, bribery, fraud and whistleblowing.

Managing Responsibility continued

3

Health and safety

The health and safety of employees and individuals likely to be affected by our business, including contractors, customers, staff and members of the public where appropriate is treated with the utmost importance. We are committed to developing and maintaining a positive and effective health and safety culture. It is our policy to seek to ensure that the group's operations are carried out at all times in compliance with the relevant health and safety guidance in the jurisdictions in which we operate.

Our health and safety policy, which is endorsed by the board, is tailored to each of our business operations and the circumstances in which they operate. It is amended to reflect changes in procedures and processes and any modifications to our control and inspection procedures. The board receives a detailed presentation on health and safety issues, covering each trading location, on an annual basis, with interim updates as considered necessary. These include comments on improvements following inspections of the UK businesses undertaken by our advisors. Each of the UK businesses receives an updated bespoke comprehensive health and safety manual for use as a source of information, guidance and training together with a set of compliance documentation at least once a year. Each of our businesses has a health and safety committee comprising representatives from the various business departments. These meet on a periodic basis and are co-ordinated by the on site health and safety manager. Management teams are encouraged to create a supportive health and safety culture and recognise the value of employee participation. The report to the board includes our businesses in Europe, which operate in accordance with the health and safety legislation and inspection practices in their respective countries.

Inspections undertaken by our third party adviser form the basis on which we determine our standards and are continually reviewed and improved. Additional inspections are undertaken where changes to operations have occurred or new premises occupied. These are complemented by annual inspections of racking systems carried out by independent externally appointed assessors and in the UK, risk inspections undertaken by our insurers at several of our businesses.

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Health and safety is an important part of employee induction, at which time we ensure that all employees are aware of our policies and of the commitment that is expected of them towards their safety. Managers, to whom the day to day responsibility for health and safety is delegated and who are best placed to monitor and control safety, are guided and supported by our third party advisors in risk assessment techniques. Job specific training, including periodic refresher training, is supported by good practice guides which set out the important features associated with many aspects of the roles and duties undertaken by employees. Good practice guides are reviewed annually to ensure they remain relevant to the business, they include an awareness of impending changes in relevant legislation and other specialist subjects. The local business manager with responsibility for health and safety has completed the Institute of Occupational Safety and Health Managing Safely Course.

Our businesses maintain good relationships with health and safety and environmental health regulators with positive and prompt responses to any findings or observations following compliance inspections. All reportable accidents are investigated and in the minority of instances where improvement is required, changes are implemented in a timely manner. There were no prosecutions for breaches of health and safety or enforcement actions in the year.

Containment and inspection regimes in higher risk areas such as fuel and lubrication stores, compressors and fork lift truck battery charging areas, are kept under review; fire risk protection having been improved, training and awareness increased and special containers sited at least five metres from the main buildings for the storage of flammable products.

Environmental

As a wholesale distributor of floorcoverings operating from distribution facilities in the UK, France, Switzerland and the Netherlands, we are not a significant consumer of electricity, gas or water. Electricity consumption is predominantly in respect of fork lift truck battery charging, the operation of specialist cutting tables used to cut lengths from full and part rolls of broadloom products, associated mechanical handling and compressed air equipment, office and warehouse lighting and office equipment. Gas is consumed predominantly in respect of office heating and very limited localised radiant heating above work stations on the cutting tables located within the distribution centre. Water consumption is limited to employee welfare and commercial vehicle washing, where some machines filter and recycle wash water. The majority of our water charges are in respect of fixed water rates relating to rain water discharge from our business locations.

Managing Responsibility continued

We seek to reduce charges by analysing invoices received in respect of water through the installation of water meters and by reducing consumption of electricity, gas and water through repair, renewal or installation of equipment to improve efficiency. Modern and energy efficient construction techniques and products are incorporated when we invest in new facilities or undertake refurbishment or repair works. During the year, we installed intelligent lighting into two of our largest distribution facilities, which is both more efficient and movement sensitive, automatically switching off during periods of inactivity. Future projects will similarly incorporate intelligent lighting systems and where practical, renewable energy solutions. During 2013 we will be installing automated meter reading in respect of sites with non-half hourly electricity meters, the benefit over time being improved consumption management.

The actual cost of electricity, gas and water in 2012 amounted to 0.20% of revenue, which was very much in line with the prior year.

Owing to the nature of our business and with our proactive approach when planning and developing new facilities, we believe that our activities generally have a low impact on the environment, with no environmental legal or compliance issues arising during the year.

The waste arising from our operations is predominantly protective plastic packaging, cardboard poles and boxes and wooden pallets. The cardboard poles from the centre of full rolls part rolls and cut lengths of carpet and vinyl delivered to our customers are later collected and re-used until no longer fit for purpose. We continue to increase the percentage that we recycle, baling plastics and cardboard and stacking unwanted pallets for dispatch to specialist re-processing agents when it is economic to do so. This has reduced the quantity of our waste going to landfill sites. Guidance on waste management is issued to the managers of the individual businesses to increase awareness of the need to control and reduce waste. Where possible, wrapping and packing materials are sourced from manufacturers where a high proportion of recycled materials are used.

We are a member of Carpet Recycling UK, a not for profit organisation formed with the aim of diverting carpet material from landfill through developing an end market for reprocessing and fibre recovery. They report that the industry diversion from landfill has increased from 2% to 10% in the last two years.

Commercial and motor vehicles are replaced respectively on a five and three year basis, in doing so improving operational efficiencies and reducing operating costs and vehicle emissions. As a result, all of our commercial vehicles comply with Euro 4 emission standards introduced in October 2006, which reduced the levels of carbon monoxide, hydrocarbon, nitrogen oxide and particulate emissions. By the end of 2013 the commercial fleet will be Euro 5 compliant, which will further reduce levels of noxious emissions that cause harm to the environment. We periodically review our fleet requirements to ensure the optimum design to maximise capacity and improve aerodynamics.

Board of Directors and Senior Management Team

Directors

Graham Waldron

Chairman

Graham was appointed executive director in June 1991 becoming Chairman later that year until 31 December 1999. On the resignation of Trevor Larman on 1 June 2006 he was re-appointed Chairman. He has 60 years experience in the floorcovering industry. He was the non-executive Chairman of Tandem Group plc until his retirement from their board on 28 April 2010.

Committees – Charities, Nominations

Tony 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 35 years experience in the floorcovering industry.

Committees – Nominations

Steve Wilson

Group Finance Director

Steve was appointed Group Finance Director in December 1991. He was the non-executive Chairman of Synergy Health plc until his retirement from their board on 22 September 2010 and is a fellow of the Institute of Chartered Accountants.

Dick Peters

Non-executive Director

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

Committees – Audit (Chairman), Nominations, Remuneration

Mike O'Leary

Senior Independent Director

Mike was appointed a non-executive director of Headlam in March 2006. He was joint COO at Misys plc between 1986 and 2000, running both their UK Insurance Division and US Healthcare Division. He was CEO of Huon Corporation and also Marlborough Stirling plc. He has undertaken a portfolio of non-executive roles since 2005 and in addition to his role at Headlam, is currently non-executive Chairman of both EMIS Group plc and Digital Healthcare Limited.

Committees – Audit, Nominations (Chairman), Remuneration (Chairman)

Andrew Eastgate

Non-executive Director

Andrew was appointed a non-executive director in May 2010. He was formerly a Partner in Pinsents including being head of Pinsents' corporate practice in Birmingham. Andrew has broad experience of advising quoted companies, particularly in connection with transactions and compliance issues. He is a non-executive director of Epwin Investment Holdings Limited.

Committees – Audit, Nominations, Remuneration

Company Secretary

Geoff Duggan

Geoff was appointed Company Secretary in April 1998. He is a fellow of the Institute of Chartered Secretaries and Administrators and a fellow of the Chartered Institute of Management Accountants.

Senior Executive Management

Gary Phillips

Finance Director, Operations

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

Tony Judge

Commercial Director, Coleshill and Tamworth businesses

Tony joined the company in May 1992 and is the Managing Director of all businesses operating from the Coleshill and Tamworth distribution centres and has operational responsibility for the Thatcham and Stockport businesses. Tony has 32 years experience in the floorcovering industry.

Keith Yates

Managing Director, Mercado

Keith joined Mercado in April 1983 and was subsequently appointed its Managing Director in 1996. In addition he has operational responsibility for the businesses in Scotland. Keith has 30 years experience in the floorcovering industry.

Mike McMaster

Commercial Director, selected UK Operations

Mike joined the company in July 1984 and was appointed to the Senior Executive Management team in January 2009, with operational responsibility for 15 of the UK businesses. Mike has 42 years experience in the floorcovering industry.

Corporate Governance Report

This report sets out how the principles of the UK Corporate Governance Code (the "Code") are applied, reports on the company's compliance with the Code's provisions and provides an explanation where the provisions have not been complied with.

The Code sets out guidance in the form of principles and provisions on how companies should be directed and controlled to follow good governance practice.

The board considers that it has complied with the provisions of the Code, as applicable to the company, throughout the year ended 31 December 2012 and up to the date of this report.

The basis on which the group generates and preserves value over the longer term and the strategy for delivering the objectives of the group are to be found in the Chairman's Statement, Chief Executive's Review and Financial review on pages 20 to 27.

Board of directors

The board is collectively responsible to shareholders for the proper management and success of the group. Its role is to provide entrepreneurial leadership within a framework of effective controls which:

- enables risk to be assessed and managed;
- sets strategic aims;
- ensures that the necessary financial and human resources are in place to meet its objectives and review management performance;
- sets the group's values and standards; and
- ensures that its obligations to its shareholders and others are understood and met.

During the year and as at 31 December 2012 the board consisted of six members, three executive directors comprising Graham Waldron, Chairman, Tony Brewer, Group Chief Executive and Steve Wilson, Group Finance Director and three independent non-executive directors, Dick Peters, Mike O'Leary and Andrew Eastgate.

The board considers the balance achieved between executive and non-executive directors during the year was appropriate and effective for the control and direction of the business. The company considers that diversity in the boardroom is essential to good business and measures are in place to ensure all appointments are made on merit.

The roles and responsibilities of the Chairman and Group Chief Executive are clearly divided and periodically reviewed by the board. Whilst collectively they are responsible for the leadership of the group, the Chairman's primary responsibility is for leading the board and ensuring its effectiveness. The Group Chief Executive is responsible for implementing strategy, running the businesses in accordance with the objectives and policies agreed by the board and for the executive management of the group. The Chairman communicates frequently with the non-executive and executive directors and the non-executive directors have the opportunity to meet with and discuss any issues or concerns with the Chairman at any time throughout the year. Matters that are not specifically reserved for the board and its committees under their terms of reference or for shareholders in general meeting are delegated to the Group Chief Executive.

The board maintains overall control of the group's affairs through a schedule of matters reserved for its decision which were reviewed in 2012. These include, but are not limited to:

- setting of group strategy;
- approval of the business objectives and annual plan;
- acquisitions and disposals;
- authority limits for capital and other expenditure;
- material treasury matters;
- changes to capital structure and dividend policy;
- committee terms of reference;
- board composition;
- succession planning;
- health and safety;
- risk management;
- financial reporting and controls; and
- corporate governance.

The board is assisted by committees that it has established with written terms of reference, details of which are set out below.

During the year the board conducted an in house evaluation of its performance with no remedial actions arising. The board reviewed the way in which it conducts its in house evaluation procedures during 2012.

The directors bring strong judgement to the board's deliberations and the size, diversity and balance of skills and experience of the board is considered appropriate for the requirements of the business. The board believes that all three non-executive directors are independent of management and free from any business or other relationship that could materially interfere with the exercise of independent and objective judgement. In making this determination the board has considered whether each director is independent in character and judgement and whether there are relationships or circumstances which are likely to, or could affect the director's judgement. Mike O'Leary, who served as the Senior Independent Director throughout the year, is available to shareholders if they have concerns which are not resolved through the normal channels of the Chairman, Group Chief Executive or Group Finance Director, or for which such contact is inappropriate. The non-executive directors do not participate in any bonus, share option or pension scheme of the company. They 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.

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 the forthcoming AGM are given to shareholders in the Notice of AGM and the biographical details of the directors are shown on page 38.

Board information, induction, training and professional development

The board has a rolling agenda which is regularly updated in respect of specific topics that affect the group including:

- health, safety and environmental matters;
- finance and operational performance;
- risk management;
- business development initiatives;
- legal and regulatory developments; and
- governance and best practice guidelines.

The board reviews the key activities of the business, receiving papers and presentations from senior executive management generally a week in advance of the meeting. The Company Secretary is responsible to the board in respect of board procedures and is available to individual directors. In conjunction with the Chairman, the Company Secretary ensures that information distributed to the board is sufficient, clear and accurate, circulated in a timely manner, and is appropriate to enable the board to discharge its duties. All directors are equally accountable for the proper stewardship of the group's affairs. However, the non-executive directors have a particular responsibility to ensure that the strategies proposed by the executive directors are fully discussed and critically examined.

The induction of newly appointed directors includes background information about the group, directors' responsibilities, board meeting procedures, a number of other governance-related issues and procedures for dealing in company shares. A briefing on the general group strategy, including visits to group businesses, is provided by the Group Chief Executive. Training and development in the year took various forms, including visits to group businesses and attendance at courses run by professional bodies on various commercial and regulatory matters. Directors receive regular updates appropriate to the business throughout the year aimed at developing and refreshing their knowledge and capabilities. All directors are considered to be suitably qualified, trained and experienced so as to be able to participate fully in the work of the board. To assist with the independent conduct of their function and, if required, in connection with their duties, a process is in place for the non-executive directors to obtain professional advice at the company's expense.

Board meetings and attendance

The board usually meets nine times a year at times that ensure the latest operating information is available for review and sufficient focus can be given to matters under consideration. During the year there is ample opportunity for the Chairman to meet with the non-executive directors without the executive directors being present, should this be deemed appropriate. In addition, directors have contact between meetings and, on occasions, visit trading locations in order to maintain contact with the group's business. A record of directors' attendance at board meetings held during the year is set out overleaf and committee meeting attendance is given in the relevant committee report.

Corporate Governance Report continued

Board meeting attendance

Graham Waldron	9/9
Tony Brewer	9/9
Stephen Wilson	9/9
Dick Peters	8/9
Mike O'Leary	9/9
Andrew Eastgate	9/9

In addition to the nine principal board meetings held during 2012 there were two meetings which approved the 2012 Interim and 2011 Annual Report and Accounts. These meetings are constituted by a committee of the board formed for that sole purpose comprising the Group Chief Executive and Group Finance Director having considered the views of the whole board beforehand.

Directors' interests and indemnity arrangements

At no time during the year did any director hold a material interest in any contract of significance with the company or any of its subsidiary undertakings, other than a third-party indemnity provision between each director and the company, and service contracts between each executive director and the company. The company has purchased and maintained throughout the year directors' and officers' liability insurance in respect of itself and its directors. The directors also have the benefit of the indemnity provision contained in the company's articles of association. This provision extends to include the directors of Headlam Group Pension Trustees Limited, a corporate trustee of the company's occupational pension schemes, in respect of liabilities that may attach to them in their capacity as directors of that corporate trustee. These provisions were in force throughout the year and are currently in force. Details of directors' remuneration, service contracts and interests in the shares of the company are set out in the Remuneration Report.

Directors' conflicts of interest

Procedures are maintained by the board whereby potential conflicts of interests are reviewed regularly. These procedures have been designed so the board may be reasonably assured that any potential situation where a director may have a direct or indirect interest which may conflict, or may possibly conflict, with the interests of the company are identified and, where appropriate, dealt with in accordance with the Companies Act 2006 and the company's articles of association. The board has not had to deal with any conflict during the period.

Board committees

The board has established Audit, Remuneration and Nomination Committees to oversee and debate important issues of policy and assist in attending to its responsibilities, with terms of reference that each comply with the provisions of the Code and are available on written request from the Company Secretary at the registered office or on the company's website. The roles of the Audit, Remuneration and Nomination Committees, whose membership is comprised of the three independent non-executive directors, with the Group Chief Executive additionally serving on the Nomination Committee, are set out below.

Audit Committee

The Audit Committee is comprised of the three non-executive directors and was chaired during the year by Dick Peters. The Company Secretary acts as secretary to the committee. Dick Peters is a chartered accountant with considerable financial and audit experience and is considered by the board to have recent and relevant financial experience.

The Audit Committee is responsible for monitoring and reviewing:

- the group's systems of internal control and the processes for monitoring and evaluating the risks facing the group on an ongoing basis;
- updates from executive directors and senior executive management on key financial control matters;
- 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;
- the integrity of the interim and annual financial statements, including a review of the significant financial reporting judgements contained therein;
- the potential impact on the financial statements of certain matters such as impairment of asset values and employee benefits;
- the effectiveness of the external audit process;

- the application of the board's policy on non-audit work performed by the group's external auditor together with the non-audit fees payable to the external auditor;
- the external auditors' plan for the audit of the group's accounts, confirmation of auditor independence and of the individuals carrying out the audit, confirmation of the proposed audit fee, approving the audit terms of engagement and management's response to any major external audit recommendations;
- reports from the external auditor on the group's systems of internal control, including a summary of and commentary on the business risks and internal control processes, and reporting to the board on the results of this review;
- non-audit services and fees;
- the appointment, re-appointment or dismissal of the external auditor;
- the appropriateness of an internal audit function;
- the group's compliance with corporate governance principles; and
- arrangements by which staff may in confidence raise concerns about possible improprieties in matters of financial reporting and other matters.

In addition, the fees and objectivity of the group's auditor are considered by the committee. The committee recommends that shareholders re-appoint KPMG Audit Plc as the group's auditor, in accordance with resolution 5 set out in the Notice of AGM, and authorises the directors to determine their remuneration, as set out in resolution 6.

The committee periodically reviews its terms of reference, most recently in 2012, and its effectiveness and recommends to the board any changes required as a result of such review.

In accordance with the Code the committee has undertaken an assessment of the need for a group internal audit function. The committee 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 committee has an agenda linked to events in the group's financial calendar, normally meeting at least twice a year, including meetings before the annual and interim results announcements. The committee met three times in the year, the three members each attending all meetings, during which it discharged its responsibilities as set out in its terms of reference and schedule of business for the year. Whilst only members of the committee are entitled to be present at meetings, the auditor, Chairman, Group Chief Executive and Group Finance Director may attend meetings by invitation. 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.

The committee has independent access to the external auditor who has direct access to the Chairman of the committee outside formal committee meetings and at each meeting there is an opportunity for the external auditor to discuss matters with the committee without any executive management being present. The committee has the specific task of keeping under review the nature and extent of non-audit services provided by the external auditor in order to ensure that objectivity and independence are maintained. The committee seeks to balance the benefits of continuity of audit personnel and the need to ensure independence through a change of audit personnel by agreeing staff rotation policies with the auditor. Whilst KPMG has been an external auditor to the group since 1992, there is a procedure in place for the audit partner to change after a period of five years, so maintaining objectivity and independence without the need and expense of changing firm. The last such change took place during 2011. The external auditor has processes in place to ensure its independence is maintained when providing non-audit services. It has written to the committee confirming that, in its opinion, it is completely independent.

The committee recognises that there are occasions when it is advantageous to use the external auditor to undertake non-audit services, when they are best placed to do so. The policy states that non-audit fees paid to the principal external auditor should not exceed 250% of the audit fee, except in the case of significant events. The Chairman of the committee is required to authorise non-audit work above a pre-agreed threshold. A breakdown of 2012 and 2011 audit and non-audit fees is provided in note 3 to the Financial Statements.

The committee has concluded, as a result of its work during the year, that it has acted in accordance with its terms of reference and has ensured, as far as possible by enquiry of them, the independence of the external auditors. The Chairman of the committee will be available at the AGM to answer any questions on the work of the committee.

Remuneration Committee

The Remuneration Committee is comprised of the three non-executive directors and was chaired during the year by Mike O'Leary. It establishes, on behalf of the board, the remuneration policy generally, approves specific arrangements for the Chairman and the executive directors and reviews and comments upon the proposed arrangements for senior executive management so as to ensure consistency within the overall remuneration policy and group strategy. Further information on the activities of the committee is given

Corporate Governance Report continued

in the Remuneration Report on pages 46 to 54 which should be read in conjunction with this report. The Remuneration Report also describes how the principles of the Code are applied in respect of remuneration matters and includes a statement on the company's policy on directors' and senior executive managers' remuneration, benefits, share scheme entitlements and pension arrangements. During the period no director was, and procedures are in place to ensure that no director is, involved in deciding or determining their own remuneration. A resolution to approve the Remuneration Report will be proposed at the AGM.

Nominations Committee

The Nominations Committee is comprised of the three non-executive directors and the Group Chief Executive and was chaired during the year by Mike O'Leary.

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 when required and met once in the year, with all members in attendance. Only members of the committee are entitled to be present at meetings but other directors may be invited by the committee to attend. The board has agreed the procedures to be followed by the 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. No director is involved in any decisions regarding their appointment.

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

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

Communication with shareholders

The company places considerable importance on communication with shareholders. When reporting to shareholders, the board aims to present a balanced and understandable assessment of the group's financial position and prospects, reporting four times a year when its half year and full year results are announced, and an interim and annual report is issued to shareholders, and through interim management statements typically released in May and November.

Further information regarding business developments is available to investors on the group's website www.headlam.com.

The company has an ongoing programme of dialogue and meetings between the executive directors and institutional investors and analysts which cover strategy, trading and market conditions. Contact with the major shareholders is principally maintained by the Group Chief Executive and Group Finance Director. During the year a number of meetings were held at certain of our businesses with the aim of providing shareholders with increased exposure to our operations and management. The Chairman ensures that the views of shareholders are communicated to the board as a whole.

The Group Chief Executive and Group Finance Director have met with the company's brokers during the year to ensure they are aware of the current views of major shareholders and of any material issues they may have. These reports include summaries 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. Whilst the Senior Independent Director and the other non-executive directors are invited to attend presentations to analysts and institutional shareholders, in particular the annual and interim results presentations, they did not attend any meetings with shareholders in the year.

Risk management and internal controls

The Code requires that the directors review the effectiveness of the group's system of internal control. The board recognises that the management of risk through the application of a consistent process is essential to ensuring a robust system of internal control, the principle risks and uncertainties facing the company including some of those identified in the Managing our Risk report on page 30.

Directors are required by the Code to review and report annually to shareholders on the effectiveness of the company's systems of internal control, which includes financial, operational and compliance controls and risk management. The board has responsibility for establishing and maintaining the group's systems of internal control and for reviewing its effectiveness whilst management is responsible for the implementation of internal control systems. The internal control provisions of the Code continue to be applied by the board through a continuous process for identifying, evaluating and managing the significant risks the group faces.

