



**headlam**<sup>®</sup>  
group plc

# Europe's leading floorcovering distributor

Annual Report and Accounts 2013



## About Us

Headlam is engaged in the marketing, supply and distribution of an extensive range of floorcovering products. The group's activities and facilities are located throughout the UK, France, Switzerland and the Netherlands.

## Our Purpose

The group's operations are aimed at providing its customers, principally independent floorcovering retailers and contractors, with a comprehensive and up to date range of competitively priced floorcovering products supported by next day delivery.

This approach presents Headlam's suppliers with an opportunity to achieve an unparalleled market access backed by cost effective distribution.

In order to provide this level of service to its customers and suppliers, Headlam has developed a diverse and autonomous operating structure that 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 Headlam to establish itself as Europe's leading floorcovering distributor.



For further detail on  
our business please visit:

[www.headlam.