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

- satisfies its customers;
- maintains proper relationships with suppliers and contractors;
- provides a safe and healthy workplace;
- develops environmentally aware processes;
- minimises the cost and consumption of increasingly scarce resources; and
- maintains a positive relationship with the communities in which it operates.

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

The board maintained its process of hierarchical reporting and review during the year in order to evaluate the effectiveness of the group's systems of financial and non-financial controls. A comprehensive series of operating and financial control procedures applying to all businesses have been developed and the group finance team perform monthly reviews to verify that the businesses are complying with the prescribed operating and financial control procedures. Additionally, the board reviews risk management arrangements and 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 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. The board has not identified any failings or weaknesses, or been advised of any, which it has determined to be significant during the course of its review of the system of internal control. There were in addition 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.

A comprehensive planning system includes detailed reviews at all business and formal reviews and approval of annual plans by the board. Actual performance is measured on a monthly basis against plan and prior year, including a detailed explanation of significant variances. Revenue, gross margin and cash flow, are reported on a daily basis against plan and prior year. The control procedures operated by the group are designed to ensure complete and accurate accounting for financial transactions and to limit the potential exposure to fraud. Guidelines for capital expenditure and investment appraisal include annual plans, detailed appraisal and review procedures, authority levels and due diligence requirements when businesses are acquired, the acquisition or disposal of a business requiring formal board approval.

These detailed reviews are an important aspect of management reporting in 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 careful management of risk considered to be a key 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 employment handbook, supported by the group's anti bribery policy. The integrity and competence of personnel is assessed during the recruitment process and monitored throughout employment.

The group promotes a high standard of health and safety management at all levels supported by training programmes at operating businesses. Group health and safety rules are monitored and audited to promote a high level of awareness and commitment, with individual businesses assessed on a periodic basis. Remedial solutions are implemented where necessary, action plans and progress being monitored and reported.

The reports on Corporate Governance and of the Audit Committee contained within have been approved by the board and are signed on its behalf by

Geoff Duggan
Company Secretary
8 March 2013

Remuneration Report

Message from the Chairman of the Remuneration Committee

Dear Shareholder

This report sets out the remuneration policy for Headlam's directors and discloses their remuneration in respect of the year ended 31 December 2012. It has been prepared in accordance with the requirements of the Companies Act 2006, the principles of the UK Corporate Governance Code (the "Code") and best practice guidelines and is subject to an advisory shareholder vote. A resolution to approve the report will be proposed at the AGM to be held on 24 May 2013, at which I will be available to answer any questions.

The last year has witnessed increasing scrutiny of executive pay and changes in its reporting are imminent. Headlam's Remuneration Committee has reviewed the changing reporting requirements and is committed to delivering greater clarity and transparency of reporting whilst continuing its independent role, bringing logic and challenge to the process of setting remuneration.

Headlam's remuneration policy has been designed to incentivise performance through effective and appropriate reward. Levels of remuneration must allow the company to attract, retain and motivate high calibre executive managers and link their rewards to business performance, thus aligning their interests with those of shareholders.

When reviewing the appropriateness of the remuneration framework for 2013, the committee considered the incentive arrangements that had applied in 2012. Examination of current business strategy and current guidelines for executive remuneration led to the conclusion that the existing framework remains appropriate.

Despite difficult trading conditions, the committee satisfied itself that progress has continued to be made in delivering against long term operating strategy. Assessment of progress included review of the 2012 Financial Statements and took into account the reporting of the auditors to the Audit Committee.

The committee will continue to monitor the effectiveness of its policy with regard to legislative change, market developments and business strategy.

M.K. O'Leary

Mike O'Leary

Chairman of the Remuneration Committee

8 March 2013

The purpose of this report is to inform shareholders of the company's policies on directors' remuneration for the year ended 31 December 2012 and, so far as practicable, for subsequent years as well, and to provide details of the remuneration of individual directors as determined by the Remuneration Committee ("the committee").

It has been prepared by the committee on behalf of the board. This report has been approved both by the committee and the board and, in accordance with the Companies Act 2006, shareholders will be asked to approve the report by way of a resolution that will be proposed at the AGM of the company on Friday 24 May 2013, at which the Chairman of the committee will be available to answer any questions.

Commentary relating to the role of the committee, the remuneration policy, share options, co-investment plan awards and explanatory notes relating to the share scheme do not require to be audited. However directors remuneration, share awards and options and pension arrangements must be audited in accordance with the relevant statutory requirements. The company has complied in full with this requirement.

Unaudited information

The role of the Remuneration Committee

The committee is responsible for setting the framework and policy for the remuneration of executive directors. These are reviewed annually to ensure that they remain appropriate and relevant. The committee is committed to the principles of accountability and transparency and to ensure that there is a clear link between reward and performance.

The committee has received delegated authority from the board to determine and agree the remuneration policy for executive directors, and it oversees the policy in respect of senior executive management. When determining policy, the committee recognises the importance of retaining capable individuals and the need to reward performance which contributes to the success of the company.

It is also responsible for determining the specific elements of the executive directors' remuneration, performance targets, contractual terms and compensation arrangements. Furthermore, it ensures that in the event of termination, contractual terms and payments are fair, both to the company and to the individual. Failure is not rewarded and the duty to mitigate loss is recognised. In addition, the Committee oversees any major changes in employee benefit structures throughout the group, approves the design of all share incentive plans, and oversees any subsequent amendment. It reviews and recommends appropriate performance conditions and targets for the variable element of remuneration and determines the extent to which the performance targets have been achieved.

Members of the committee regularly attend specialist seminars and events on the subject of remuneration and review data and surveys from a variety of published sources with particular reference to the scale and composition of the total remuneration packages to executives. No payments were made in the last fiscal year to external consultants for advice or data.

In setting remuneration policy and levels for the executive directors, the committee takes into account the economic environment and financial performance of the group, along with remuneration and employment conditions of the senior executive management and other group employees.

The committee's terms of reference are available from the company on request and are available on the company's website, www.headlam.com. They are reviewed periodically to take account of best practice and corporate governance requirements and were last reviewed in 2012.

Composition of the Remuneration committee

The committee comprises Mike O'Leary (Chairman), Dick Peters and Andrew Eastgate, all of whom served throughout both 2012 and 2011. Other than as shareholders, the members of the committee have no personal financial interest in matters to be decided, no potential conflicts of interest and, as independent non-executive directors, no day to day involvement in running the business. In accordance with the committee's terms of reference, no-one attending a committee meeting may participate in discussions relating to their own terms and conditions of service or remuneration.

During the period, the committee met twice and all members were in attendance. Whilst only members of the committee are entitled to be present at meetings, the Chairman, Group Chief Executive and Group Finance Director may attend meetings by invitation, doing so in part on both occasions in the year.

Remuneration Report continued

Remuneration policy

Following a review in October 2012, the committee concluded that the current remuneration policy remains appropriate and the objectives continue to be:

- to ensure that the remuneration structure supports the strategy of the business;
- to ensure that the remuneration structure motivates the executive directors to succeed and rewards them appropriately for their contribution to the attainment of the group's strategic objectives;
- to maintain motivation for future achievement through reward schemes based on performance;
- to facilitate the building and retention of a high calibre and focused team;
- to align the executive directors' interests with those of shareholders by offering participation in schemes which provide opportunity to build meaningful shareholdings in the company; and
- to facilitate effective succession planning.

In order to encourage and reward enhanced business performance and shareholder returns, the committee considers that a substantial proportion of the executive director's remuneration should be variable and performance related. The committee is satisfied that the incentive structure does not raise governance issues by inadvertently motivating or encouraging irresponsible or reckless behaviour.

In deciding that the current remuneration strategy remains appropriate for 2013, the committee has taken into account the group's performance over the last year and the current economic environment. The remuneration policy will continue to be monitored and reviewed by the committee to ensure that the remuneration structure and associated performance measures remain appropriately aligned with the group's strategic objectives.

The individual salary, bonus and benefit levels of the executive directors are and will continue to be reviewed annually by the committee.

The committee considers that in making smaller but more frequent awards under the long term incentive schemes, each subject to the attainment of specific performance targets over a three year period, it further aligns the interests of directors.

Remuneration components

The current components of executive remuneration and how they are aligned with the overall business strategy are summarised in the table below:

Component	Policy for executive directors	Purpose and link to business strategy
Base salaries	– Reviewed annually – Influenced by role and experience – Movements determined by reference to workforce	– Market competitive salaries help the group to recruit, retain and motivate the best talent – Relative to the increase applicable to the wider workforce
Annual performance bonus	– Based on achieving stretching group profit before tax targets – Maximum of 150% of base salary for significant outperformance – No bonus for performance below pre–determined level	– Alignment with the group's strategic priorities of increasing market share and improving profitability – Maximum bonuses are only available for the delivery of above target growth in earnings
2008 Co-Investment Plan	– Deferral of between 15% and 100% of annual bonus – Other funds can be invested under certain circumstances – Up to 2 for 1 matching subject to stretching EPS and TSR targets	– Involves personal financial commitment – Encourages executives to increase their company shareholding – Aligns executives' interests with strategic objectives – Performance conditions are based on EPS and TSR
Other benefits	– The group provides a company car, medical insurance and life assurance cover to its executive directors and senior executive management	– Provision of market typical employee benefits assist the group to recruit, retain and motivate

The group has not provided pension benefits to the executive directors in the year. Furthermore, it does not anticipate making future payment or providing future benefits.

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, provided that there is no conflict of interest, although the board retains the discretion to vary this policy. Fees received by executive directors in respect of external non-executive appointments are retained by the individual director. None of the executive directors held any other directorships outside of the group during the year.

Base salaries

Generally, the appropriate market rate for comparable positions and levels of responsibility and the individual executive's experience, performance and value to the business are reflected in the committee's assessment of base salaries.

The committee reviews base salary annually with any change taking effect from 1 January. When reviewing base salaries, the committee takes account of the current economic climate, challenges facing the business and pay environment for employees in general. The committee has approved an inflationary increase of 2% for 2013 to base salaries for the group's workforce, including the executive directors. The exception to this will be where increases need to be granted to any employees whose base salary considerably undervalues their worth to the business or to individuals who are promoted to a more senior role. This exception did not apply to the executive directors.

Non salary benefits

The non-salary benefits for executive directors comprise a company car and fuel, non-contributory private medical insurance and life assurance which are similar to those provided in comparable companies.

Non executive director fees and benefits

Non-executive directors' fees are reviewed by the board annually by reference to prevailing market conditions and at a level which will attract individuals with the necessary experience and ability to make a positive contribution to the group's affairs. The annual fees were reviewed with effect from 1 January 2013 increasing by 2% to £36,595, with an additional £5,225 being paid to the respective chairmen of the Audit and Remuneration Committees. Non-executive directors are not involved in any discussion or decision about their own remuneration nor do they participate in any of the company's share schemes, incentive plans or pension schemes. The aggregate limit for fees paid to non-executive directors is laid down in the articles. Mike O'Leary has been designated Senior Independent Director for which he receives no additional fees. Non-executive directors do not receive any form of benefits.

Annual cash bonus

The performance related reward is based on annual objectives and links individual performance with a business financial target. The performance related bonus is calculated by reference to the group's audited profit before tax compared with the financial target. The committee establishes the financial target and reviews the annual performance related bonus each year to ensure that it remains competitive and, whilst subject to a stretching target, continues to offer an incentive to the executive directors.

The basis for determining the performance related scheme for 2012 was the same as that for 2011, with the exception of an increase in the financial target.

An annual performance bonus of 75% of base salary is attainable on achieving the financial target, with a maximum bonus of 150% for over-achievement against the target. The maximum bonus payment of 150% can only be paid for achieving a performance of 28% or more above the target. In the event that actual performance is 90% of the financial target, a bonus of 10% of base salary will be awarded. A bonus is not awarded for a performance of below 90% of target. In adopting the performance parameters described above, the committee decided that there would be no discretion to make bonus awards for further over or under performance. The committee has decided to implement a similar arrangement for determining the annual performance bonus for 2013.

In 2012 the bonus was based on 75% of base salary on attainment of target plus a further 23.31% for attainment of above target performance, such outperformance being calculated by reference to a predetermined matrix, subject to a maximum of 150% of base salary.

Share incentive arrangements

In order to align their interests with the company's shareholders, the committee is keen to encourage executive directors to increase their shareholdings in the company. An executive director is required to have a beneficial, including family, interest, in the shares of the company equivalent in value to their annual base salary. Newly appointed directors are expected to build their interest over a five year period.

Remuneration Report continued

Directors' beneficial interests

	Shareholdings at 8 March 2013	Shareholdings at 31 December 2012	Shareholdings at 31 December 2011
Executive directors			
Graham Waldron	379,755	379,755	360,638
Tony Brewer	519,942	519,942	519,942
Steve Wilson	450,770	450,770	450,770
Non-executive directors			
Dick Peters	5,000	5,000	5,000
Mike O'Leary	1,000	1,000	1,000
Andrew Eastgate	1,000	1,000	1,000

None of the shares detailed above are subject to deferral or performance conditions, all being owned outright.

The committee recognises the importance of share incentives in recruiting and retaining directors and employees on whose performance the success of the company depends. The share incentive arrangements also provide a key link between rewards to executive directors and senior executive management and the achievement of a sustained improvement in long term financial performance.

Shareholders have approved the following share-based incentive schemes :

- Headlam Group Sharesave Scheme 2012
- Headlam Group Approved Executive Share Option Scheme 2008
- Headlam Group Unapproved Executive Share Option Scheme 2008 ("ESOS")
- Headlam Group Performance Share Plan 2008 ("PSP")
- Headlam Group Co-Investment Plan 2008 ("CIP")

The committee intend to use the CIP as the principal incentive vehicle for executive directors, with awards being made on an annual basis. Whilst awards have been made under the CIP, as detailed below, the committee has not yet implemented either the PSP or the ESOS and does not intend to do so during 2013. Details of the schemes will be disclosed in the event of an award being made under these schemes or plans.

Headlam Group Sharesave Scheme 2012

Employee share ownership is encouraged. With the exception of non-executive directors, all employees are eligible to participate in the scheme. Options granted under the scheme may not normally be exercisable until the option holder has completed their three or five year savings contract, monthly savings being a minimum of £10 and a maximum of £250. Options may be granted at a price which represents a discount to market price at the date of grant of up to 20%. On 11 May 2012, options were granted over 462,323 shares to 282 employees for savings terms of either three or five years at an option price of 238p per share, representing a 20% discount to the average market price of the three days immediately preceding the award.

Headlam Group Co-Investment Plan 2008 (the "CIP")

Participants may be invited, at the discretion of the committee, to take not less than 15% and up to 100% of their annual bonus in the form of shares, the number of shares allocated being calculated by reference to the net value of the bonus after deduction of income tax and employees' national insurance. If an annual bonus award is not achieved in any year and therefore not available for investment in the CIP, the committee may permit participants to invest alternative funds but subject to a maximum of 50% of any bonus paid in the preceding year. In addition, instead of investing a bonus award or other funds, the participant may utilise shares already held and previously acquired in the market, however this may only apply to awards up to an aggregate value equating to one times base salary.

Participants are granted awards in the form of matching shares. The maximum value of the matching share award is twice the value of the shares that would have been acquired with the gross bonus award. It is currently intended that awards will be satisfied by the transfer of shares from an employee share trust, such shares having been acquired by the trust on the market to the extent required. Subject to the satisfaction in full or part of the relevant performance targets, an award will be exercisable between three and ten years after the award date.

Performance targets are measured over a fixed period of three years, beginning not earlier than the year in which an award is made, with 80% of the award determined by EPS growth targets and 20% by TSR targets as measured by reference to the FTSE SmallCap Index, of which the company is a constituent member.

Matching share awards under the CIP were granted on 5 October 2012 to the executive directors which were subject to the TSR and EPS performance targets described above. The awards were determined by reference to 25% of base salary and to the ordinary share price over the preceding three months of 293.38 pence, with matching share awards of up to two for one. Vesting is dependent on achievement of the performance targets set out below with straight line matching between median and upper quartile for the TSR condition and between RPI +3%p.a. and RPI+6%p.a. for the EPS condition.

Matching	EPS	TSR
None	Less than RPI +3% p.a.	Below median
One for one matching	RPI+3% p.a.	Median
Two for one matching	RPI+6% p.a.	Upper quartile

Dilution

The committee is aware of, and supports, the ABI guidelines regarding dilution and regularly monitors compliance with these requirements. The committee included provisions which limit the number of newly issued shares which can be granted in a 10 year period to 10% of the issued share capital under all employee schemes and 5% under the discretionary share plans.

As at the date of this report, the company's usage of shares against the limits detailed above in respect of the all employee schemes was 2% of the issued share capital and in respect of grants under discretionary plans was 0.5% of issued capital. It is the committee's intention that options exercised under the SAYE scheme and the two executive share option schemes will be satisfied by shares held in treasury. With regard to the CIP, the committee will instigate market purchases of shares, through a trust, taking account of the likelihood of performance targets being met and also potential lapsing of awards because of leavers.

Further information on share-based payments is set out in note 21 to the Financial Statements.

Retirement benefits

The group has not provided pension benefits to the executive directors in the year. Furthermore, it does not anticipate making future payments or providing future benefits.

The group provides an opportunity for its senior executive management to participate in occupational pension arrangements, detail in respect of which is given on page 88.

Service contracts

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

Contracts in respect of the Group Chief Executive Officer and the Group Finance Director are on a rolling 12 month basis. These were entered into on 11 October 2005 and are terminable by either the director or the company subject to 12 months written notice. Payments upon the termination of their contracts will be equal to base salary for the duration of the notice period. The contracts contain neither a liquidated damages nor a change of control clause and it is the company's policy that any payments made to a director in the event of termination reflect the circumstances giving rise to termination and, where considered appropriate, the obligation of the outgoing director to mitigate his loss. Accordingly, consideration is given to making compensation payments in instalments and is conditional on the leaver's employment and earnings status.

The executive directors' contracts are available for inspection at the registered office of the company during normal business hours on each business day.

Non-executive directors

The non-executive directors do not have service agreements but instead are appointed for an initial period of three years by letter of appointment which is terminable by either party subject to one month's notice, for which no compensation is payable. At the end of the initial period, the company discusses with the non-executive director whether they wish to renew their appointment and if it is in the best interests of the company for their appointment to be renewed. Such renewal would normally be for a further period of three years and subject to the same termination conditions. Non-executive directors are typically expected to serve two three-year terms, although the board may invite them to serve for an additional period. All appointments and subsequent re-appointments are subject to approval by shareholders. Letters of appointment for non-executive directors are available on application to the Company Secretary.

Remuneration Report continued

Most recent re-election dates

The table below shows the dates of appointment and the most recent re-election dates for directors.

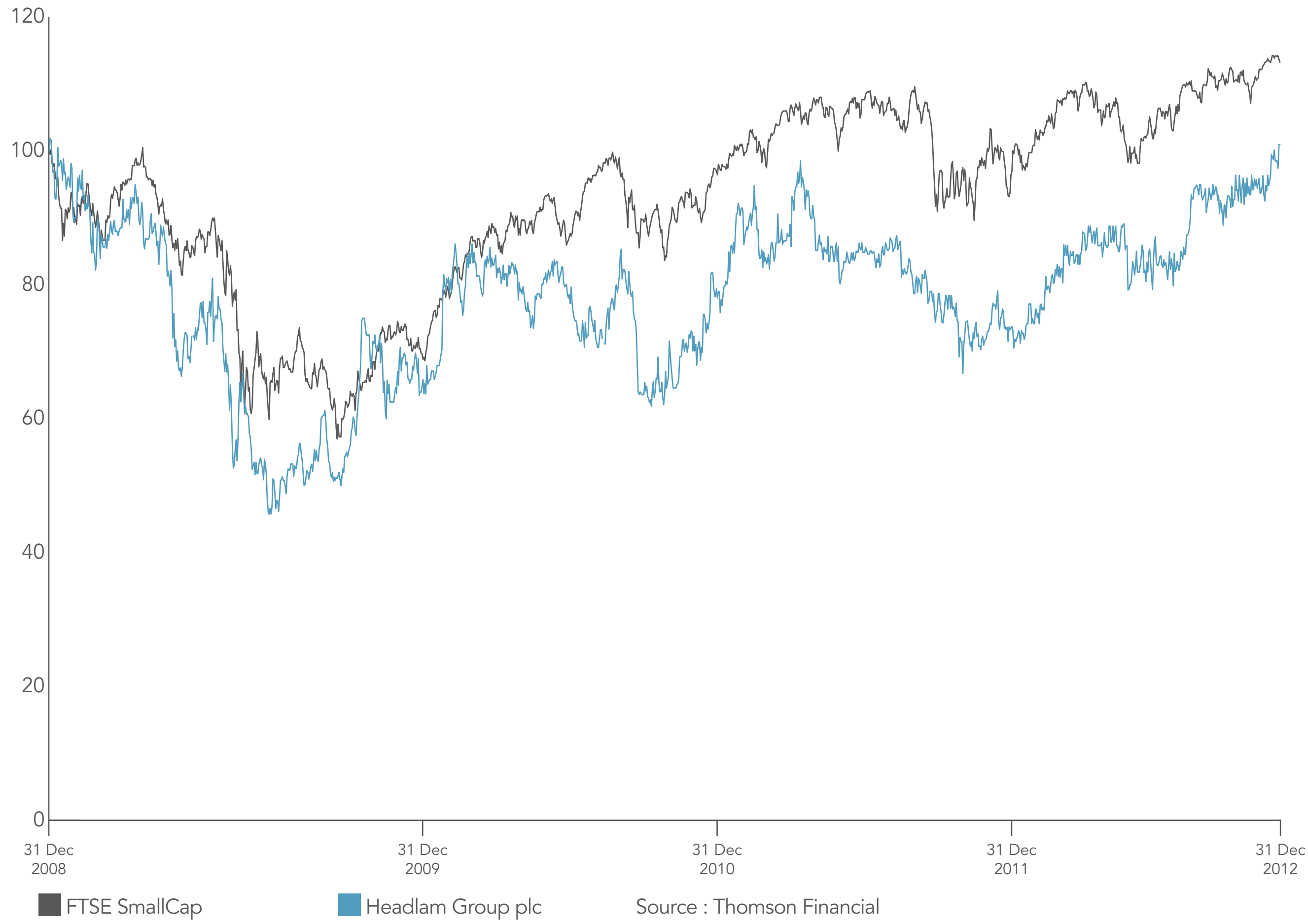
	Date of appointment	Date of last re-election at an AGM
Executive directors		
Graham Waldron	June 1991	June 2010
Tony Brewer	June 1991	June 2011
Steve Wilson	December 1991	June 2012
Non-executive directors		
Dick Peters	December 2005	June 2010
Mike O'Leary	March 2006	June 2011
Andrew Eastgate	May 2010	June 2012

Performance graph

The graph below has been produced in accordance with the requirements of Schedule 8 of the Large and Medium sized Companies and Groups (Accounts Reports) Regulations 2008. It shows the return for an investment in the company's shares for the period from 1 January 2008 to 31 December 2012 compared to an investment in the FTSE Small Cap index. The calculation of the return assumes dividends are reinvested to purchase additional equity.

The FTSE SmallCap index has been selected as a comparator due to the company being a constituent member within the household goods and textiles sector. This allows comparison of the company's performance against the performance of the index as a whole.

Five-year Return Index for FTSE Small Cap as at 31 December 2012



Audited information
Directors' remuneration

The remuneration of each director for the year ended 31 December 2012 compared to 2011 is shown below.

	Salary and fees		Non salary benefits		Performance related pay		Pensions		Share-based incentive schemes		Total	
	2012 £000	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000
Executive directors												
Tony Brewer	**533**	520	**29**	24	**524**	518	**–**	33	**–**	–	**1,086**	1,095
Steve Wilson	**385**	376	**32**	31	**378**	374	**–**	–	**–**	–	**795**	781
Graham Waldron	**118**	115	**22**	21	**–**	–	**–**	–	**–**	–	**140**	136
Non-executive directors												
Andrew Eastgate	**36**	35	**–**	–	**–**	–	**–**	–	**–**	–	**36**	35
Mike O'Leary	**41**	40	**–**	–	**–**	–	**–**	–	**–**	–	**41**	40
Dick Peters	**41**	40	**–**	–	**–**	–	**–**	–	**–**	–	**41**	40
	1,154	1,126	**83**	76	**902**	892	**–**	33	**–**	–	**2,139**	2,127

Gains made by directors

The aggregate amount of gains made by executive directors on the exercise of share options was £2,256 (2011: £nil).

Directors' interests in share option schemes

Details of executive directors' interests in the SAYE scheme and executive share option schemes and CIP are set out below, a description of which, together with relevant performance conditions, is given on pages 50 to 51:

		Granted in the year			Exercised in the year					
	At 1 January 2012	Number	Option price (p)	Lapsed during the year	Number	Market price on exercise	At 31 December 2012	Exercise price (p)	Earliest exercise date	Latest exercise date
Tony Brewer										
1998 USOS (i)	342,858	–	–	342,858	–	–	nil	420.00	Aug 2008	Aug 2012
1998 ESOS (ii)	7,142	–	–	–	–	–	7,142	420.00	Aug 2008	Aug 2015
Sharesave (iii)	7,043	–	–	–	–	–	7,043	222.20	Jul 2014	Jan 2015
CIP (v)	98,859	–	–	–	–	–	98,859	nil	Oct 2013	Oct 2020
CIP (v)	100,000	–	–	–	–	–	100,000	nil	Aug 2014	Aug 2021
CIP (v)	–	90,838	–	–	–	–	90,838	nil	Oct 2015	Oct 2022
Steve Wilson										
1998 USOS (i)	242,858	–	–	242,858	–	–	nil	420.00	Aug 2008	Aug 2012
1998 ESOS (ii)	7,142	–	–	–	–	–	7,142	420.00	Aug 2008	Aug 2015
Sharesave (iii)	7,043	–	–	–	–	–	7,043	222.20	Jul 2014	Jan 2015
CIP (v)	71,388	–	–	–	–	–	71,388	nil	Oct 2013	Oct 2020
CIP (v)	72,212	–	–	–	–	–	72,212	nil	Aug 2014	Aug 2021
CIP (v)	–	65,614	–	–	–	–	65,614	nil	Oct 2015	Oct 2022
Graham Waldron										
Sharesave (iii)	4,117	–	–	–	4,117	277.00	nil	222.20	Jul 2012	Jan 2013
Sharesave (iv)	–	3,781	238.00	–	–	–	3,781	238.00	Jul 2015	Jan 2016

(i) Headlam Group Unapproved Executive Share Option Scheme 1998 (1998 USOS)
(ii) Headlam Group Approved Executive Share Option Scheme 1998 (1998 ESOS)
(iii) Headlam Group Sharesave Scheme 2009 (Sharesave)
(iv) Headlam Group Sharesave Scheme 2012 (Sharesave)
(v) Headlam Group Co-Investment Plan 2008 (CIP)

Remuneration Report continued

Maximum value of awards granted to executive directors as at 31 December 2012

Details of executive directors' share-based awards are set out below, a description of which, together with relevant performance conditions, is given on pages 50 to 51:

	Awards granted	Maximum award	Awards vested	Awards lapsed	Maximum outstanding awards at 31 Dec 2012	Option price (p)	Market price at date of grant (p)	Maximum award £	Earliest vesting date	Expiry
Tony Brewer										
CIP (v)	7 Oct 2010	98,859	–	–	98,859	nil	312	308,440	Oct 2013	Oct 2020
CIP	23 Aug 2011	100,000	–	–	100,000	nil	274	274,000	Aug 2014	Aug 2021
CIP	5 Oct 2012	90,838	–	–	90,838	nil	300	272,514	Oct 2015	Oct 2022
1998 ESOS (i)	22 Aug 2005	342,858	–	342,858	nil	420	424	nil	Aug 2008	Aug 2012
1998 ESOS (ii)	22 Aug 2005	7,142	–	–	7,142	420	424	286	Aug 2008	Aug 2015
SAYE (iii)	11 May 2011	7,043	–	–	7,045	222.20	297	5,268	Jul 2014	Jan 2015
Steve Wilson										
CIP (v)	7 Oct 2010	71,388	–	–	71,388		312	222,730	Oct 2013	Oct 2020
CIP	23 Aug 2011	72,212	–	–	72,212		274	197,861	Aug 2014	Aug 2021
CIP	5 Oct 2012	65,614	–	–	65,614		300	196,842	Oct 2015	Oct 2022
1998 ESOS (i)	22 Aug 2005	242,858	–	242,858	nil	420	424	nil	Aug 2008	Aug 2012
1998 ESOS (ii)	22 Aug 2005	7,142	–	–	7,142	420	424	286	Aug 2008	Aug 2015
SAYE (iii)	11 May 2011	7,043	–	–	7,045	222.20	297	5,268	Jul 2014	Jan 2015
Graham Waldron										
SAYE (iii)	11 May 2011	4,117	4,117	–	nil	222.20	297	–	Jul 2012	Jan 2013
SAYE (iv)	11 May 2012	3,781	–	–	3,781	238	306	2,571	Jul 2015	Jan 2016

(i) Headlam Group Unapproved Executive Share Option Scheme 1998 (1998 USOS)
(ii) Headlam Group Approved Executive Share Option Scheme 1998 (1998 ESOS)
(iii) Headlam Group Sharesave Scheme 2009 (Sharesave)
(iv) Headlam Group Sharesave Scheme 2012 (Sharesave)
(v) Headlam Group Co-Investment Plan 2008 (CIP)

The mid market closing price of a Headlam Group plc ordinary share on 31 December 2012, the last trading day of the financial year, was 330p and the price range during the year was 255p to 330p, with an average price of 294.31p. There were no changes in the options held by the directors between 31 December 2012 and 8 March 2013. The company's register of director's interests, which is open to inspection, contains full details of directors' share interests.

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

M.K. O'Leary

Mike O'Leary
Chairman of the Remuneration Committee
8 March 2013

Other Statutory Disclosures

Directors' report

The Annual Report includes the Directors' report and the audited Financial Statements for the year ended 31 December 2012. Certain information required to be disclosed in the Directors' report is provided in other sections of this Annual Report. This includes the Chairman's Statement, the Chief Executive's Review, the Financial Review, the Corporate Governance Report, the Remuneration Report and specific elements of the Financial Statements noted below and , accordingly, these are incorporated into the Director's report by reference.

Principal activities

The principal activities of the group are wholly aligned to the sales, marketing, supply and distribution of floorcovering and certain other ancillary products. The principal activity of the company is that of a holding company and its principal trading subsidiaries are listed on page 107. Further details of the group's activities and future plans are set out in the Chief Executive's Review and the Financial Review on pages 22 to 27.

Dividends

An interim dividend of 4.65p per share (2011: 4.30p) was paid on 2 January 2013 to shareholders on the register at the close of business on 7 December 2012. The directors propose a final dividend of 10.20p per ordinary share (2011: 9.85p), to be paid on 1 July 2013 to shareholders on the register of members at the close of business on 7 June 2013, the associated ex-dividend date being 5 June 2013. This would bring the total dividend for the year to 14.85p per ordinary share (2011: 14.15p). The payment of the final dividend is subject to shareholder approval at the AGM.

Directors

There were no changes to the board in the year and no other person has acted as a director of the company during the year. The company's articles of association ("articles") give directors power to appoint and replace directors. They also provide that each director shall retire from office and shall be eligible for re-appointment at the third AGM after the general meeting at which they were appointed or last re-appointed. Accordingly, Graham Waldron and Dick Peters, who both 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 evaluation, each of these individuals' performance continues to be effective and they have expressed a willingness to continue in their roles.

Directors' and officers' indemnity insurance

The articles entitle the directors of the company, to the extent permitted by the Companies Act 2006 and other applicable legislation (together, the Companies Acts), to be indemnified out of the assets of the company in the event that they suffer any expenses in connection with certain proceedings relating to the execution of their duties as directors of the company. In addition, and in common with many other companies, the company has insurance in favour of its directors and officers in respect of certain losses or liabilities to which they may be exposed due to their office.

Directors' conflict of interests

No director had, at any time during the period under review, any interests in any contract with the company or any of its subsidiaries, a position which was unchanged at 8 March 2013.

Appointment and replacement of directors

The directors shall be not less than three and not more than eight in number, although the company may by ordinary resolution vary these numbers. Directors may be appointed by the company by ordinary resolution or by the board, a director appointed by the board holding office only until the next AGM of the company after their appointment at which they are then eligible to stand for election. The articles provide that at every AGM of the company, one-third of the directors, those longest in office since last election, shall retire from office and may offer themselves for re-election, such number to exclude any director who was appointed by the board and is standing for election. The company does not seek to comply with the provision in The UK Corporate Governance Code which requires the annual re-election of directors.

The company may by ordinary resolution, but subject to special notice, remove any director before the expiry of the director's period of office. The office of a director shall be vacated if certain circumstances arise, as set out in the articles.

Other Statutory Disclosures continued

Change of control

The company has entered into certain agreements that may take effect, alter or terminate upon a change of control of the company following a takeover bid. The significant agreements in this respect are the group's term loan and certain of its employee share schemes. The group's term loan facilities include a provision such that, in the event of a change of control, the relevant lender may cancel all or any part of the relevant facility and/or declare that all amounts outstanding under the relevant facility are immediately due and payable by the company.

Outstanding options granted under the SAYE scheme may be exercised within a period of six months from a change of control of the company following a takeover bid taking place, or will lapse upon the expiry of such a period.

Matching share awards granted under the 2008 CIP and awards granted under the 2008 PSP may, proportionate to the performance period, vest within a period of six months from a change of control of the company. At the end of such period, awards will lapse and cease to be exercisable to the extent not exercised.

There are no agreements between the company and its directors providing for compensation for loss of office that occurs as a result of a change of control.

Fixed assets

A consideration of the market value of the group's tangible fixed assets is detailed in note 1 of the Financial Statements.

Supplier payment policy

It is the group's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the company and its suppliers. 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 generally not based on any particular code or standard relating to payment practice. The number of creditor days of the company at 31 December 2012 was 43.5 days (2011: 46.7 days).

Employees

The group recognises the value of its employees and seeks to create an energetic, dynamic and responsive environment in which to work. The company maintains a policy of employing the best candidates available in every position, regardless of gender, ethnic group or background and is committed to fair and equal treatment. It places considerable importance on communications with employees which take place at many levels through the organisation and by a variety of means on both a formal and informal level.

Reward is linked to business plans and targets thereby giving employees the opportunity to share in the financial success of the group. In keeping with the structure of the business, this policy is applied locally, and as a result, staff of all levels regularly benefit from achieving local targets.

Where existing employees become disabled, it is the group's policy wherever practicable, to provide continuing employment under normal terms and conditions and to provide training, career development and promotion wherever appropriate and gives full and fair consideration to applications for employment from disabled persons. Further details of arrangements relating to employees are described in the Managing Responsibility report on pages 32 to 37 and the average number of employees and their remuneration are shown in note 4 to the Financial Statements.

The company has communicated an internally operated whistle blowing policy and procedure to employees. The policy enables them to report any concerns on matters affecting the group or their employment, without fear of recrimination, and reduces the risk of malpractice taking place and remaining unreported. In addition, the group does not tolerate matters of discrimination or harassment and bullying and policies and procedures are in place for reporting and dealing with these matters.

Employees are encouraged to own shares in the company and the group operates an HMRC Approved Savings Related Share Option Scheme (SAYE). Those employees who choose to take up the option to purchase shares in the company may enter into a savings arrangement for either a three or five year period, with the option price determined by reference to the share price at the date of grant. On exercise the shares are purchased by the employee free of income tax and national insurance although capital gains tax rules apply.

Contributions for political and charitable purposes

The group's Charities Committee considers requests for charitable donations within set criteria. During 2012, in addition to donations made to overseas charities, the group supported Pennies from Heaven. This is a charitable payroll giving scheme where the group matches the monthly contributions made by employees, inclusive of gift aid, £11,100 being donated to Great Ormond Street Hospital Children's Charity and MacMillan Cancer Support in the last 12 months. In addition, employees participated in a variety of fund raising activities and supported charities local to their businesses. The group contributed charitable donations to UK charitable organisations, principally to local organisations serving the communities in which it operates, of £35,192 (2011: £39,523).

The group's policy is not to make any donations for political purposes in the UK or to donate to EU political parties or incur EU political expenditure. Accordingly neither the company nor its subsidiaries made any political donations or incurred political expenditure in the financial period under review (2011: £nil).

Share capital

As at 31 December 2012, the issued share capital of the company comprised a single class of ordinary shares of five pence each, with 85,363,743 shares in issue at that date. No shares were issued during the year and there were no additions to treasury shares. Of the 2,241,197 shares held in treasury at the start of the year, 413,403 were transferred of treasury in connection with the SAYE and executive share option schemes leaving 1,827,794 at the year end representing 2.14% of the issued share capital. Proceeds received in respect of the 413,403 shares were £916,000. Details of the company's share capital are set out in note 22 of the Financial Statements which should be treated as forming part of this report.

Subject to the provisions of the articles and the Companies Acts, shares may be issued with such rights or restrictions as the company may by ordinary resolution determine or, if the company has not so determined, as the directors may decide. There are however no restrictions on the transfer of securities in the company, except that certain restrictions may from time to time be imposed by law or regulation, for example, insider trading laws, and pursuant to the Listing Rules of the Financial Services Authority (the Listing Rules), whereby certain employees require the approval of the company to deal in the company's shares.

The company is not aware of any agreements between holders of securities that may result in restrictions on the transfer of securities in the company.

AGM

This year's AGM will be held at the group's distribution facility in Tamworth on Friday 24 May 2013 at 10.00 a.m. The notice convening this meeting is set out within this Annual Report and Accounts on page 109, along with explanatory notes regarding the resolutions that will be proposed at the meeting on pages 113 to 115. The directors consider that each of the resolutions to be proposed is in the best interests of the company and the shareholders as a whole. Accordingly, the directors unanimously recommend that all shareholders vote in favour of all resolutions, as the directors intend to do in respect of their own beneficial holdings.

Auditors

KPMG Audit plc have expressed their willingness to continue in office as Auditors and a resolution will be proposed to reappoint them at the AGM. The auditor responsibilities are set out on page 61 and should be read in conjunction with those of the directors as set out at the end of this report.

Authority to allot shares and disapply statutory pre-emption rights

Subject to certain limits, at the AGM on 15 June 2012, the directors were granted general authority to allot shares in the company together with an authority to allot shares in the company in connection with a rights issue and in respect of cash without first offering them to existing shareholders. Whilst no shares have been allotted by the company during the year, the directors will be seeking to renew these authorities to allot unissued shares and to disapply statutory pre-emption rights at the forthcoming AGM. Further details are set out in the notice of AGM.

Purchase of own shares

At the AGM on 15 June 2012, the company was given the authority to purchase shares in the company up to 10% of the issued share capital. Whilst no shares have been purchased under the buyback authority by the company during the year, the directors will be seeking to renew this authority for the company to purchase its ordinary shares at the forthcoming AGM. Further details are set out in the notice of AGM.

Other Statutory Disclosures continued

Rights under employees' share schemes

As at 31 December 2012, Kleinwort Benson (Channel Islands) Limited ("Kleinwort Benson"), as trustee of the Headlam Group Employee Trust Company Limited ("Trust") which acts as the trustee of the Headlam Group Co-Investment Plan 2008 ("CIP") and the Headlam Group Performance Share Plan 2008 ("PSP"), which were approved by shareholders on 20 June 2008, held 600,000 shares, approximately 0.7% of the issued share capital of the company, on trust for the benefit of the directors and certain senior managers of the group. Kleinwort Benson waives the dividends payable in respect of these shares.

As at the same date, the Trust held 100,088 shares, approximately 0.1% of the issued share capital of the company, which may be used to fulfil the exercise of SAYE options, the dividend payable in respect of these shares similarly being waived.

Substantial shareholdings

As at 31 December 2012, and unchanged at 28 February 2013, in accordance with rule 5.1 of the disclosure and transparency rules, the company had been notified of the following interests in the ordinary share capital of the company.

Ordinary shares of five pence each

Shareholder	Nature of holding	Number	Per cent
Franklin Templeton Institutional, LLC	Indirect	13,943,364	16.69
The Capital Group Companies Inc	Indirect	6,618,232	7.92
Tweedy, Browne Company LLC	Direct	4,523,274	5.41
Rathbone Brothers plc	Indirect	4,320,800	5.17
JO Hambro Capital Management Limited	Direct	4,162,424	4.98
Threadneedle Investments	Indirect and Direct	4,154,941	4.97
Schroders plc	Indirect	4,119,581	4.93
Investmentaktiengesellschaft fuer langfristige Investoren TGV	Direct	2,773,093	3.32
Heronbridge Investment Management LLP	Direct	2,514,982	3.01
Kames Capital	Indirect and Direct	2,508,586	3.00

Securities carrying special rights

There are no requirements for prior approval of any transfers and no person holds securities in the company carrying special rights with regard to control of the company.

Voting

On a show of hands at a general meeting of the company every holder of ordinary shares present in person and entitled to vote shall have one vote and, on a poll, every member present in person or by proxy and entitled to vote shall have one vote for every ordinary share held. The notice of AGM specifies deadlines for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be passed at the AGM. All proxy votes are counted and the numbers for, against or withheld in relation to each resolution are announced at the AGM and published on the company's website after the meeting. The holders of ordinary shares are entitled to receive the company's Annual Report and Accounts, to attend and speak at general meetings of the company, to appoint proxies and to exercise voting rights. The company is not aware of any agreements between holders of securities that may result in restrictions on voting rights. Further shareholder information is available on pages 116 to 117.

Powers of the directors

Subject to the articles, the Companies Acts and any directions given by the company by special resolution, the business of the company will be managed by the board, which may exercise all the powers of the company.

Amendment of articles

The company's articles may only be amended by a special resolution at a general meeting of shareholders.

UK Corporate Governance Code

The board reviews it's work on the UK Corporate Governance Code in the Corporate Governance Report on pages 40 to 45. The Code is available to view at www.frc.org.uk, the website of the Financial Reporting Council.

Disclosure of information to auditors

So far as each director is aware, there is no audit information relevant to the preparation of the Independent Auditors' Report of which the auditors are unaware, and each director has taken all the steps they ought to have taken as directors to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

This report was approved by the board on 8 March 2013 and signed on its behalf by

G Duggan

Geoff Duggan
Company Secretary
8 March 2013

Statement of Directors' Responsibilities in Respect of the Annual Report and Accounts and the Financial Statements

The directors are responsible for preparing the Annual Report and Accounts 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.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable 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 adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They 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 complies with that law and those regulations.

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

Responsibility statement of the directors in respect of the Annual Report and Accounts

We confirm that to the best of our knowledge:

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

Signed on behalf of the board

Steve Wilson
Group Finance Director
8 March 2013

Independent Auditor's Report

to the members of Headlam Group plc

We have audited the financial statements of Headlam Group plc for the year ended 31 December 2012 set out on pages 62 to 67. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 60, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2012 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

- the directors' statement, set out on page 27, in relation to going concern;
- the part of the Corporate Governance Statement on pages 32 to 37 relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

G. Neale

Graham Neale
(Senior Statutory Auditor)

for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
One Snowhill
Snowhill Queensway
Birmingham
B4 6HG
8 March 2013

Consolidated Income Statement
for the year ended 31 December 2012

	Note	2012 £000	2011 £000
Revenue	2	**585,984**	569,795
Cost of sales		**(410,251)**	(394,056)
Gross profit		**175,733**	175,739
Distribution expenses		**(109,621)**	(110,623)
Administrative expenses		**(36,798)**	(37,064)
Operating profit	2	**29,314**	28,052
Finance income	6	**4,476**	4,520
Finance expenses	6	**(5,329)**	(4,984)
Net finance costs		**(853)**	(464)
Profit before tax	3	**28,461**	27,588
Taxation	7	**(7,092)**	(7,184)
Profit for the year attributable to the equity shareholders		**21,369**	20,404
Dividend paid per share	22	**14.15p**	12.40p
Earnings per share			
Basic	9	**25.8p**	24.6p
Diluted	9	**25.7p**	24.4p

All group operations during the financial years were continuing operations.

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2012

		Group	
	Note	**2012 £000**	2011 £000
Profit for the year attributable to the equity shareholders		**21,369**	20,404
Other comprehensive income:			
Foreign exchange translation differences arising on translation of overseas operations		**(389)**	(234)
Actuarial losses and gains on defined benefit plans	20	**(5,595)**	(7,839)
Effective portion of changes in fair value of cash flow hedges		**(383)**	–
Transfers to profit or loss on cash flow hedges		**44**	–
Income tax on other comprehensive income		**1,168**	1,855
Other comprehensive (expense)/income for the year		**(5,155)**	(6,218)
Total comprehensive income attributable to the equity shareholders for the year		**16,214**	14,186

Statements of Financial Position

at 31 December 2012

	Note	Group 2012 £000	Group 2011 £000	Company 2012 £000	Company 2011 £000
Assets					
Non-current assets					
Property, plant and equipment	10	**96,182**	94,201	**79,672**	76,551
Intangible assets	11	**13,210**	13,210	**–**	–
Investments in subsidiary undertakings	12	**–**	–	**88,136**	87,341
Deferred tax assets	13	**2,376**	962	**1,294**	381
		111,768	108,373	**169,102**	164,273
Current assets					
Inventories	14	**115,332**	114,196	**–**	–
Trade and other receivables	15	**108,070**	111,656	**15,121**	14,951
Income tax receivable	8	**–**	–		221
Cash and cash equivalents	16	**49,798**	41,494	**28,763**	23,921
Assets held for sale	17	**212**	362	**212**	362
		273,412	267,708	**44,096**	39,455
Total assets		**385,180**	376,081	**213,198**	203,728
Liabilities					
Current liabilities					
Other interest-bearing loans and borrowings	18	**(213)**	(30,219)	**–**	(30,000)
Trade and other payables	19	**(153,755)**	(154,490)	**(39,653)**	(36,326)
Employee benefits	20	**(2,754)**	(2,669)	**(2,754)**	(2,669)
Income tax payable	8	**(7,117)**	(6,678)	**(2,988)**	–
		(163,839)	(194,056)	**(45,395)**	(68,995)
Non-current liabilities					
Other interest-bearing loans and borrowings	18	**(33,371)**	(3,691)	**(30,000)**	–
Employee benefits	20	**(14,641)**	(11,789)	**(12,590)**	(9,866)
		(48,012)	(15,480)	**(42,590)**	(9,866)
Total liabilities		**(211,851)**	(209,536)	**(87,985)**	(78,861)
Net assets		**173,329**	166,545	**125,213**	124,867
Equity attributable to equity holders of the parent					
Share capital	22	**4,268**	4,268	**4,268**	4,268
Share premium		**53,512**	53,512	**53,512**	53,512
Other reserves	22	**(5,812)**	(7,013)	**8,998**	7,408
Retained earnings		**121,361**	115,778	**58,435**	59,679
Total equity		**173,329**	166,545	**125,213**	124,867

These Financial Statements were approved by the board of directors on 8 March 2013 and were signed on its behalf by:

Tony Brewer
Director

Steve Wilson
Director

Company Number: 460129

Statement of Changes in Equity

for the year ended 31 December 2012

Group	Share capital £000	Share premium £000	Capital redemption reserve £000	Translation reserve £000	Cash flow hedging reserve £000	Treasury reserve £000	Retained earnings £000	Total equity £000
Balance at 1 January 2011	4,268	53,512	88	6,391	–	(13,050)	112,529	163,738
Profit for the year attributable to the equity shareholders	–	–	–	–	–	–	20,404	20,404
Other comprehensive income	–	–	–	(234)	–	–	(5,984)	(6,218)
Total comprehensive income for the year	–	–	–	(234)	–	–	14,420	14,186
Transactions with equity shareholders, recorded directly in equity								
Share-based payments	–	–	–	–	–	–	871	871
Consideration for purchase of own shares	–	–	–	–	–	(1,575)	–	(1,575)
Share options exercised by employees	–	–	–	–	–	1,367	(1,357)	10
Deferred tax on share options	–	–	–	–	–	–	(390)	(390)
Dividends to equity holders	–	–	–	–	–	–	(10,295)	(10,295)
Total contributions by and distributions to equity shareholders	–	–	–	–	–	(208)	(11,171)	(11,379)
Balance at 31 December 2011	4,268	53,512	88	6,157	–	(13,258)	115,778	166,545
Balance at 1 January 2012	**4,268**	**53,512**	**88**	**6,157**	**–**	**(13,258)**	**115,778**	**166,545**
Profit for the year attributable to the equity shareholders	**–**	**–**	**–**	**–**	**–**	**–**	**21,369**	**21,369**
Other comprehensive income	**–**	**–**	**–**	**(389)**	**(339)**	**–**	**(4,427)**	**(5,155)**
Total comprehensive income for the year	**–**	**–**	**–**	**(389)**	**(339)**	**–**	**16,942**	**16,214**
Transactions with equity shareholders, recorded directly in equity								
Share-based payments	**–**	**–**	**–**	**–**	**–**	**–**	**1,183**	**1,183**
Share options exercised by employees	**–**	**–**	**–**	**–**	**–**	**1,929**	**(1,013)**	**916**
Deferred tax on share options	**–**	**–**	**–**	**–**	**–**	**–**	**134**	**134**
Dividends to equity holders	**–**	**–**	**–**	**–**	**–**	**–**	**(11,663)**	**(11,663)**
Total contributions by and distributions to equity shareholders	**–**	**–**	**–**	**–**	**–**	**1,929**	**(11,359)**	**(9,430)**
Balance at 31 December 2012	**4,268**	**53,512**	**88**	**5,768**	**(339)**	**(11,329)**	**121,361**	**173,329**

Statement of Changes in Equity

for the year ended 31 December 2012

Company	Share capital £000	Share premium £000	Capital redemption reserve £000	Special reserve £000	Cash flow hedging reserve £000	Treasury reserve £000	Retained earnings £000	Total equity £000
Balance at 1 January 2011	4,268	53,512	88	20,578	–	(13,050)	69,775	135,171
Profit for the year attributable to the equity shareholders	–	–	–	–	–	–	6,419	6,419
Other comprehensive income	–	–	–	–	–	–	(5,577)	(5,577)
Total comprehensive income for the year	–	–	–	–	–	–	842	842
Transactions with equity shareholders, recorded directly in equity								
Share-based payments	–	–	–	–	–	–	871	871
Consideration for purchase of own shares	–	–	–	–	–	(1,575)	–	(1,575)
Share options exercised by employees	–	–	–	–	–	1,367	(1,357)	10
Deferred tax on share options	–	–	–	–	–	–	(157)	(157)
Dividends to equity holders	–	–	–	–	–	–	(10,295)	(10,295)
Total contributions by and distributions to equity shareholders	–	–	–	–	–	(208)	(10,938)	(11,146)
Balance at 31 December 2011	4,268	53,512	88	20,578	–	(13,258)	59,679	124,867
Balance at 1 January 2012	**4,268**	**53,512**	**88**	**20,578**	**–**	**(13,258)**	**59,679**	**124,867**
Profit for the year attributable to the equity shareholders	**–**	**–**	**–**	**–**	**–**	**–**	**14,705**	**14,705**
Other comprehensive income	**–**	**–**	**–**	**–**	**(339)**	**–**	**(4,501)**	**(4,840)**
Total comprehensive income for the year	**–**	**–**	**–**	**–**	**(339)**	**–**	**10,204**	**9,865**
Transactions with equity shareholders, recorded directly in equity								
Share-based payments	**–**	**–**	**–**	**–**	**–**	**–**	**1,183**	**1,183**
Share options exercised by employees	**–**	**–**	**–**	**–**	**–**	**1,929**	**(1,013)**	**916**
Deferred tax on share options	**–**	**–**	**–**	**–**	**–**	**–**	**45**	**45**
Dividends to equity holders	**–**	**–**	**–**	**–**	**–**	**–**	**(11,663)**	**(11,663)**
Total contributions by and distributions to equity shareholders	**–**	**–**	**–**	**–**	**–**	**1,929**	**(11,448)**	**(9,519)**
Balance at 31 December 2012	**4,268**	**53,512**	**88**	**20,578**	**(339)**	**(11,329)**	**58,435**	**125,213**

Cash Flow Statements

for the year ended 31 December 2012

	Note	Group 2012 £000	Group 2011 £000	Company 2012 £000	Company 2011 £000
Cash flows from operating activities					
Profit before tax for the year		**28,461**	27,588	**1,700**	2,428
Adjustments for:					
Depreciation, amortisation and impairment		**4,695**	4,883	**1,468**	1,471
Net settlement loss on enhanced transfer value exercise		**–**	56	**–**	56
Finance income	6	**(4,476)**	(4,520)	**(4,261)**	(4,370)
Finance expense	6	**5,329**	4,984	**4,425**	4,263
Profit on sale of property, plant and equipment		**(185)**	(86)	**(133)**	–
Share-based payments	21	**1,183**	871	**388**	233
Operating cash flows before changes in working capital and other payables		**35,007**	33,776	**3,587**	4,083
Change in inventories		**(491)**	(8,700)	**–**	–
Change in trade and other receivables		**3,498**	(9,764)	**25**	392
Change in trade and other payables		**(819)**	5,544	**2,972**	8,708
Cash generated from the operations		**37,195**	20,856	**6,584**	13,183
Interest paid		**(1,682)**	(1,342)	**(897)**	(614)
Tax (paid)/received		**(6,766)**	(3,380)	**3,295**	1,330
Additional contributions to defined benefit plan	20	**(2,839)**	(2,781)	**(2,839)**	(2,781)
Enhanced transfer value exercise payments		**–**	(3,302)	**–**	(3,302)
Net cash flow from operating activities		**25,908**	10,051	**6,143**	7,816
Cash flows from investing activities					
Proceeds from sale of property, plant and equipment		**1,530**	110	**1,391**	–
Interest received		**768**	751	**453**	429
Dividends received		**–**	–	**13,299**	4,221
Acquisition of subsidiaries, net of cash acquired	24	**(771)**	–	**–**	–
Acquisition of property, plant and equipment	10	**(7,999)**	(2,035)	**(5,697)**	(54)
Net cash flow from investing activities		**(6,472)**	(1,174)	**9,446**	4,596
Cash flows from financing activities					
Proceeds from the issue of treasury shares		**916**	10	**916**	10
Payment to acquire own shares		**–**	(1,575)	**–**	(1,575)
Repayment of borrowings		**(213)**	(228)	**–**	–
Dividends paid	22	**(11,663)**	(10,295)	**(11,663)**	(10,295)
Net cash flow from financing activities		**(10,960)**	(12,088)	**(10,747)**	(11,860)
Net increase/(decrease) in cash and cash equivalents		**8,476**	(3,211)	**4,842**	552
Cash and cash equivalents at 1 January		**41,494**	44,758	**23,921**	23,369
Effect of exchange rate fluctuations on cash held		**(172)**	(53)	**–**	–
Cash and cash equivalents at 31 December	16	**49,798**	41,494	**28,763**	23,921

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

Notes to the Financial Statements

1 ACCOUNTING POLICIES

Reporting entity

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

Statement of compliance

Both the company's financial statements and the group's financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards as adopted by the EU ("adopted IFRS"). On publishing the company's financial statements here together with the group financial statements, the company is taking advantage of the exemption in s408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements.

The company and group financial statements were authorised for issuance on 8 March 2013.

Basis of preparation

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

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

(a) Measurement convention

These financial statements are presented in pounds sterling, which is the group's functional currency. All financial information presented in pounds sterling has been rounded to the nearest thousand.

The company and group financial statements are prepared on the historical cost basis with the exception of derivative financial instruments and pension scheme assets, both of which are stated at fair value. Non-current assets held for sale are stated at the lower of previous carrying amount and fair value less costs to sell.

The financial statements have been prepared on a going concern basis. In determining the appropriate basis of preparation of the financial statements the directors are required to consider whether the group can continue in operational existence for the foreseeable future.

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chairman's Statement and Chief Executive's Review on pages 20 to 25.

The financial position of the group, its cash flows, liquidity position and borrowing facilities are described in the Financial Review on pages 26 to 27. In addition, note 23 to the Financial Statements include the group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The group meets its day-to-day working capital requirements through its banking facilities. On the 8 March 2012 the group completed a refinancing of its existing facilities, which were due for renewal in July 2012. The group's new banking arrangements, which run to March 2017 increased the level of committed facilities from £30 million to £40 million, and maintain uncommitted facilities at £35 million, which are renewable on an annual basis.

The directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

(b) Use of accounting estimates and judgements

The preparation of financial statements in conformity with adopted IFRSs requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting year. Although these estimates are based on management's best knowledge of the amount, events or actions, actual results ultimately may differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The key sources of estimation uncertainty at the Statement of Financial Position 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 commences, the existing facility is marketed for sale and this action can on occasions give rise to an adverse difference between carrying value and market value. At the Statement of Financial Position date, the assets have been reported at their carrying value. Market values are formally assessed for all properties on a triennial basis and compared with the carrying values.

1 ACCOUNTING POLICIES continued

At the latest review, carried out at 31 December 2010, the 2012 carrying value of UK freehold and long leasehold land and buildings would have exceeded market value (on an existing use basis) by £10,987,000. The directors consider that the carrying value of the UK freehold and long leasehold land and buildings is supported by their ongoing value in use within the business. An impairment review has been undertaken on the portfolio each year. No impairment was considered necessary in 2012 or 2011.

Goodwill impairment

The outcome of the group's annual impairment test for goodwill is dependent on the forecast cash flows of each cash-generating unit together with key management assumptions including profit growth and discount rates. No impairment resulted from the annual impairment test for 2012.

Deferred tax assets

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

Employee benefits

The deficit relating to the group's defined benefit plans is assessed annually in accordance with IAS 19 and after taking independent actuarial advice. The principle assumptions are set out in note 20. The amount of the deficit is dependent on plan asset and liability values and the actuarial assumptions used to determine the deficit.

The assumptions include asset growth rates, pension and salary increases, price inflation, discount rate used to measure actuarial liabilities and mortality rates.

(c) Impact of newly adopted accounting standards

There have been no significant changes in accounting policies or any material impact on the group financial statements arising from the adoption of new accounting standards and interpretations in 2012.

(d) IFRS not yet applied

The following amendment has been published and endorsed by the EU, but have not yet been applied by the group in these financial statements:

- Amendments to International Accounting Standard 1 relating to the presentation of Items of Other Comprehensive Income
- International Financial Reporting Standard (IFRS) 10 "Consolidated Financial Statements"
- International Financial Reporting Standard (IFRS) 11 "Joint Arrangements"
- International Financial Reporting Standard (IFRS) 12 "Disclosure of interests in other entities"
- International Financial Reporting Standard (IFRS) 13 "Fair value measurement"
- Amendment to International Accounting Standard (IAS) 19 "Employee benefits"
- International Accounting Standard 27 "Separate Financial Statements (2011)"
- International Accounting Standard 28 "Investments in Associates and Joint Ventures (2011)"
- IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine"
- Amendments to International Accounting Standard 32 and International Financial Reporting Standard 7 relating to Offsetting Financial Assets and Financial Liabilities

Except for the amendment to IAS 19, none of these standards or amendments are expected to impact profit, earnings per share and net assets in future periods.

The amendment to IAS 19 makes significant changes to the recognition and measurement of the defined benefit pension expense and termination benefits and disclosures relating to all employee benefits. The amendment is effective for accounting periods commencing on 1 January 2013 and it is anticipated that the total pension cost relating to defined benefit schemes recognised in the income statement in 2013 will be approximately £2.1 million on a revised IAS 19 basis.

In 2013, comparative information for 2012 will be restated on a revised IAS 19 basis, which will lead to an increase of £0.6 million in the reported 2012 total pension cost to £2.1 million.

Basis of consolidation

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.

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

The financial statements of subsidiaries are included in the group's 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 in the group's financial statements.

Notes to the Financial Statements continued

1 ACCOUNTING POLICIES continued

Foreign currency

Foreign currency transactions

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 Statement of Financial Position 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.

Financial statements of foreign operations

The assets and liabilities of foreign subsidiaries, are translated at foreign exchange rates ruling at the Statement of Financial Position date.

The revenues, expenses and cash flows 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 and reflected as a movement in the Statement of Comprehensive Income.

In respect of all foreign operations, any differences that have arisen after 1 January 2004, the date of transition to IFRS, are presented as a separate component of equity.

Foreign currency exposure

Note 23 contains information about the foreign currency exposure of the group and risks in relation to foreign exchange movements.

Derivative financial instruments

The group holds derivative financial instruments to hedge its foreign currency and its interest rate risk exposures. Derivatives are recognised initially at fair value; attributable transaction costs are recognised in the income statement when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Cash flow hedges

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in the income statement. If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to the income statement in the same period that the hedged item affects profit or loss.

The fair value of interest rate swaps is based on third party valuations. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

The fair value of forward exchange contracts is their quoted market price at the Statement of Financial Position date, being the present value of the quoted forward price. The gain or loss on remeasurement to fair value of forward exchange contracts is recognised immediately in the income statement.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and any other costs directly attributable to bringing the asset to a working condition for its intended use.

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.

Depreciation is charged to the income statement on a straight-line basis. 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%
Land is not depreciated.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognised in the income statement.

1 ACCOUNTING POLICIES continued

Goodwill and other intangible assets

Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries. In respect of business acquisitions that have occurred since 1 January 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

Following the requirements of IFRS 3 revised, transaction costs associated with acquisitions and movements in contingent consideration are recognised in the income statement.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortised but, tested annually for impairment, or more frequently when there is an indicator that the unit may be impaired.

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.

Other intangibles

Other intangible assets that are acquired by the group are stated at cost less accumulated amortisation and impairment losses. Intangible assets recognised as a result of a business combination are stated at fair value at the date of acquisition less cumulative amortisation and impairment losses.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets unless such lives are indefinite. Intangible assets with an indefinite useful life and goodwill are systematically tested for impairment at each Statement of Financial Position 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 one and 24 months.

Non-current assets held for sale

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

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

Trade and other receivables

Trade and other receivables are initially stated at fair value and subsequently at amortised cost less impairment losses. Debts are provided for, the credit loss allowance, on specific receivables in full as soon as they are known to be “bad” or it becomes apparent that payment is “doubtful”.

Inventories

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

Allowances for inventory losses are determined by reference to each individual product and are calculated by assessing the age and quantity of each individual product.

Cash and cash equivalents

Cash and cash equivalents are carried in the Statement of Financial Position at amortised cost.

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

Impairment

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

The recoverable amount for goodwill is estimated at each Statement of Financial Position date.

For the purposes of impairment testing assets are grouped together into the smallest group of assets that generates cash flows from continuing use that are largely independent of the cash inflows from other groups of assets.

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.

Notes to the Financial Statements continued

1 ACCOUNTING POLICIES continued

Calculation of recoverable amount

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

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

Reversals of impairment

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.

Trade payables

Trade payables are initially recognised at fair value and then are stated at amortised cost.

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.

Borrowing costs

Borrowing costs are capitalised where the group constructs qualifying assets. All other borrowing costs are written off to the income statement as incurred.

Borrowing costs are charged to the income statement using the effective interest rate method.

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 is deducted. The liability discount rate is the yield at the Statement of Financial Position 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 Comprehensive Income.

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

The group operates a UK defined benefit pension plan and a defined benefit plan in Switzerland. In the UK 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.

1 ACCOUNTING POLICIES continued

Further details of the share plans are given in the Remuneration Report on pages 46 to 54.

The fair value of options granted is recognised as an employee expense with a corresponding increase in equity over the period that the employees unconditionally become entitled to the award. 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 market conditions such as share prices not achieving the threshold for vesting.

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

Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, net of any tax effects is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to or from retained earnings.

Revenue

Revenue from the sale of goods is measured at the fair value of the consideration, net of trade discounts and excludes intra-group sales and value added and similar taxes. Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods are transferred to the buyer (which is the date on which goods are received by the customer), 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.

Lease payments

Leases are classified as finance leases whenever the lease transfers substantially all the risks and rewards of ownership to the group. All other leases are treated as operating leases.

Assets held under finance leases are included in property, plant and equipment at the lower of fair value at the date of acquisition or the present value of the minimum lease payments. The capital element of outstanding finance leases is included in financial liabilities. The finance charge element of rentals is charged to the income statement at a constant period rate of charge on the outstanding obligations.

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.

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.

Dividends

Interim and final dividends are recognised when they are paid or when approved by the members in a general meeting. Final dividends proposed by the board and unpaid at the end of the year are not recognised in the financial statements.

Taxation

Income tax 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 Statement of Financial Position date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the Statement of Financial Position 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.

Notes to the Financial Statements continued

2 SEGMENT REPORTING

The group has 52 operating segments in the UK and five operating segments in continental Europe. Each segment represents an individual trading operation, and each operation is wholly aligned to the sales, marketing, supply and distribution of floorcovering products. The operating results of each operation are regularly reviewed by the Chief Operating Decision Maker, which is deemed to be the Group Chief Executive. Discrete financial information is available for each segment and used by the Group Chief Executive to assess performance and decide on resource allocation.

The operating segments have been aggregated to the extent that they have similar economic characteristics, with relevance to products and services, type and class of customer, methods of sale and distribution and the regulatory environment in which they operate. The group's internal management structure and financial reporting systems differentiate the operating segments on the basis of the differing economic characteristics in the UK and continental Europe and accordingly present these as two separate reportable segments. This distinction is embedded in the construction of operating reports reviewed by the Group Chief Executive, the board and the executive management team and forms the basis for the presentation of operating segment information given below.

	UK		Continental Europe		Total	
	2012 £000	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000
Revenue						
External revenues	**492,256**	466,968	**93,728**	102,827	**585,984**	569,795
Reportable segment operating profit	**28,275**	25,696	**2,036**	2,830	**30,311**	28,526
Reportable segment assets	**226,595**	220,878	**39,583**	45,427	**266,178**	266,305
Reportable segment liabilities	**(137,563)**	(136,358)	**(15,853)**	(18,132)	**(153,416)**	(154,490)

During the year there are no inter-segment revenues for the reportable segments *(2011: £nil)*.

Reconciliations of reportable segment profit, assets and liabilities and other material items:

	2012 £000	2011 £000
Profit for the year		
Total profit for reportable segments	**30,311**	28,526
Unallocated expense	**(997)**	(474)
Operating profit	**29,314**	28,052
Finance income	**4,476**	4,520
Finance expense	**(5,329)**	(4,984)
Profit before taxation	**28,461**	27,588
Taxation	**(7,092)**	(7,184)
Profit for the year	**21,369**	20,404

2 SEGMENT REPORTING continued

	2012 £000	2011 £000
Assets		
Total assets for reportable segments	**266,178**	266,305
Unallocated assets:		
Properties, plant and equipment	**87,651**	84,531
Deferred tax assets	**2,376**	962
Assets held for sale	**212**	362
Cash and cash equivalents	**28,763**	23,921
Total assets	**385,180**	376,081
Liabilities		
Total liabilities for reportable segments	**(153,416)**	(154,490)
Unallocated liabilities:		
Employee benefits	**(17,395)**	(14,458)
Other interest-bearing loans and borrowings	**(33,584)**	(33,910)
Income tax payable	**(7,117)**	(6,678)
Derivative liabilities	**(339)**	–
Total liabilities	**(211,851)**	(209,536)

	UK £000	Continental Europe £000	Reportable segment total £000	Unallocated £000	Consolidated total £000
Other material items 2012					
Capital expenditure	**2,008**	**271**	**2,279**	**5,720**	**7,999**
Depreciation	**2,193**	**648**	**2,841**	**1,764**	**4,605**
Amortisation	**–**	**–**	**–**	**90**	**90**
Other material items 2011					
Capital expenditure	1,358	593	1,951	84	2,035
Depreciation	2,240	798	3,038	1,845	4,883

In the UK the group's freehold properties are held within Headlam Group plc and a rent is charged to the operating segments for the period of use. Therefore the operating reports reviewed by the Group Chief Executive show all the UK properties as unallocated and the operating segments report a segment result that includes a property rent. This is reflected in the above disclosure.

Each segment is a continuing operation.

The Group Chief Executive, the board and the senior executive management team have access to information that provides details on revenue by principal product group for the two reportable segments, as set out in the following table:

	UK		Continental Europe		Total	
	2012 £000	2011 £000	2012 £000	2011 £000	2012 £000	2011 £000
Revenue						
Residential	**337,569**	320,290	**43,959**	50,047	**381,528**	370,337
Commercial	**154,687**	146,678	**49,769**	52,780	**204,456**	199,458
	492,256	466,968	**93,728**	102,827	**585,984**	569,795

Notes to the Financial Statements continued

3 PROFIT BEFORE TAX

The following are included in profit before tax:

	2012 £000	2011 £000
Depreciation on property, plant and equipment	**4,605**	4,883
Amortisation of intangible assets	**90**	–
Profit on sale of property, plant and equipment	**(185)**	(86)
Operating lease rentals		
Plant and machinery	**9,821**	9,421
Land and buildings	**1,814**	1,628

Auditor's remuneration:

	2012 £000	2011 £000
Audit of these financial statements	**68**	64
Amounts received by the auditors and their associates in respect of:		
Audit of financial statements of subsidiaries of the company	**155**	152
Other tax advisory services	**3**	38
All other services	**14**	7
	240	261

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.

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	
	2012	2011
By sector:		
Floorcoverings	**2,098**	2,053
Central operations	**9**	9
	2,107	2,062
By function:		
Sales and distribution	**1,947**	1,896
Administration	**160**	166
	2,107	2,062

The aggregate payroll costs were as follows:

	£000	£000
Wages and salaries	**67,188**	66,755
Equity settled share-based payment expense	**1,183**	871
Social security costs	**8,805**	8,965
Pension costs *(note 20)*	**3,663**	3,472
	80,839	80,063

5 EMOLUMENTS OF KEY MANAGEMENT PERSONNEL

Executive and non-executive directors are considered to be the key management personnel of the group.

	2012 £000	2011 £000
Short term employee benefits	**2,137**	2,094
Equity settled share-based payment expense	**312**	199
	2,449	2,293

Short term employee benefits comprise salary and benefits earned during the year and bonuses awarded for the year.

6 FINANCE INCOME AND EXPENSE

	2012 £000	2011 £000
Interest income:		
Bank interest	**783**	657
Other	**–**	49
Return on defined benefit plan assets	**3,693**	3,814
Finance income	**4,476**	4,520
Interest expense:		
Bank loans, overdrafts and other financial expenses	**(1,490)**	(1,188)
Net change in fair value of cash flow hedges transferred from equity	**(44)**	–
Interest on defined benefit plan obligation	**(3,628)**	(3,796)
Other	**(167)**	–
Finance expenses	**(5,329)**	(4,984)

7 TAXATION

Recognised in the income statement

	2012 £000	2011 £000
Current tax expense:		
Current year	**6,959**	6,026
Adjustments for prior years	**253**	(241)
	7,212	5,785
Deferred tax expense:		
Origination and reversal of temporary differences	**377**	1,707
Effect of change in UK tax rate	**(126)**	(180)
Adjustments for prior years	**(371)**	(128)
	(120)	1,399
Total tax in income statement	**7,092**	7,184

Notes to the Financial Statements continued

7 TAXATION continued

	2012 £000	2011 £000
Tax relating to items credited/(charged) to equity		
Current tax on:		
Income and expenses recognised directly in equity	**8**	–
Deferred tax on:		
Share options	**134**	(390)
Deferred tax on other comprehensive income:		
Defined benefit plans	**1,082**	1,855
Cash flow hedge	**78**	–
Total tax reported directly in reserves	**1,302**	1,465

The 2012 Budget on 21 March 2012 announced that the UK corporation tax rate will reduce to 22% by 2014, and the December 2012 Autumn Statement announced a planned further reduction to 21% by 2014.

A reduction in the rate from 26% to 25% (effective from 1 April 2012) was substantively enacted on 5 July 2011, and further reductions to 24% (effective from 1 April 2012) and 23% (effective from 1 April 2013) were substantively enacted on 26 March 2012 and 3 July 2012 respectively. This will reduce the company's future current tax charge accordingly. The deferred tax asset at 31 December 2012 has been calculated based on the rate of 23% substantively enacted at the balance sheet date.

It has not yet been possible to quantify the full anticipated effect of the announced further 2% rate reduction, although this will further reduce the company's future current tax charge and reduce the company's deferred tax asset accordingly.

Reconciliation of effective tax rate

	2012		2011	
	%	£000	%	£000
Profit before tax		**28,461**		27,588
Tax using the UK corporation tax rate	**24.5**	**6,972**	26.5	7,309
Effect of change in UK tax rate	**(0.4)**	**(118)**	(0.5)	(147)
Profit on sale of non-qualifying fixed assets	**(0.2)**	**(68)**	–	–
Non-deductible expenses	**1.5**	**427**	1.5	419
Effect of tax rates in foreign jurisdictions	**(0.1)**	**(4)**	(0.1)	(28)
Over provided in prior years	**(0.4)**	**(117)**	(1.4)	(369)
Total tax in income statement	**24.9**	**7,092**	26.0	7,184

8 CURRENT TAX LIABILITIES

The group's current tax liability of £7,117,000 *(2011: £6,678,000)* represents the amount of income tax payable in respect of current and prior year periods which exceed any amounts recoverable. The company's current tax liability of £2,988,000 *(2011: £221,000 asset)* represents the amount of income tax payable in respect of current and prior year periods which exceed any amounts recoverable.

9 EARNINGS PER SHARE

	2012 £000	2011 £000
Earnings		
Earnings for the purposes of basic earnings per share being profit attributable to equity holders of the parent	**21,369**	20,404

	2012	2011
Number of shares		
Issued ordinary shares at 31 December	**85,363,743**	85,363,743
Effect of shares held in treasury	**(2,672,553)**	(2,423,159)
Weighted average number of ordinary shares for the purposes of basic earnings per share	**82,691,190**	82,940,584
Effect of diluted potential ordinary shares:		
Weighted average number of ordinary shares at 31 December	**82,691,190**	82,940,584
Dilutive effect of share options	**446,420**	596,479
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**83,137,610**	83,537,063

At 31 December 2012, the company held 2,427,794 *(2011: 2,841,197)* shares which have been disclosed in the treasury reserve and these are excluded from the calculation of earnings per share.

Notes to the Financial Statements continued

10 PROPERTY, PLANT AND EQUIPMENT

Group	Land & buildings £000	Plant & equipment £000	Under construction £000	Total £000
Cost				
Balance at 1 January 2011	100,454	27,464	58	127,976
Additions	31	1,950	54	2,035
Disposals	–	(1,633)	–	(1,633)
Effect of movements in foreign exchange	(127)	(121)	–	(248)
Balance at 31 December 2011	100,358	27,660	112	128,130
Balance at 1 January 2012	**100,358**	**27,660**	**112**	**128,130**
Acquisitions	**4**	**51**	**–**	**55**
Additions	**212**	**2,138**	**5,649**	**7,999**
Disposals	**(1,224)**	**(1,369)**	**(2)**	**(2,595)**
Effect of movements in foreign exchange	**(329)**	**(199)**	**–**	**(528)**
Transfer to use	**1,003**	**–**	**(1,003)**	**–**
Transfer to assets held for sale	**(270)**	**–**	**–**	**(270)**
Balance at 31 December 2012	**99,754**	**28,281**	**4,756**	**132,791**
Depreciation				
Balance at 1 January 2011	14,106	16,655	–	30,761
Depreciation charge for the year	1,811	3,072	–	4,883
Disposals	–	(1,609)	–	(1,609)
Effect of movements in foreign exchange	(17)	(89)	–	(106)
Balance at 31 December 2011	15,900	18,029	–	33,929
Balance at 1 January 2012	**15,900**	**18,029**	**–**	**33,929**
Depreciation charge for the year	**1,744**	**2,861**	**–**	**4,605**
Disposals	**(337)**	**(1,273)**	**–**	**(1,610)**
Effect of movements in foreign exchange	**(118)**	**(139)**	**–**	**(257)**
Transfer to assets held for sale	**(58)**	**–**	**–**	**(58)**
Balance at 31 December 2012	**17,131**	**19,478**	**–**	**36,609**
Net book value				
At 1 January 2011	86,348	10,809	58	97,215
At 31 December 2011 and 1 January 2012	84,458	9,631	112	94,201
At 31 December 2012	**82,623**	**8,803**	**4,756**	**96,182**

At 31 December 2012 the cost less accumulated depreciation of long leasehold property held by the group was £8,332,000 *(2011: £8,512,000).*

10 PROPERTY, PLANT AND EQUIPMENT continued

Company	Land & buildings £000	Plant & equipment £000	Under construction £000	Total £000
Cost				
Balance at 1 January 2011	87,418	596	58	88,072
Additions	–	–	54	54
Disposals	–	(305)	–	(305)
Balance at 31 December 2011	87,418	291	112	87,821
Balance at 1 January 2012	**87,418**	**291**	**112**	**87,821**
Additions	**1**	**47**	**5,649**	**5,697**
Disposals	**(1,202)**	**(169)**	**(2)**	**(1,373)**
Transfer to use	**1,003**	**–**	**(1,003)**	**–**
Transfer to assets held for sale	**(270)**	**–**	**–**	**(270)**
Balance at 31 December 2012	**86,950**	**169**	**4,756**	**91,875**
Depreciation				
Balance at 1 January 2011	9,605	499	–	10,104
Depreciation charge for the year	1,432	39	–	1,471
Disposals	–	(305)	–	(305)
Balance at 31 December 2011	11,037	233	–	11,270
Balance at 1 January 2012	**11,037**	**233**	**–**	**11,270**
Depreciation charge for the year	**1,426**	**42**	**–**	**1,468**
Disposals	**(315)**	**(162)**	**–**	**(477)**
Transfer to assets held for sale	**(58)**	**–**	**–**	**(58)**
Balance at 31 December 2012	**12,090**	**113**	**–**	**12,203**
Net book value				
At 1 January 2011	77,813	97	58	77,968
At 31 December 2011 and 1 January 2012	76,381	58	112	76,551
At 31 December 2012	**74,860**	**56**	**4,756**	**79,672**

At 31 December 2012 the cost less accumulated depreciation of long leasehold property held by the company was £8,332,000 *(2011: £8,512,000).*

Notes to the Financial Statements continued

11 INTANGIBLE ASSETS – GROUP

	Goodwill £000	Customer lists £000	Total £000
Cost			
Balance at 1 January 2011 and 31 December 2011	13,210	4,142	17,352
Balance at 1 January 2012	**13,210**	**4,142**	**17,352**
Additions *(note 24)*	**–**	**90**	**90**
Balance at 31 December 2012	**13,210**	**4,232**	**17,442**
Amortisation			
Balance at 1 January 2011 and 31 December 2011	–	4,142	4,142
Balance at 1 January 2012	**–**	**4,142**	**4,142**
Charge for the year	**–**	**90**	**90**
Balance at 31 December 2012	**–**	**4,232**	**4,232**
Net book value			
At 1 January 2011 and 31 December 2011	13,210	–	13,210
At 1 January 2012 and 31 December 2012	**13,210**	**–**	**13,210**

Cumulative impairment losses recognised in relation to goodwill is £nil (*2011: £nil*).

Impairment tests for cash-generating units containing goodwill ("CGU")

Goodwill is attributed to the businesses identified below for the purpose of testing impairment. These businesses are the lowest level at which goodwill is monitored and represent operating segments.

The aggregate carrying amounts of goodwill allocated to each CGU are as follows:

	Reported Segment	2012 £000	2011 £000
Joseph, Hamilton & Seaton	**UK**	**4,348**	4,348
Crucial Trading	**UK**	**1,369**	1,369
Belcolor AG	**Continental Europe**	**3,342**	3,342
LMS SA	**Continental Europe**	**3,197**	3,197
Other	**UK**	**954**	954
		13,210	13,210

Impairment

Each year, or whenever events or a change in the economic environment or performance indicates a risk of impairment, the group reviews the value of goodwill balances allocated to its cash-generating units.

An impairment test is a comparison of the carrying value of the assets of a business or CGU to their recoverable amount. The recoverable amount represents the higher of the CGU's fair value less the cost to sell and value in use. Where the recoverable amount is less than the carrying value, an impairment results. During the year, all goodwill was tested for impairment, with no impairment charge resulting.

Value in use was determined by discounting the future cash flows generated from the continuing use of the CGU on a basis consistent with 2011, and applying the following key assumptions.

11 INTANGIBLE ASSETS – GROUP continued

Key assumptions

Cash flows were projected based on actual operating results, the approved 2013 business plan and management assessment of planned performance in the period to 2017. For the purpose of impairment testing the cash flows were assumed to grow into perpetuity at a rate of 2.5% beyond 2017.

The main assumptions within the operating cash flows used for 2013 include the achievement of future sales volumes and prices for all key product lines, control of purchase prices, achievement of budgeted operating costs and no significant adverse foreign exchange rate movements. These assumptions have been reviewed in light of the current economic environment.

The directors have estimated the discount rate by reference to an industry average weighted average cost of capital. This has been adjusted to include an appropriate risk factor to reflect current economic circumstances and the risk profile of the CGUs. A pre tax weighted average cost of capital of 12.3% *(2011: 12.2%)* has been used for impairment testing, adjusted to 14.1% *(2011: 13.2%)* for continental Europe to reflect the differing risk profile of that segment. The pre tax discount rate has been applied to the pre tax cash flows.

The CGUs in the UK have similar characteristics, and risk profiles, and therefore a single discount rate has been applied to each UK CGU. Similarly, the directors view the CGUs in continental Europe as having consistent risk profiles and therefore a single risk factor has been applied. The CGUs in continental Europe operate under a different regulatory environment and this is therefore reflected in the risk factor used to determine the discount rates in the UK and continental Europe.

Sensitivity analysis

The two key assumptions made by the directors are the discount rate used and the growth rate beyond 2017.

With the exception of the goodwill attributed to the LMS CGU, sensitivity analysis has been carried out by reference to both of these assumptions and neither a 1% increase in the discount rate or a 1% reduction in the growth rate would result in any impairment.

In respect of the goodwill attributed to the LMS CGU, a 0.5% increase in the discount rate or a 0.8% reduction in the growth rate into perpetuity would result in an impairment. This sensitivity reflects the current difficult trading conditions in continental Europe.

12 INVESTMENTS IN SUBSIDIARIES

Summary information on investments in subsidiary undertakings is as follows:

	£000
Cost	
Balance at 1 January 2011	86,703
Share options granted to employees of subsidiary undertakings	638
Balance at 31 December 2011	87,341
Balance at 1 January 2012	**87,341**
Share options granted to employees of subsidiary undertakings	**795**
Balance at 31 December 2012	**88,136**
Carrying value	
At 1 January 2011	86,703
At 31 December 2011	87,341
At 31 December 2012	**88,136**

The principal trading subsidiaries are listed on page 107. There were no impairments recognised on the company's investments in subsidiaries at the year ended 31 December 2012.

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	
	2012 £000	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000
Property, plant and equipment	**–**	–	**(2,661)**	(3,198)	**(2,661)**	(3,198)
Intangible assets	**–**	–	**(209)**	(206)	**(209)**	(206)
Employee benefits	**4,680**	3,793	**–**	–	**4,680**	3,793
Hedging	**78**	–	**–**	–	**78**	–
Other items	**488**	573	**–**	–	**488**	573
Tax assets/(liabilities)	**5,246**	4,366	**(2,870)**	(3,404)	**2,376**	962
Set-off of tax	**(2,870)**	(3,404)	**2,870**	3,404	**–**	–
	2,376	962	**–**	–	**2,376**	962

Movement in deferred tax during the year

	1 January 2012 £000	**Recognised income £000**	**Recognised in equity £000**	**31 December 2012 £000**
Property, plant and equipment	**(3,198)**	**537**	**–**	**(2,661)**
Intangible assets	**(206)**	**(3)**	**–**	**(209)**
Employee benefits	**3,793**	**(329)**	**1,216**	**4,680**
Hedging	**–**	**–**	**78**	**78**
Other items	**573**	**(85)**	**–**	**488**
	962	**120**	**1,294**	**2,376**

Movement in deferred tax during the prior year

	1 January 2011 £000	Recognised in income £000	Recognised in equity £000	31 December 2011 £000
Property, plant and equipment	(3,683)	485	–	(3,198)
Intangible assets	(223)	17	–	(206)
Employee benefits	3,891	(1,563)	1,465	3,793
Other items	911	(338)	–	573
	896	(1,399)	1,465	962

Unrecognised deferred tax assets and liabilities

At the Statement of Financial Position date the group has unused capital losses of £10,055,000 *(2011: £10,380,000)* available for offset against future chargeable gains. No deferred tax asset has been recognised in respect of this amount as the directors do not anticipate incurring significant chargeable gains in the foreseeable future.

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	
	2012 £000	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000
Property, plant and equipment	**–**	–	**(2,571)**	(2,962)	**(2,571)**	(2,962)
Employee benefits	**3,621**	3,086	**–**	–	**3,621**	3,086
Hedging	**78**	–	**–**	–	**78**	–
Other items	**166**	257	**–**	–	**166**	257
Tax assets/(liabilities)	**3,865**	3,343	**(2,571)**	(2,962)	**1,294**	381
Set-off of tax	**(2,571)**	(2,962)	**2,571**	2,962	**–**	–
	1,294	381	**–**	–	**1,294**	381

Movement in deferred tax during the year

	1 January 2012 £000	**Recognised in income £000**	**Recognised in equity £000**	**31 December 2012 £000**
Property, plant and equipment	**(2,962)**	**391**	**–**	**(2,571)**
Employee benefits	**3,086**	**(627)**	**1,162**	**3,621**
Hedging	**–**	**–**	**78**	**78**
Other items	**257**	**(91)**	**–**	**166**
	381	**(327)**	**1,240**	**1,294**

Movement in deferred tax during the prior year

	1 January 2011 £000	Recognised in income £000	Recognised in equity £000	31 December 2011 £000
Property, plant and equipment	(3,271)	309	–	(2,962)
Employee benefits	3,217	(1,694)	1,563	3,086
Other items	267	(10)	–	257
	213	(1,395)	1,563	381

Unrecognised deferred tax assets and liabilities

At the Statement of Financial Position date the company has unused capital losses of £10,055,000 *(2011: £10,380,000)* available for offset against future chargeable gains. No deferred tax asset has been recognised in respect of this amount as the directors do not anticipate incurring significant chargeable gains in the foreseeable future.

Notes to the Financial Statements continued

14 INVENTORIES

	Group		Company	
	2012 £000	2011 £000	2012 £000	2011 £000
	115,332	114,196	**–**	–

Cost of sales consists of the following:

	Group		Company	
	2012 £000	2011 £000	2012 £000	2011 £000
Material cost	**407,223**	391,345	**–**	–
Processing cost	**3,028**	2,711	**–**	–
	410,251	394,056	**–**	–

15 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2012 £000	2011 £000	2012 £000	2011 £000
Trade receivables	**85,378**	87,848	**–**	–
Prepayments and accrued income	**3,425**	4,089	**47**	59
Other receivables	**19,267**	19,569	**177**	180
Amounts due from subsidiary undertakings	**–**	–	**14,897**	14,712
Derivative assets used for economic hedging:				
Other derivatives at fair value	**–**	150	**–**	–
	108,070	111,656	**15,121**	14,951

£1,993,000 *(2011:£2,635,000)* was recognised as an impairment loss in the Consolidated Income Statement in respect of trade receivables.

The impairment loss is attributable to the reportable segments as follows:

	2012 £000	2011 £000
UK	**1,651**	2,324
Continental Europe	**342**	311
	1,993	2,635

16 CASH, CASH EQUIVALENTS AND BANK OVERDRAFTS

	Group		Company	
	2012 £000	2011 £000	2012 £000	2011 £000
Cash and cash equivalents per Statement of Financial Position	**49,798**	41,494	**28,763**	23,921

17 ASSETS HELD FOR SALE

	Group		Company	
	2012 £000	2011 £000	2012 £000	2011 £000
Assets classified as held for sale:				
Property, plant and equipment	**212**	362	**212**	362

At the year end the company held a freehold property in the West Midlands, UK that was being actively marketed for sale and was expected to be disposed of during 2013. The proposed property sale was as a result of the business relocating to a larger leasehold property in close proximity.

At 31 December 2012 the West Midlands property formed part of the properties, plant and equipment reported under unallocated assets in note 2 as it is primarily a group activity to hold and maintain the properties.

At 31 December 2011 the company held a freehold property in Bishop Auckland, UK that was disposed of during early 2012.

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.

On 8 March 2012 the group refinanced the terms of its banking facilities. The refinancing increased the availability of committed facilities from £30 million to £40 million, and extended the availability to four years. On 15 January 2013 an option was taken to extend this by an additional year in line with the facility agreement and the renewal date is now March 2017. Uncommitted facilities were maintained at £35 million, renewable on an annual basis.

For more information about the group's and company's exposure to interest rate and foreign currency risk, see note 23.

	Group		Company	
	2012 £000	2011 £000	**2012 £000**	2011 £000
Current liabilities				
Interest-bearing loan	**213**	30,219	**–**	30,000
	213	30,219	**–**	30,000
Non-current liabilities				
Interest-bearing loans	**33,371**	3,691	**30,000**	–
	33,371	3,691	**30,000**	–

Included within the interest-bearing loans is an amount directly attributable to borrowing costs of £nil *(2011: £nil)*.

The group has undrawn borrowing facilities expiring in one year or less which, at 31 December 2012, amounted to £53,294,000 *(2011: £43,521,000)*. 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.

The undrawn borrowing facilities are as follows:

	Interest rate %	**2012 £000**	Interest rate %	2011 £000
UK	**2.04**	**45,000**	1.94	35,000
Netherlands	**1.61**	**1,217**	2.39	1,253
France	**0.86**	**3,650**	1.30	3,759
Switzerland	**1.50**	**3,427**	1.40	3,509
		53,294		43,521

All the borrowing facilities above bear interest at floating rates, however the group entered into two interest rate swaps on 11 June 2012 to fix £20 million of its sterling denominated borrowings. The swaps are due to mature on 8 March 2016. The Swiss facility may be drawn as an overdraft or fixed rate loan with different rates depending on the term and amount.

19 TRADE AND OTHER PAYABLES

	Group		Company	
	2012 £000	2011 £000	2012 £000	**2011 £000**
Trade payables	**116,559**	114,077	**518**	141
Taxation and social security	**13,796**	13,646	**1,615**	1,791
Non-trade payables and accrued expenses	**23,050**	26,767	**3,579**	3,621
Amounts due to subsidiary undertakings	**–**	–	**33,602**	30,773
Derivative liabilities used for economic hedging:				
Derivatives used for hedging	**339**	–	**339**	–
Other derivatives at fair value	**11**	–	**–**	–
	153,755	154,490	**39,653**	36,326

Included within non-trade payables and accrued expenses is an amount of £44,000 for accrued interest on unsecured bank loans *(2011: £37,000)*.

The group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 23.

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS

During the year, the group operated a UK and Swiss defined benefit plan and defined contribution plans in the UK, France and the Netherlands. The Headlam Group plc Staff Retirement Benefits Scheme is the principal defined benefit plan which provides benefits to UK 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 2011 using the attained age method. The main annual rate assumptions used by the actuary were, increase in salaries 4.9%, increase of pensions in payment 3.4%, discount rate before retirement 6.4%, discount rate after retirement 4.65% and inflation 3.4%. Assets were taken at their audited market value at the valuation date. This valuation also used revised mortality assumptions. These revised assumptions have been derived to take account of the characteristics of plan members and include a greater allowance for future increases in longevity compared with the assumptions previously adopted.

During 2010, the UK Government announced a move to adopting Consumer Price Inflation ("CPI") rather than Retail Price Inflation ("RPI") as the basis for inflation assumptions underpinning retirement benefit obligations. The directors have considered this change and associated guidance. Having taken advice, the company has determined that RPI remains the appropriate basis for measuring its obligations, such that the change announced has had no impact on the group's retirement benefit obligations.

Included within the total staff costs as disclosed in note 4 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 £2,117,000 *(2011: £1,973,000)*. Contributions amounting to £143,000 *(2011: £133,000)* in respect of December 2012 payroll were paid in January 2013.

The total group cost of operating the plans during the year was £3,663,000 *(2011: £3,472,000)* and, at 31 December 2012, there was an amount of £286,000 *(2011: £326,000)* owed to the plans, being employer and employee contributions due for December 2012, which was paid in January 2013.

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	
	2012 £000	2011 £000	**2012 £000**	2011 £000
Present value of funded defined benefit obligations	**(93,499)**	(84,923)	**(82,735)**	(74,737)
Fair value of plan assets	**76,388**	70,692	**67,391**	62,202
Net obligations	**(17,111)**	(14,231)	**(15,344)**	(12,535)
Recognised liability for defined benefit obligations	**(17,111)**	(14,231)	**(15,344)**	(12,535)
Other long term employee benefits	**(284)**	(227)	**–**	–
Total employee benefits	**(17,395)**	(14,458)	**(15,344)**	(12,535)
Analysed as:				
Current liabilities	**(2,754)**	(2,669)	**(2,754)**	(2,669)
Non-current liabilities	**(14,641)**	(11,789)	**(12,590)**	(9,866)
Total employee benefits	**(17,395)**	(14,458)	**(15,344)**	(12,535)

Following the actuarial valuation of the Headlam Group plc Staff Retirement Benefits Scheme as at 31 March 2008 and the latest valuation as at 31 March 2011, a recovery plan was agreed between the Trustees of the scheme and the company to fund the deficit. In accordance with the recovery plan, payments were made to the scheme during 2012 of £2,662,000 which, in accordance with the recovery plan, increase to £2,747,000 in 2013. It was agreed that recovery payments, which commenced on 1 January 2009 and will cease on 31 December 2015, were to increase by 3.2% each year. The next actuarial valuation is due at 31 March 2014 and the opportunity will be used to reassess the recovery plan.

In addition to the recovery payments, company contributions as at the date of the last valuation have been fixed at 24.7% of pensionable salaries at that date, with no allowance made in respect of subsequent leavers. This represented an additional contribution amounting to £177,000 during 2012 *(2011: £202,000)*.

During 2013, the group and company expect to pay regular ongoing contributions of approximately £3,932,000 to the UK defined benefit plan of which £2,747,000 relates to the agreed recovery payments, the balance being estimated service costs.

20 EMPLOYEE BENEFITS continued

Movements in present value of defined benefit obligation

	Group		Company	
	2012 £000	2011 £000	**2012 £000**	2011 £000
At 1 January	**84,923**	80,889	**74,737**	71,713
Current service cost	**1,546**	1,499	**1,040**	1,067
Interest cost	**3,628**	3,796	**3,404**	3,542
Actuarial losses	**6,155**	7,998	**6,023**	7,278
Benefits paid	**(2,925)**	(9,727)	**(2,681)**	(9,084)
Contributions by members	**412**	436	**212**	221
Effect of movements in foreign exchange	**(240)**	32	**–**	–
At 31 December	**93,499**	84,923	**82,735**	74,737

Movements in fair value of plan assets

	Group		Company	
	2012 £000	2011 £000	**2012 £000**	2011 £000
At 1 January	**70,692**	68,451	**62,202**	60,382
Expected return on plan assets	**3,693**	3,814	**3,502**	3,524
Actuarial gains/(losses)	**560**	159	**327**	(19)
Contributions by employer:				
Future service contributions	**1,297**	1,505	**971**	1,151
Past service deficit contributions	**2,662**	2,579	**2,662**	2,579
Additional past service deficit contributions	**177**	202	**177**	202
Contributions for enhanced transfer values	**–**	3,246	**–**	3,246
Employer augmentations	**19**	–	**19**	–
Contributions by members	**412**	436	**212**	221
Benefits paid	**(2,925)**	(9,727)	**(2,681)**	(9,084)
Effect of movements in foreign exchange	**(199)**	27	**–**	–
At 31 December	**76,388**	70,692	**67,391**	62,202

Expense recognised in the income statement relating to defined benefit obligation (excluding transfer value exercise)

	Group	
	2012 £000	2011 £000
Current service cost	**1,546**	1,499
Interest on defined benefit plan obligation	**3,628**	3,796
Expected return on defined benefit plan assets	**(3,693)**	(3,814)
Total	**1,481**	1,481

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS continued

The (income)/expense recognised in the following line items in the Consolidated Income Statement are:

	Group	
	2012 £000	2011 £000
Administrative expenses	**1,546**	1,499
Net financing income	**(65)**	(18)
	1,481	1,481

Actuarial gains and losses in the Statement of Comprehensive Income:

	Group	
	2012 £000	2011 £000
Actuarial losses on defined benefit obligation	**(6,155)**	(7,998)
Actuarial gain on plan assets	**560**	159
	(5,595)	(7,839)

Cumulative actuarial losses reported in the Statement of Comprehensive Income since 1 January 2004, the transition date to IFRS, are £28,863,000 *(2011: £23,268,000)*. Cumulative actuarial losses reported in the company's Statement of Comprehensive Income are £27,356,000 *(2011: £21,660,000)*.

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

	Group		Company	
	2012 £000	2011 £000	2012 £000	2011 £000
Equities	**17,158**	13,349	**15,178**	11,626
Government debt	**7,668**	7,445	**7,668**	7,445
Corporate bonds	**25,142**	24,671	**20,331**	20,613
Annuities	**4,951**	4,775	**4,951**	4,775
Commodities	**6,297**	4,386	**6,297**	4,386
Hedge funds	**7,067**	7,751	**7,067**	7,751
Other	**8,105**	8,315	**5,899**	5,606
	76,388	70,692	**67,391**	62,202
Actual return on plan assets	**4,252**	4,343	**3,829**	3,505

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.

20 EMPLOYEE BENEFITS continued

Principal actuarial assumptions are as follows:

	UK 2012 %	UK 2011 %	Swiss 2012 %	Swiss 2011 %
Discount rate	**4.1**	4.6	**1.8**	2.3
Future salary increases	**4.5**	4.6	**2.0**	2.0
Future pension increases	**3.0**	3.1	**0.5**	0.5
Inflation rate	**3.0**	3.1	**1.0**	1.0
Expected rate of return on plan assets	**5.6**	5.6	**1.8**	2.3
Mortality table assumptions:				
UK pre-retirement	**AC00 (Ultimate) table**	AC00 (Ultimate) table		
UK post-retirement – future pensioners	**94%(M)/100%(F) of the S1PA tables with future improvements from 2004 in line with the CMI mortality projections model CMI_2010 with a long term rate of improvement of 1% per annum.**	94%(M)/100%(F) of the S1PA tables with future improvements from 2004 in line with the CMI mortality projections model CMI_2010 with a long term rate of improvement of 1% per annum.		
UK post-retirement – current pensioners	**94%(M)/100%(F) of the S1PA tables with future improvements from 2004 in line with the CMI mortality projections model CMI_2010 with a long term rate of improvement of 1% per annum.**	94%(M)/100%(F) of the S1PA tables with future improvements from 2004 in line with the CMI mortality projections model CMI_2010 with a long term rate of improvement of 1% per annum.		
Swiss scheme	**–**	–	**BVG 2010**	BVG 2010

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

	Group 2012	Group 2011	Company 2012	Company 2011
Non-pensioner male	**23.6**	23.6	**23.6**	23.6
Pensioner male	**22.2**	22.1	**22.2**	22.1
Non-pensioner female	**25.5**	25.5	**25.5**	25.5
Pensioner female	**24.0**	23.9	**24.0**	23.9

Notes to the Financial Statements continued

20 EMPLOYEE BENEFITS continued

Company

The principal actuarial assumptions for the company are the same as those disclosed for the UK above.

History of plans

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

Statement of Financial Position

Group	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000
Present value of defined benefit obligation	**(93,499)**	(84,923)	(80,889)	(88,253)	(69,441)
Fair value of plan assets	**76,388**	70,692	68,451	65,803	55,139
Deficit	**(17,111)**	(14,231)	(12,438)	(22,450)	(14,302)

Company	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000
Present value of defined benefit obligation	**(82,735)**	(74,737)	(71,713)	(81,412)	(62,443)
Fair value of plan assets	**67,391**	62,202	60,382	59,583	49,534
Deficit	**(15,344)**	(12,535)	(11,331)	(21,829)	(12,909)

Experience adjustments

Group	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000
On plan liabilities	**(520)**	1,289	(588)	(1,787)	83
On plan assets	**560**	159	3,195	6,083	(11,798)
As a percentage of plan liabilities	**(0.6%)**	1.5%	(0.7%)	(2.0%)	0.1%
As a percentage of plan assets	**0.7%**	0.2%	4.7%	9.2%	(21.4%)

Company	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000
On plan liabilities	**19**	1,404	(522)	(1,402)	(24)
On plan assets	**327**	(19)	3,274	5,559	(10,785)
As a percentage of plan liabilities	**0.0%**	1.9%	(0.7%)	(1.7%)	(0.0%)
As a percentage of plan assets	**0.5%**	(0.0%)	5.4%	9.3%	(21.8%)

During the year, the group operated an employment indemnity scheme in connection with a foreign subsidiary undertaking to provide for lump sum cash payments due to employees retiring on their normal retirement date. The present value of the retirement indemnity obligation at 31 December 2012 is £284,000 *(2011: £227,000)*.

21 SHARE BASED PAYMENTS

Group and company

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

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

Additionally, the group operates a savings related share option scheme ("sharesave scheme") which is open to employees subject to eligibility criteria determined by the directors prior to each option grant. The most recent grant was on 11 May 2012 when employees with over one month's service were invited to participate.

The group also operates a 2008 HMRC approved scheme, a 2008 unapproved scheme, the Headlam Group Performance Share Plan 2008 and the Headlam Group Co-Investment Plan 2008. Further details of these schemes and plans are given in the Remuneration Report on pages 46 and 54.

21 SHARE-BASED PAYMENTS continued

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

Grant date/employees entitled	Number of instruments 2012	2011	Vesting conditions	Contractual life of options
Approved 1998 scheme granted to key management 14 April 2003	**5,000**	40,404	Movement of the group's basic earnings per share exceeding RPI over the relevant period	14/04/06 – 14/04/13
Unapproved 1998 scheme granted to key management 22 August 2005	**–**	1,242,864	Movement of the group's basic earnings per share exceeding RPI by 3% – 5% pa over the relevant period	22/08/08 – 22/08/12
Approved 1998 scheme granted to key management 22 August 2005	**57,136**	57,136	Movement of the group's basic earnings per share exceeding that of RPI by 3% pa over the relevant period	22/08/08 – 22/08/15
Five-year sharesave scheme granted to other employees 25 May 2006	**–**	40,499	Continuous service	01/07/11 – 01/01/12
Three-year sharesave scheme granted to other employees 8 May 2008	**–**	54,808	Continuous service	01/07/11 – 01/01/12
Five-year sharesave scheme granted to other employees 8 May 2008	**36,168**	42,608	Continuous service	01/07/13 – 01/01/14
Three-year sharesave scheme granted to other employees 19 May 2009	**164**	381,457	Continuous service	01/07/12 – 01/01/13
Five-year sharesave scheme granted to other employees 19 May 2009	**344,666**	374,246	Continuous service	01/07/14 – 01/01/15
Three-year sharesave scheme granted to other employees 21 May 2010	**48,715**	53,486	Continuous service	01/07/13 – 01/01/14
Five-year sharesave scheme granted to other employees 21 May 2010	**61,327**	63,928	Continuous service	01/07/15 – 01/01/16
Headlam Group Co-Investment Plan 2008 granted to key management 8 October 2010*	**468,828**	468,828	If the real earnings per share growth is over 3%pa – 50% vesting, over 6% – 100% vesting. TSR – if company is ranked at median or above – 50%, upper quartile – 100%	08/10/13 – 08/10/20
Three-year sharesave scheme granted to other employees 11 May 2011	**87,259**	116,966	Continuous service	01/07/14 – 01/01/15
Five-year sharesave scheme granted to other employees 11 May 2011	**61,066**	73,104	Continuous service	01/07/16 – 01/01/17
Headlam Group Co-Investment Plan 2008 granted to key management 23 August 2011*	**436,346**	436,346	If the real earnings per share growth is over 3%pa – 50% vesting, over 6% – 100% vesting. TSR – if company is ranked at median or above – 50%, upper quartile – 100%	23/08/14 – 23/08/21
Three-year sharesave scheme granted to other employees 11 May 2012	**364,855**	–	Continuous service	01/07/15 – 01/01/16
Five-year sharesave scheme granted to other employees 11 May 2012	**79,272**	–	Continuous service	01/07/17 – 01/01/18
Headlam Group Co-Investment Plan 2008 granted to key management 5 October 2012*	**440,968**	–	If the real earnings per share growth is over 3%pa – 50% vesting, over 6% – 100% vesting. TSR – if company is ranked at median or above – 50%, upper quartile – 100%	06/10/15 – 06/10/22
Total share options	**2,491,770**	3,446,680		

*Further details are provided on pages 50 and 51 of the Remuneration Report.

Notes to the Financial Statements continued

21 SHARE-BASED PAYMENTS continued

The number and weighted average exercise prices of share options are as follows:

	Weighted average exercise price 2012	Number of options 2012	Weighted average exercise price 2011	Number of options 2011
Outstanding at the beginning of the year	**245.0**	**3,446,680**	281.9	2,895,667
Exercised during the year	**221.6**	**(413,403)**	222.2	(4,406)
Granted during the year	**121.8**	**903,291**	79.0	642,588
Lapsed during the year	**401.8**	**(1,444,798)**	246.2	(87,169)
Outstanding at the end of the year	**113.4**	**2,491,770**	245.0	3,446,680
Exercisable at the end of the year	**403.0**	**62,300**	409.2	1,435,711

The weighted average share price for options exercised during the year was 284.3p, *(2011: 304.7p)*. The options outstanding at the year end have an exercise price in the range of 215.0p to 420.0p and a weighted average contractual life of 2.1 years.

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. In order to estimate the fair value of the services received the company uses an appropriate option pricing model, either the Black-Scholes or the Monte Carlo option pricing model.

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

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

Details of share options granted during 2012 are shown below:

2012		Three-year Co-Investment Plan 2008	Three-year Sharesave scheme	Three-year Sharesave scheme
Number of options		**440,968**	**381,413**	**80,910**
Fair value at measurement date:				
No performance conditions		**–**	**68.5p**	**83.7p**
Performance conditions	EPS 80% & TSR 20%	**252.6p**	**–**	**–**
Share price at 31 December		**330.0p**	**330.0p**	**330.0p**
Exercise price		**–**	**238.0p**	**238.0p**
Expected volatility		**33.6%pa**	**33.6%pa**	**40.2%pa**
Option life		**3 years**	**3 years**	**5 years**
Dividend yield		**5.0%pa**	**4.9%pa**	**4.9%pa**
Risk-free rate of interest		**0.3%pa**	**0.6%pa**	**1.1%pa**

21 SHARE-BASED PAYMENTS continued

Details of share options granted during 2011 are shown below:

2011		Three-year Co-Investment Plan 2008	Three-year Sharesave scheme	Three-year Sharesave scheme
Number of options		436,346	126,868	79,374
Fair value at measurement date:				
No performance conditions		–	96.9p	109.7p
Performance conditions	EPS 80% and TSR 20%	222.4p	–	–
Share price at 31 December		255.0p	255.0p	255.0p
Exercise price		–	246.0p	246.0p
Expected volatility		40.0%p.a.	47.8%p.a.	50.0%p.a.
Option life		3 years	3 years	5 years
Dividend yield		4.5%p.a.	4.8%p.a.	4.8%p.a.
Risk-free rate of interest		0.85%p.a.	1.5%p.a.	2.45%p.a.

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

	Group		Company		Subsidiaries	
	2012 £000	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000
Share options granted in 2006 under the SAYE five-year scheme	**–**	15	**–**	–	**–**	15
Share options granted in 2008 under the SAYE three-year scheme	**–**	58	**–**	–	**–**	58
Share options granted in 2008 under the SAYE five-year scheme	**63**	63	**–**	–	**63**	63
Share options granted in 2009 under the SAYE three-year scheme	**54**	102	**–**	3	**54**	99
Share options granted in 2009 under the SAYE five-year scheme	**33**	30	**1**	1	**32**	29
Share options granted in 2010 under the SAYE three-year scheme	**27**	27	**–**	–	**27**	27
Share options granted in 2010 under the SAYE five-year scheme	**14**	14	**–**	–	**14**	14
Headlam Group Co-Investment Plan 2008 (awarded 2010)	**414**	410	**177**	175	**237**	235
Share options granted in 2011 under the SAYE three-year scheme	**41**	26	**–**	–	**41**	26
Share options granted in 2011 under the SAYE five-year scheme	**17**	11	**2**	1	**15**	10
Headlam Group Co-Investment Plan 2008 (awarded 2011)	**323**	115	**151**	54	**172**	61
Share options granted in 2012 under the SAYE three-year scheme	**56**	–	**1**	–	**55**	–
Share options granted in 2012 under the SAYE five-year scheme	**9**	–	**–**	–	**9**	–
Headlam Group Co-Investment Plan 2008 (awarded 2012)	**132**	–	**56**	–	**76**	–
Total expense recognised	**1,183**	871	**388**	234	**795**	637

Notes to the Financial Statements continued

22 CAPITAL AND RESERVES

Share capital

	Ordinary shares	
	2012	2011
Number of shares		
On issue at 1 January and 31 December – authorised	**107,840,000**	107,840,000
On issue at 1 January and 31 December – fully paid	**85,363,743**	85,363,743

	2012 £000	2011 £000
Allotted, called up and fully paid		
Ordinary shares of 5p each	**4,268**	4,268
	4,268	4,268
Shares classified as liabilities	**–**	–
Shares classified in shareholders funds	**4,268**	4,268
	4,268	4,268

At 31 December 2012, the company held 2,427,794 *(2011: 2,841,197)* shares which have been disclosed in the treasury reserve. Dividends are not payable on these shares and they are excluded from the calculation of earnings per share. The shares held in treasury represent 2.8% *(2011: 3.3%)* of the issued share capital with a nominal value of £121,390 *(2011: £142,060)*.

In the period from 31 December 2012 to 8 March 2013 no shares have been purchased by the company.

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.

Dividends

	2012 £000	2011 £000
Interim dividend for 2011 of 4.30p paid 3 January 2012	**3,544**	–
Final dividend for 2011 of 9.85p paid 2 July 2012	**8,119**	–
Interim dividend for 2010 of 3.83p paid 4 January 2011	**–**	3,180
Final dividend for 2010 of 8.57p paid 1 July 2011	**–**	7,115
	11,663	10,295

The final proposed dividend of 10.20p per share *(2011: 9.85p per share)* will not be provided for until authorised by shareholders at the forthcoming AGM.

Interim dividends of 4.65p per share *(2011: 4.30p per share)* are provided for when the dividend is paid. The dividend was paid on 2 January 2013 and totalled £3,850,000.

The total value of dividends proposed but not recognised at 31 December 2012 is £12,299,000 *(2011: £11,663,000)*.

Reserves

Other reserves

Other reserves as disclosed on the Statement of Financial Position comprise the capital redemption reserve, translation reserve, cash flow hedging reserve and treasury reserve. For the company this also includes a special reserve.

22 CAPITAL AND RESERVES continued

Capital redemption reserve

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

Translation reserve

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

Cash flow hedging reserve

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

Treasury Reserve

The treasury reserve compromises the cost of the company's shares held by the group.

Special Reserve

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

23 FINANCIAL INSTRUMENTS

The main financial risks arising in the normal course of the group's business are credit risk, liquidity risk, and market risks arising from interest rate risk and foreign currency risk. This note presents information about the group's exposure to each of the above risks, the group's objectives, policies and processes for measuring and managing risks and the group's management of capital.
Further quantitative disclosures are included throughout these financial statements.

Credit risk and credit quality

Credit risk is the risk of financial loss to the group if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the group's trade receivables.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset and as at the Statement of Financial Position date, in the directors' opinion there were no significant concentrations of credit risk likely to cause financial loss to the group.

The group has 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 and these are frequently reviewed by management to limit exposure. Businesses must obtain central approval from executive directors or senior executive management for credit limits in excess of £10,000. The group does not require collateral in respect of financial assets.

The credit control procedures described above, coupled with the diversified nature of the group's trade receivables, lead the directors to believe that there is limited credit risk exposure and that the credit quality of these assets is robust.

Other receivables comprise amounts due to the group which historically have been received within three months of the year end. The directors have considered the inherent risk profile of other receivables at the year end and are of the view that this historical experience will prevail for the foreseeable future and accordingly consider the credit quality of these assets to be robust.

Cash and cash equivalents represent deposits with reputable financial institutions in the UK and continental Europe and hence, the directors consider the credit quality of cash and cash equivalents to be robust.

Notes to the Financial Statements continued

23 FINANCIAL INSTRUMENTS continued

The carrying amount of financial assets at the Statement of Financial Position date was:

	Group		Company	
	2012 £000	2011 £000	**2012 £000**	2011 £000
Trade and other receivables *(note 15)*	**104,645**	107,567	**15,074**	14,892
Cash and cash equivalents *(note 16)*	**49,798**	41,494	**28,763**	23,921
	154,443	149,061	**43,837**	38,813

The fair values of the above financial assets at both 31 December 2012 and 2011, are deemed to approximate to carrying value due to the short term maturity of the instruments.

The maximum exposure to credit risk for trade receivables at the Statement of Financial Position date by geographic region was:

	Group		Company	
	2012 £000	2011 £000	**2012 £000**	2011 £000
UK	**73,373**	74,597	**–**	–
Continental Europe	**12,005**	13,251	**–**	–
	85,378	87,848	**–**	–

The ageing of trade receivables at the Statement of Financial Position date was:

	2012		2011	
Group	**Gross £000**	**Impairment £000**	Gross £000	Impairment £000
Not past due	**80,531**	**–**	81,191	(230)
Past due 0-30 days	**4,334**	**(156)**	4,428	(306)
Past due 31-120 days	**3,167**	**(2,498)**	5,260	(2,495)
	88,032	**(2,654)**	90,879	(3,031)

All other receivables and derivative financial assets are not past due *(2011: not past due)*.

The company had trade receivables of £nil *(2011: £nil)*.

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

	Group		Company	
	2012 £000	2011 £000	**2012 £000**	2011 £000
Balance at 1 January	**3,031**	2,927	**–**	–
Amounts provided	**1,993**	2,635	**–**	–
Amounts utilised	**(2,348)**	(2,510)	**–**	–
Effect of movements in foreign exchange	**(22)**	(21)	**–**	–
Balance at 31 December	**2,654**	3,031	**–**	–

Based on historic default rates, the group believes that no general impairment allowance is necessary in respect of trade receivables, however, the group provides fully for specific debts when required. During the year the group's impairment loss as a percentage of revenue amounted to 0.34% *(2011: 0.46%)*.

Liquidity risk

Liquidity risk is the risk that the group will not be able to meet its financial obligations as they fall due. The group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, with sufficient headroom to cope with abnormal market conditions. As at 31 December 2012 cash and cash equivalents covered the amounts of borrowings maturing in the next 12 months with a net positive liquidity of £49,585,000 *(2011: £11,275,000)*. Details of the total facilities that the group has access to are given in note 18.

23 FINANCIAL INSTRUMENTS continued

The following are the contractual maturities of financial liabilities:

31 December 2012 Group	Carrying amount £000	Contractual cash flows £000	1 year or less £000	1–2 years £000	2–5 years £000	More than 5 years £000
Non-derivative financial liabilities						
Unsecured bank loans	**33,584**	**(37,296)**	**(1,079)**	**(1,075)**	**(32,534)**	**(2,608)**
Trade and other payables	**139,609**	**(139,609)**	**(139,609)**	**–**	**–**	**–**
Derivative financial liabilities						
Interest rate swaps used for hedging	**339**	**(339)**	**(129)**	**(122)**	**(88)**	**–**
Forward exchange contracts used for hedging	**11**	**(11)**	**(11)**	**–**	**–**	**–**
	173,543	**(177,255)**	**(140,827)**	**(1,197)**	**(32,622)**	**(2,608)**

31 December 2011 Group	Carrying amount £000	Contractual cash flows £000	1 year or less £000	1–2 years £000	2–5 years £000	More than 5 years £000
Non-derivative financial liabilities						
Unsecured bank loans	33,910	(34,924)	(30,571)	(334)	(962)	(3,057)
Trade and other payables	140,844	(140,844)	(140,844)	–	–	–
	174,754	(175,768)	(171,415)	(334)	(962)	(3,057)

31 December 2012 Company	Carrying amount £000	Contractual cash flows £000	1 year or less £000	1–2 years £000	2–5 years £000
Non-derivative financial liabilities					
Unsecured bank loans	**30,000**	**(33,335)**	**(800)**	**(800)**	**(31,734)**
Trade and other payables	**37,699**	**(37,699)**	**(37,699)**	**–**	**–**
Derivative financial liabilities					
Interest rate swaps used for hedging	**339**	**(339)**	**(129)**	**(122)**	**(88)**
	68,038	**(71,373)**	**(38,628)**	**(922)**	**(31,822)**

31 December 2011 Company	Carrying amount £000	Contractual cash flows £000	1 year or less £000	1–2 years £000	2–5 years £000
Non-derivative financial liabilities					
Unsecured bank loans	30,000	(30,230)	(30,230)	–	–
Trade and other payables	34,535	(34,535)	(34,535)	–	–
	64,535	(64,765)	(64,765)	–	–

The value of the group's and company's financial liabilities as detailed above at 31 December 2012 and 2011 were not materially different to the carrying value. Fair values were calculated using market rates, where available. 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 Statement of Financial Position date.

Notes to the Financial Statements continued

23 FINANCIAL INSTRUMENTS continued

The table below sets out the group's accounting classification of each class of financial assets and liabilities at 31 December 2012 and 2011.

31 December 2012	Available for sale £000	Other derivatives at fair value £000	Amortised cost £000	Total carrying value £000
Cash and cash equivalents	49,798	–	–	49,798
Borrowings due within one year	–	–	(213)	(213)
Borrowings due after one year	–	–	(33,371)	(33,371)
Trade payables	–	–	(116,559)	(116,559)
Non–trade payables	–	–	(23,050)	(23,050)
Trade receivables	–	–	85,378	85,378
Other receivables	–	–	19,267	19,267
Derivative liabilities	–	(350)	–	(350)
	49,798	(350)	(68,548)	(19,100)

31 December 2011	Available for sale £000	Other derivatives at fair value £000	Amortised cost £000	Total carrying value £000
Cash and cash equivalents	41,494	–	–	41,494
Borrowings due within one year	–	–	(30,219)	(30,219)
Borrowings due after one year	–	–	(3,691)	(3,691)
Trade payables	–	–	(114,077)	(114,077)
Non-trade payables	–	–	(26,767)	(26,767)
Trade receivables	–	–	87,848	87,848
Other receivables	–	–	19,569	19,569
Derivative assets	–	150	–	150
	41,494	150	(67,337)	(25,693)

Under IAS 39, all derivative financial instruments not in a hedge relationship are derivatives at fair value through the income statement. The group does not use derivatives for speculative purposes. All transactions in derivative financial instruments are undertaken to manage the risks arising from underlying business activities.

Interest rate risk

The company and group are exposed to interest rate fluctuations on their borrowings and cash deposits. Borrowings are principally held in sterling and euros at both fixed and floating rates, deposits are in sterling, euros and Swiss francs at floating rates.

Floating rate borrowings are linked to the London Interbank Offered Rate and Euribor Over Night Index Average. The group adopts a policy of reviewing its floating rate exposure to ensure that if interest rates rise the effect on the group's income statement is manageable. In accordance with this policy, and in order to manage it's exposure to UK interest rates, the group entered into two interest rate swaps in 2012 to fix £20 million of its sterling denominated borrowings. These interest rate swaps were designated as a hedging instrument and accounted for as a cash flow hedge in accordance with the requirements of IAS 39. The cash flows will occur over the period to 8 March 2016.

The fair value of these interest rate swaps are included in the Statement of Financial Position as a £339,000 derivative liability *(2011: £nil)*.

23 FINANCIAL INSTRUMENTS continued

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

	Group Carrying amount		Company Carrying amount	
	2012 £000	2011 £000	**2012 £000**	2011 £000
Variable rate instruments				
Financial assets	**49,798**	41,494	**28,763**	23,921
Financial liabilities	**(33,584)**	(33,910)	**(30,000)**	(30,000)
	16,214	7,584	**(1,237)**	(6,079)

There were no fixed rate instruments held by the group at 31 December 2012 *(2011: £nil)*.

Sensitivity analysis

A change of 100 basis points in the interest rates at the reporting date would have increased/(decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis is performed on the same basis for 2011.

	Group				Company			
	Profit or loss		Equity		Profit or loss		Equity	
	100bp increase £000	100bp decrease £000	100bp increase £000	100bp decrease £000	100bp increase £000	100bp decrease £000	100bp increase £000	100bp decrease £000
31 December 2012								
Variable rate instruments	**162**	**(162)**	**–**	**–**	**(12)**	**12**	**–**	**–**
31 December 2011								
Variable rate instruments	76	(76)	–	–	(61)	61	–	–

Foreign currency risk

The group and company are exposed to movements in currency exchange rates arising from transaction currency cash flows and the translation of the results and net assets of overseas subsidiaries. The currencies giving rise to this risk are primarily the euro, Swiss franc and US dollar.

The group and company use forward exchange contracts to hedge their foreign currency transactional risk. A future foreign currency contract would be entered into where there was a known requirement for the currency due to planned imports that are not invoiced in the functional currency of the acquiring company. These forward exchange contracts would have a maturity of less than one year after the Statement of Financial Position 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 2012 amounted to £11,000 *(2011: asset £150,000)*.

For the 12 month period to 31 December 2012, 6.9% *(2011: 10.1%)* of the group's operating profit was derived from overseas subsidiaries and at 31 December 2012, 21.0% *(2011: 24.4%)* of the group's net operating assets related to overseas subsidiary operations. Hedge accounting, following the adoption of IFRS, has not been applied to these operations.

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

Notes to the Financial Statements continued

23 FINANCIAL INSTRUMENTS continued

The exposure to foreign currency risk was as follows:

2012	Group Euro amount £000	Group Other amount £000	Group Total £000	Company Euro amount £000	Company Other amount £000	Company Total £000
Trade and other receivables	**102**	**255**	**357**	**76**	**17**	**93**
Cash and cash equivalents	**420**	**476**	**896**	**42**	**–**	**42**
Trade and other payables	**(1,175)**	**(1,219)**	**(2,394)**	**–**	**–**	**–**
	(653)	**(488)**	**(1,141)**	**118**	**17**	**135**

2011	Group Euro amount £000	Group Other amount £000	Group Total £000	Company Euro amount £000	Company Other amount £000	Company Total £000
Trade and other receivables	86	143	229	77	17	94
Cash and cash equivalents	214	579	793	16	1	17
Trade and other payables	(1,165)	(1,412)	(2,577)	–	–	–
	(865)	(690)	(1,555)	93	18	111

Sensitivity analysis

A 10% weakening of sterling against the following currencies at 31 December would have increased/(decreased) profit or loss by the amounts shown below, there is no equity effect. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2011.

	Group 2012 £000	Group 2011 £000	Company 2012 £000	Company 2011 £000
Euro	**(65)**	(86)	**12**	9
Other	**(49)**	(69)	**2**	2

A 10% strengthening of sterling against the above currencies at 31 December would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Fair values hierarchy

The financial instruments carried at fair value are categorised according to their valuation method. The different levels have been defined below:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly, as prices or indirectly, derived from prices.
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The group has two interest rates swaps used for hedging which were fair valued in accordance with level 2 for the year ended 31 December 2012 *(2011: not applicable)* and forward currency contracts which were fair valued in accordance with level 2 *(2011: level 2).*

Fair values

The carrying amounts shown in the Statement of Financial Position for financial instruments are a reasonable approximation to fair value.

Trade receivables, trade payables and cash and cash equivalents

Fair values are assumed to approximate to cost due to the short term maturity of the instrument.

23 FINANCIAL INSTRUMENTS continued

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 Statement of Financial Position date.

Capital management

The group views its finance capital resources as primary comprising share capital, bank loans and operating cash flow.

The board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The board closely monitors its shareholder base, dividend yield and earnings per share. In the medium term the group aims to maintain a dividend cover of 1.7 times.

The board encourages employees of the group to hold the company's ordinary shares. The group operates a number of employee share option schemes. In previous years the company has acquired a number of its own shares under a share buy-back programme, and some of these shares have been used for issuing shares under the group's various share option incentive schemes.

Certain of the company's subsidiaries are required to maintain issued share capital at levels to support capital adequacy requirements prevailing in the legislative environment in which they operate.

In order to maintain or adjust the capital structure, the group may adjust the amount of dividends made payable to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

On 8 March 2012, the group completed a refinancing of its banking facilities. The new facilities comprise £40 million committed facility and £35 million uncommitted facility. This represents an increase in total available facilities of £10 million. The uncommitted facility, coupled with cash generated from operations, is used to fund the group's ongoing working capital requirements. The committed facility is in place to support the group's strategic investment plans.

No changes were made to the objectives, policies or processes during the years ended 31 December 2012 and 31 December 2011.

24 ACQUISITIONS

On 31 August 2012, a group subsidiary company acquired 100% of the issued share capital of Flooring Accessories Limited, a distributor of residential and commercial floorcovering, principally in South Wales for a cash consideration of £627,000. The primary reason for this acquisition is for the group to enhance its position in the south of Wales. Since its acquisition the business has contributed revenue of £550,000 and a loss of £75,000 to the Consolidated Statement of Comprehensive Income for the year ended 31 December 2012. If the acquisition had occurred on 1 January 2012 group revenue would have been an estimated £588 million and profit after tax would have been an estimated £21.3 million.

On 5 December 2012, a group subsidiary company acquired the trade and assets of C.K. Davie Limited, a distributor of residential and commercial floorcovering, principally in the north of Scotland, for a cash consideration of £191,000. The primary reason for this acquisition is for the group to enhance its position in the Scottish floorcovering market. Since its acquisition the business has contributed revenue of £192,000 and a loss of £54,000 to the Consolidated Statement of Comprehensive Income for the year ended 31 December 2012. If the acquisition had occurred on 1 January 2012 group revenue would have been an estimated £589 million and profit after tax would have been an estimated £21.3 million.

Notes to the Financial Statements continued

24 ACQUISITIONS continued

	Acquiree's book value £000	Fair value adjustments £000	Acquisition amounts £000
Acquiree's net assets at the acquisition date:			
Intangible assets	–	90	90
Property, plant and equipment	55	–	55
Inventories	1,013	–	1,013
Trade and other receivables	340	–	340
Cash at bank and in hand	47	–	47
Trade and other payables	(727)	–	(727)
Net identifiable assets and liabilities	728	90	818
Goodwill on acquisition			–
Consideration paid			818
Satisfied by:			
Cash			818

Analysis of cash flows:	
On completion	(818)
Costs of acquisition	(57)
	(875)

Professional fees of £57,000 were incurred on the acquisitions and have been expensed to the income statement within administration expenses.

The book value of receivables given in the table above represent the gross contracted amounts receivable. At the acquisition date the entire book value of receivables was expected to be collected.

No goodwill has arisen on the acquisition of Flooring Accessories Limited or the trade and assets of C.K. Davie Limited. The intangible assets on acquisition were attributed to customer order books.

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

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

Whilst acquired customer order books are a key component at the point of acquisition, this position quickly dissipates during the post acquisition period. The dynamic and renewable nature of this class of asset is the reason the group elects to amortise it over a period of one to 24 months, the precise period being dependent upon the size of the acquired business.

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	2012 Land and buildings £000	2012 Plant and machinery £000	2012 Total £000	2011 Land and buildings £000	2011 Plant and machinery £000	2011 Total £000
Less than one year	**1,989**	**8,748**	**10,737**	1,330	8,317	9,647
Between one and five years	**4,152**	**15,650**	**19,802**	3,747	14,305	18,052
More than five years	**2,628**	**–**	**2,628**	2,626	5	2,631
	8,769	**24,398**	**33,167**	7,703	22,627	30,330

Company	2012 Land and buildings £000	2012 Plant and machinery £000	2012 Total £000	2011 Land and buildings £000	2011 Plant and machinery £000	2011 Total £000
Less than one year	**77**	**7**	**84**	26	7	33
Between one and five years	**105**	**10**	**115**	105	16	121
More than five years	**1,933**	**–**	**1,933**	1,959	–	1,959
	2,115	**17**	**2,132**	2,090	23	2,113

The group leases the majority of its motor and commercial vehicles on terms that range between three and five years and during the year ended 31 December 2012, total operating lease expense of £11,635,000 was recognised in the Consolidated Income Statement (*2011: £11,049,000*).

26 CAPITAL COMMITMENTS

Group

During the year ended 31 December 2012, the group entered into commitments to purchase property, plant and equipment for £11,268,000 (*2011: £709,000*). These commitments are expected to be settled in the following financial year.

Company

During the year ended 31 December 2012, the company entered into commitments to purchase property, plant and equipment for £10,902,000 (*2011: £44,000*). This commitment is expected to be settled in the following financial year.

27 RELATED PARTIES

Group and Company

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

The group has re-evaluated its interpretation of key management personnel and consider that this relates to the executive and non-executive directors of the group as identified on page 38.

As at 31 December 2012, directors of the company and their immediate relatives controlled 1.6% of the voting shares of the company (*2011:1.6%*).

Non-executive directors receive a fee for their services to the board.

Other than disclosed in the Remuneration Report, there were no other transactions with personnel in either the current or preceding year. The cost charged to administrative expenses relating to share plans of key personnel amounted to £312,000 (*2011: £199,000*).

Notes to the Financial Statements continued

27 RELATED PARTIES continued

Company only

In addition to the transactions with key personnel the company has the following transactions:

Transactions with other group companies

	Highest during the year £000	Balance at 31 December 2012 £000	Highest during the year £000	Balance at 31 December 2011 £000
Amounts due from subsidiaries	**16,579**	**14,897**	25,829	14,712
Amounts due to subsidiaries	**(33,602)**	**(33,602)**	(33,671)	(30,773)

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 year since this is the time when the company levies its recharge of its operating expenses.

Related party transactions reported in the income statement

	For year ended 31 December 2012 £000	For year ended 31 December 2011 £000
Rental income	**6,368**	6,451
Dividends received	**13,299**	4,221
Recharge of operating expenses	**2,241**	2,206
Interest income	**160**	240
Pension recharge	**177**	200

28 SUBSEQUENT EVENTS

Management have given due consideration to any events occurring in the period from the reporting date to the date these financial statements were authorised for issue and have concluded that there are no material adjusting or non-adjusting events to be disclosed in these financial statements, with the exception of the matters described below.

On 15 January, the company requested the extension of its committed facilities for an additional year in line with the facility agreement dated 8 March 2012. This request was agreed by the two lending parties and has therefore extended the termination date to the date falling five years after the date of the facility agreement.

On 22 February 2013, a subsidiary company of Headlam Group plc entered into an agreement to acquire the business and certain assets of Hall's Floorings Limited, with completion anticipated to occur on 28 March 2013. Hall's Floorings, a distributor of residential floorcovering based in Edmonton, north London, is a supplier to independent floorcovering retailers throughout most of England with revenue for the year ended 31 December 2012 of approximately £8.2 million. On completion, initial consideration of approximately £472,000, will be payable and a further £243,000 will be incurred on settling an outstanding debt. A further £150,000 will be payable following verification of the fair value of assets acquired. The disclosures required by IFRS 3 have not been made as initial acquisition accounting will remain incomplete until after formal completion of the acquisition.

Principal Trading Subsidiaries

	Place of incorporation
* HFD Limited	Great Britain
* MCD Group Limited	Great Britain
Headlam BV	Netherlands
LMS SA	France
* Belcolor AG	Switzerland

All of these subsidiaries are wholly owned and their principal activities are wholly aligned to the sales, marketing, supply and distribution of floorcovering and certain other ancillary products.

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

Financial Record

	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000
Trading results					
Revenue	**585,984**	569,795	535,690	533,793	557,296
Gross profit	**175,733**	175,739	164,959	162,260	174,626
Overheads	**(146,419)**	(147,687)	(138,893)	(137,502)	(132,904)
Operating profit	**29,314**	28,052	26,066	24,758	41,722
Profit before net financing costs	**29,314**	28,052	26,066	24,758	41,722
Net financing costs	**(853)**	(464)	(1,060)	(2,694)	(1,602)
Profit on ordinary activities before tax	**28,461**	27,588	25,006	22,064	40,120
Taxation	**(7,092)**	(7,184)	(7,127)	(6,168)	(11,433)
Profit on ordinary activities after taxation	**21,369**	20,404	17,879	15,896	28,687
Shareholder value					
Paid dividend per share	**14.15p**	12.40p	11.00p	19.70p	23.10p
Proposed dividend per share	**14.85p**	14.15p	12.40p	11.00p	19.70p
Earnings per share	**25.8p**	24.6p	21.5p	19.1p	34.5p
Net assets					
Non-current assets					
Property, plant and equipment	**96,182**	94,201	97,215	96,530	99,741
Intangible assets	**13,210**	13,210	13,210	13,210	13,210
Deferred tax assets	**2,376**	962	896	4,731	1,516
	111,768	108,373	111,321	114,471	114,467
Current assets					
Inventories	**115,332**	114,196	105,694	99,637	107,597
Trade and other receivables	**108,070**	111,656	102,240	101,149	105,942
Cash and cash equivalents	**49,798**	41,494	44,758	45,737	35,193
Assets held for sale	**212**	362	362	2,275	–
	273,412	267,708	253,054	248,798	248,732
Total assets	**385,180**	376,081	364,375	363,269	363,199
Current liabilities					
Bank overdraft	**–**	–	–	(758)	–
Other interest-bearing loans and borrowings	**(213)**	(30,219)	(225)	(900)	(4,506)
Trade and other payables	**(153,755)**	(154,490)	(149,476)	(143,216)	(143,369)
Employee benefits	**(2,754)**	(2,669)	(2,586)	(2,506)	(2,428)
Income tax payable	**(7,117)**	(6,678)	(4,201)	(8,615)	(9,546)
	(163,839)	(194,056)	(156,488)	(155,995)	(159,849)
Non-current liabilities					
Other interest-bearing loans and borrowings	**(33,371)**	(3,691)	(34,011)	(34,392)	(30,000)
Employee benefits	**(14,641)**	(11,789)	(10,138)	(20,253)	(12,216)
	(48,012)	(15,480)	(44,149)	(54,645)	(42,216)
Total liabilities	**(211,851)**	(209,536)	(200,637)	(210,640)	(202,065)
Net assets	**173,329**	166,545	163,738	152,629	161,134

Notice of AGM

Notice is hereby given that the 65th Annual General Meeting of Headlam Group plc will be held at the group's distribution facility located at Relay Park, Relay Drive, Tamworth, B77 5PR on Friday 24 May 2013 at 10.00 a.m. for the following purposes.

As ordinary business

1. To receive, consider and adopt the Annual Report and Accounts, the Directors' Report and the Independent Auditor's Report for the year ended 31 December 2012.
2. To declare a final dividend for the year ended 31 December 2012 of 10.20 pence per ordinary share.
3. To re-elect as a director Graham Waldron who is retiring by rotation in accordance with the company's articles.
4. To re-elect as a director Dick Peters who is retiring by rotation in accordance with the company's articles.
5. To re-appoint KPMG Audit Plc as Independent Auditor of the company from the conclusion of the meeting until the conclusion of the next general meeting at which accounts are laid before the shareholders.
6. To authorise the directors to determine the Independent Auditor's remuneration.
7. To approve the Remuneration Report for the year ended 31 December 2012.

As special business

To consider and, if thought fit, pass the following resolutions of which resolution 8 will be proposed as an ordinary resolution and resolutions 9 to 11 will be proposed as special resolutions:

8. Authority to allot shares

(a) that the directors be generally and unconditionally authorised pursuant to section 551 of the Companies Act 2006 (the "Act") to allot shares in the company, and to grant rights to subscribe for or to convert any security into shares in the company, up to an aggregate nominal amount of £620,000 for a period expiring (unless previously renewed, varied or revoked by the company in general meeting) at the end of the 2014 AGM (or, if earlier, at the close of business on 30 June 2014), and save that the company may before such expiry make an offer or agreement which would or might require shares to be allotted, or rights to subscribe for or convert any security into shares to be granted, after expiry of this authority and the directors may allot shares and grant rights in pursuance of any such offer or agreement as if this authority had not expired;

(b) that, subject to paragraph (c), all existing authorities given to the directors pursuant to section 551 of the Act be revoked by this resolution; and

(c) that paragraph (b) shall be without prejudice to the continuing authority of the directors to allot shares or grant rights to subscribe for or convert any security into shares pursuant to an offer or agreement made by the company before the expiry of the authority pursuant to which such offer or agreement was made.

9. Dis-application of pre-emption rights

that, subject to the passing of resolution 8 in this Notice and in place of all existing powers to allot securities given to the directors, the directors be generally empowered pursuant to section 570 and section 573 of the Act to allot equity securities (as defined in section 560 of the Act) for cash, pursuant to the authority conferred by resolution 8 in this Notice, as if section 561 of the Act did not apply to the allotment.

This power:

(a) expires (unless previously renewed, varied or revoked by the company in general meeting) at the end of the 2014 AGM if passed (or, if earlier, at the close of business on 30 June 2014), save that the company may, before such expiry, make an offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot equity securities in pursuance of any such offer or agreement as if this power had not expired; and

Notice of AGM continued

(b) shall be limited to:

(i) the allotment of equity securities in connection with an issue to holders of ordinary shares of 5 pence in the capital of the company in proportion (as nearly as may be practicable) to their existing holdings and to people who hold other equity securities, if this is required by the rights of those securities or, if the directors consider it necessary, as permitted by the rights of those securities and so that the directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or under the laws of, any territory or any other matter; and

(ii) the allotment of equity securities for cash otherwise than pursuant to paragraph 9(b)(i) up to an aggregate nominal amount of £213,000.

This power applies in relation to a sale of shares which is an allotment of equity securities by virtue of section 560(3) of the Act as if, in the first paragraph of this resolution, the words "pursuant to the authority conferred by resolution 8 in this Notice" were omitted.

10. Authority to purchase own shares

that the company be and is hereby generally and unconditionally authorised for the purposes of section 701 of the Act to make market purchases (within the meaning of section 693(4) of the Act) of ordinary shares of 5 pence in the capital of the company, subject to the following conditions:

(a) the maximum number of ordinary shares which may be purchased is 8,536,000;

(b) the minimum price (exclusive of expenses) which may be paid for an ordinary share is 5 pence;

(c) the maximum price (exclusive of expenses) which may be paid for each ordinary share is the higher of: (i) an amount equal to 105% of the average of the middle market quotations of an ordinary share of the company as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the share is contracted to be purchased; and (ii) an amount equal to the higher of the price of the last independent trade of an ordinary share and the highest current independent bid for an ordinary share as derived from the London Stock Exchange Trading System; and

(d) the authority conferred by this resolution shall expire at the conclusion of the 2014 AGM or, if earlier, at the close of business on 30 June 2014 (except in relation to the purchase of shares the contract for which was made before the expiry of this authority and which might be concluded wholly or partly after such expiry).

11. Shareholder rights directive

that the company be and is hereby generally and unconditionally authorised to hold general meetings (other than annual general meetings) on 14 days' clear notice from the date of the passing of this resolution, provided that the authority shall expire at the conclusion of the AGM of the company to be held in 2014 or 30 June 2014, whichever is the earlier.

By order of the board

Geoff Duggan
Company Secretary
8 March 2013

Headlam Group plc
Registered No. 460129, England
Registered office:
Gorsey Lane, Coleshill
Birmingham, B46 1LW

Explanatory Notes to the Proposed Resolutions

This year's AGM will be held at the group's distribution facility at Relay Park, Relay Drive, Tamworth, B77 5PR on Friday 24 May 2013 at 10.00 a.m.

A description of the resolutions that will be proposed at the meeting is set out below.

Resolutions 1 to 8 inclusive are proposed as ordinary resolutions which means, that for each of these resolutions to be passed, more than half the votes cast must be cast in favour of the resolution. Resolutions 9 to 11 inclusive are proposed as special resolutions, which means, that for each of those resolutions to be passed, at least three quarters of the votes cast must be cast in favour of the resolution.

Resolution 1 – Annual Report and Accounts

The company is required by law to present to shareholders at the AGM its audited accounts and the directors and independent auditors' reports for the financial year ended 31 December 2012. Shareholders are invited to vote to receive and adopt the Annual Report and Accounts for the year ended 31 December 2012.

Resolution 2 – Declaration of dividend

The directors recommend the payment of a final dividend of 10.20p on each of the ordinary shares entitled thereto, which together with the interim dividend of 4.65p, gives a total dividend of 14.85p for the year ended 31 December 2012. Subject to approval of the declaration of the final dividend at the AGM, the final dividend will be paid on 1 July 2013 to the holders of ordinary shares whose names are recorded on the register of members at the close of business on 7 June 2013.

Resolution 3 – Re-election of Graham Waldron as a director

Graham Waldron is retiring by rotation in accordance with the company's articles and is offering himself for re-election by shareholders. Under the articles, directors are required to retire every three years. Graham was appointed an executive director in June 1991 and Chairman later that year, resigning as Chairman in 1999 but being re-appointed in 2006. The board believes that Graham should be re-elected and makes such a recommendation to shareholders.

Resolution 4 – Re-election of Dick Peters as a director

Dick Peters is retiring by rotation in accordance with the company's articles and is offering himself for re-election by shareholders. Under the articles, directors are required to retire every three years. Dick was appointed a non-executive director in December 2005 at which time he joined the Nominations, Audit and Remuneration Committees, becoming Chairman of the Audit Committee. The board believes that Dick Peters should be re-elected and makes such a recommendation to shareholders.

Resolution 5 – Re-appointment of Auditor

The company is required to appoint an auditor at each general meeting at which accounts are laid before the company, to hold office until the end of the next such meeting. This resolution proposes the appointment of an auditor. KPMG has expressed its willingness to continue in office.

Resolution 6 – Agreement of Auditor remuneration

In addition to the company's requirement to appoint an auditor, shareholder authority is sought for the directors to determine the remuneration to be paid to the auditor for the period of appointment.

Resolution 7 – Remuneration Report

Shareholders are being asked to approve the 2012 Remuneration Report, which is set out on pages 46 to 54 of the company's Annual Report and Accounts. Whilst the payment of remuneration to the directors is not dependent on the passing of the resolution, the board will take the vote into account when considering the future development and operation of the company's remuneration policy and practice.

Special Business – Resolutions 8 to 11
Resolution 8 – Authority to allot shares

Shareholders are being asked to pass the necessary resolution to grant to the directors a general authority, for the purpose of section 551 of the Companies Act 2006, to allot relevant securities. With due regard to the ABI guidelines and to comments received from shareholders, the proposed general authority, similar to last year, is to allot up to an aggregate nominal amount of £620,000

Explanatory Notes to the Proposed Resolutions continued

representing 12,400,000 ordinary shares (15% of the company's ordinary share capital (excluding treasury shares) in issue at 8 March 2013 (the latest practical date prior to the publication of this report)). As at 8 March 2013, the company held 1,827,794 treasury shares, which represented approximately 2.14% of the company's issued share capital (excluding treasury shares), which the company can cancel or hold for sale or use to meet the obligations under the company's employee share schemes.

This authority will lapse at the conclusion of the AGM to be held in 2014, or, if earlier, on 30 June 2014. The directors consider that this authority is desirable to allow the company to retain flexibility, although they have no current intention of exercising this authority except in connection with the company's employee share schemes.

Resolution 9 – Dis-application of pre-emption rights

Shareholders are being asked to pass a resolution to empower the directors to allot equity securities, or sell treasury shares, for cash as if section 561 of the Companies Act 2006 (which gives shareholders certain pre-emption rights on the issue of shares or rights to subscribe for or convert securities into shares) did not apply to any such allotment. The resolution allows the issue or sale of shares of up to an aggregate nominal amount of £620,000 representing 12,400,000 ordinary shares in respect of rights issues and other issues pro-rata to existing entitlements, and also allows issues or sales for cash (other than in relation to a rights issue) limited to shares having an aggregate nominal amount of £213,000 (5% of the company's ordinary share capital in issue at 8 March 2013). The authority will lapse at the conclusion of the AGM to be held in 2014 or, if earlier, on 30 June 2014.

The directors confirm that they have no present intention of exercising this authority.

In accordance with The Pre-Emption Group's Statement of Principles available at www.pre-emptiongroup.org.uk, the directors also confirm their intention that no more than 7.5% of the issued share capital of the company (excluding treasury shares) will be issued for cash on a non pre-emptive basis during any rolling three-year period.

Resolution 10 – Purchase of own shares

The directors believe that it is in the interests of the company and its members to continue to have the flexibility to purchase its own shares and this resolution seeks authority from members to do so. The directors intend only to exercise this authority where, after considering market conditions prevailing at the time, they believe that the effect of such exercise would be to increase the earnings per share and be in the best interests of shareholders generally. The effect of such purchases would either be to cancel the number of shares in issue or the directors may elect to hold them in treasury pursuant to the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 (the "Regulations"). The Regulations enable certain listed companies to hold shares in treasury, as an alternative to cancelling them, following a purchase of own shares by a company in accordance with the Companies Act 2006. Shares held in treasury may subsequently be cancelled, sold for cash or used to satisfy share options and share awards under a company's employee share scheme. Once held in treasury, a company is not entitled to exercise any rights, including the right to attend and vote at meetings in respect of the shares. Further, no dividend or other distribution of the company's assets may be made to the company in respect of the treasury shares.

This resolution renews the authority given at the AGM held in 2011 and 2012. The authority is in respect of 10% of the company's issued ordinary share capital as at 8 March 2013 and will lapse at the conclusion of the AGM to be held in 2014 or, if earlier, on 30 June 2014. The resolution specifies the maximum and minimum prices at which the shares may be bought. If the company buys any of its shares under the authority proposed by resolution 10, the board will decide at the time whether to cancel them immediately or hold them in treasury. The purchase of shares will be dependent on market conditions and will also take into account the cash generated in the business and other investment opportunities that may arise over time. During the year the company made no purchases of its own shares.

Details of share options outstanding and treasury share movements including details of own shares acquired by the company are shown respectively in notes 21 and 22 to the Financial Statements.

Resolution 11 – Shareholder rights directive

This will be proposed as a special resolution to approve the holding of general meetings, other than AGMs, on 14 days' notice. Although the company's articles currently permit this, the Shareholder Rights Directive requires a shareholder resolution to be passed to authorise general meetings to be held on 14 days' notice. Without the passing of resolution 11, the minimum notice period under the regulations would be 21 days. If resolution 11 is passed by the shareholders, the regulations would only allow the company to call a general meeting on 14 days' notice if it were to make a system of electronic voting available to its shareholders in respect of the meeting in question. The directors consider it to be in the best interest of shareholders to pass resolution 11, which is a repeat of the same resolution passed at the AGM's in 2011 and 2012, in order to prevent being constrained by the regulations implementing the directive. It will be necessary for a similar resolution to be put to shareholders at each subsequent AGM. It is intended that this flexibility will only be used for non-routine business and where merited in the interests of shareholders as a whole.

Explanatory Notes to the Notice of Meeting

Notes 1 to 17 below give further explanation as to the proxy, voting and attendance procedures at the AGM.

1. Entitlement to appoint proxies.

A member entitled to attend and vote at the meeting is also entitled to appoint a proxy or proxies to attend, speak and vote instead of him.

A member may appoint more than one proxy in relation to the meeting, provided that each proxy is appointed to exercise the rights attached to a different share or shares held by that member. A proxy need not be a member of the company. Appointment of a proxy will not preclude a member from attending and voting in person at the meeting. To appoint more than one proxy, a member must complete a photocopy of the enclosed proxy card or obtain additional forms from Capita Registrars, telephone 0871 664 0300 (calls cost 10p per minute plus network charges). Lines are open 8.30 a.m.–5.30 p.m. Monday to Friday. Please also indicate by ticking the relevant box if the proxy appointment is one of multiple appointments being made.

Multiple proxy appointments should be returned together in the same envelope. Enter in the box provided the number of shares in relation to which your proxy is authorised or leave the box blank to authorise your proxy to act in relation to your full voting entitlement.

2. Appointing proxies

To be effective, the instrument appointing a proxy and any power of attorney or other authority under which it is executed (or a notarially certified copy of such power or authority) must reach Capita Registrars, Proxies Department, The Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU not less than 48 hours before the time for holding the meeting. A form of proxy is enclosed with this Notice.

3. Electronic proxy appointment through Crest

CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual (available via www.euro-clear.com/CREST). 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 or instruction made using the CREST service to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with Euroclear UK & Ireland Limited's ("Euroclear UK & Ireland") specifications and must contain the information required for such instructions, as described in the CREST manual. The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID RA10) by the latest time for the 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 CREST application host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.

CREST members and, where applicable, their CREST sponsors, or voting service providers should note that Euroclear UK and Ireland does not make available special procedures in CREST for any particular message. Normal system timing 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, 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 systems and timing.

The company may treat as invalid a CREST proxy instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertified Securities Regulations 2001.

Explanatory Notes to the Notice of Meeting continued

4. Joint holders

In the case of joint holders of a share the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders. For this purpose seniority is determined by the order in which the names of the holders stand in the register of members in respect of the joint holding.

5. Entitlement to attend and vote

Pursuant to Regulation 41 of the Un-certificated Securities Regulations 2001, the time by which a person must be entered on the register of members in order to have the right to attend and vote at the AGM is 6.00 p.m. on 22 May 2012 or, if the meeting is adjourned, 6.00 p.m. on the date two days before the date for the adjourned meeting. Changes to entries on the register of members after that time will be disregarded in determining the right of any person to attend or vote at the meeting.

6. Corporate representatives

Corporations may appoint one or more corporate representatives who, on its behalf, may exercise all of its powers as a member.

7. Nominated person

If you are a person who has been nominated under section 146 of the Companies Act 2006 to enjoy nomination rights (a "Nominated Person") you may, under an agreement between you and the member of the company who has nominated you, have a right to be appointed (or have someone else appointed) as a proxy for the meeting. If you do not have such a proxy appointment right, or you do but do not wish to exercise it, you may have a right to give instructions to the member who has appointed you as to the exercise of voting rights. If you are a Nominated Person, the statement of the rights of members in relation to the appointment of proxies above does not apply. Such rights can only be exercised by a registered member of the company.

8. Issued share capital/voting rights

As at 8 March 2013 the company's issued share capital, including treasury shares, consisted of 85,363,743 ordinary shares of 5p ("shares"). Of these 1,822,794 shares were held in treasury, the voting rights and entitlement to dividend of which were automatically suspended. Accordingly the total number of voting rights in the company as at that date was 83,540,949.

9. Right to ask questions

A shareholder attending the meeting has the right to ask questions relating to the business being dealt with at the meeting in accordance with section 319A of the Act. In certain circumstances prescribed by section 319A of the Act, the company need not answer a question.

10. Shareholder requests under section 527 of the Act

Under section 527 Companies Act 2006, members of the company representing at least 5% of the total voting rights of the company or at least 100 members who have a right to vote and hold shares in the company on which there has been paid up an average sum per member of at least £100, may require the company to publish on its website a statement setting out any matter relating to the audit of the company's accounts or any circumstances connected with KPMG Audit Plc ceasing to hold office since the last AGM that the members propose to raise at the meeting. Where the company is required to publish such a statement on its website, it may not require the members making the request to pay its expenses in complying with the request. The company must forward the statement to the company's auditor not later than the time when it makes the statement available on its website. The business of the meeting includes any such statement that the company has been required to publish on its website.

11. Non-shareholder attendance

Persons who are not shareholders in the company will not be admitted to the meeting unless prior arrangements are made with the company.

12. Access arrangements

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

13. Communicating with the company in relation to the AGM

Except as provided above, members who wish to communicate with the company in relation to the AGM should do so using the following means:

(a) by writing to the Company Secretary at the company's registered office address at Gorsey Lane, Coleshill, Birmingham, B46 1LW;

or

(b) by writing to Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU.

No other methods of communication will be accepted. In particular, you may not use any electronic address provided either in this Notice or in any related documents (including, without limitation, the Annual Report and Accounts 2012 and the form(s) of proxy) to communicate with the company for any purpose other than those expressly stated in this Notice or in such other related documents.

14. Inspection of documents

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 the 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 (Saturday, 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.

15. Voting results

The results of the voting at the AGM will be announced through a Regulatory Information Service and will appear on our website www.headlam.com.

16. Website

A copy of this Notice, and other information required by section 311A of the Act, can be found at www.headlam.com.

17. Data protection statement

Your personal data includes all data provided by you, or on your behalf, which relates to you as a shareholder, including your name and contact details, the votes you cast and your Reference Number (attributed to you by the company).

The company determines the purposes for which and the manner in which your personal data is to be processed. The company and any third party to whom it discloses the data (including the company's Registrars) may process your personal data for the purposes of compiling and updating the company's records, fulfilling its legal obligations and processing the shareholder rights you exercise.

Shareholder Information

Shareholder helpline

The company'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 company shares. If you have a question about your shareholding in the company you should contact: Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU. email: ssd@capitaregistrars.com, telephone 0871 664 0300 (calls cost 10p plus network extras). Lines are open 8.30 a.m.-5.30 p.m. Monday to Friday.

Frequent shareholder enquiries

If you change your address

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

If you change your name

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

Lost share certificates

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 the company's 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, write to Capita to request the accounts are consolidated.

Buying and selling shares in the UK

If you wish to trade in the company's 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 shares

Transferring shares to someone else requires the completion of a stock transfer form. This form, and details of the procedure you need to follow, is available from Capita's website www.capitaregistrars.com. 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 company's website.

The company's website

The company's website at www.headlam.com provides news, details of activities, and 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

Warning to shareholders – boiler room scams

We have been made aware of our shareholders receiving unsolicited telephone calls from companies offering to buy Headlam shares at a substantial premium to the prevailing market price for a large shareholder intending to make a takeover bid. These callers, who can be extremely persuasive and persistent, are usually based overseas and are commonly known as "boiler room scams". Shareholders are advised to be wary of any unsolicited investment advice or approach to buy or sell shares… if it sounds too good to be true, it probably is.

If you receive an unsolicited investment approach, you should:

- confirm the name of the person calling and the organisation they represent;
- check that they are registered with the Financial Services Authority (FSA) by calling 0845 606 1234 or by visiting www.fsa.gov.uk/register/and contact the firm using the details on the register;
- report the matter to the FSA by calling 0845 606 1234 or by visiting www.fsa.gov.uk/pages/consumerinformation

Please note that if you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme. Further information on this or similar activity can be found on the FSA website www.moneymadeclear.fsa.gov.uk. If you have any queries, please contact the Company Secretary.

Advisers

Auditor

KPMG Audit Plc
One Snowhill
Snow Hill Queensway
Birmingham
B4 6GH

Taxation advisers

Deloitte LLP
Four Brindley Place
Birmingham
B1 2HZ

Principal bankers

Barclays Bank PLC
PO Box 3333
One Snowhill
Snow Hill Queensway
Birmingham
B3 2WN

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

Solicitors

Pinsent Masons LLP
3 Colmore Circus
Birmingham
B4 6BH

Stockbrokers

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

Registrars

Capita Registrars
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU

Financial Calendar

Announcements

Interim Management Statement	17 May 2013
Annual General Meeting	24 May 2013
Interim results announced	23 August 2013
Interim Management Statement	15 November 2013
Full year results announced	March 2014

Dividend dates

Final dividend for 2012, if approved, payable to qualifying shareholders on the register as at 7 June 2013	1 July 2013
Interim dividend for 2013 announced	23 August 2013
Interim dividend for 2013 payable	2 January 2014

Shareholder Notes

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Paper from responsible sources
FSC® C016486
www.fsc.org

This annual report is printed on Hello Silk. Both the paper mill and printer involved in the production support the growth of responsible forest management and are both accredited to ISO 14001 which specifies a process for continuous environmental improvement and both are FSC® certified. If you have finished reading this report and no longer wish to retain it, please pass it on to other interested readers or dispose of it in your recycled paper waste.

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Registration
Registered in England and Wales
Number 460129

For further detail on our business please visit:
www.headlam.com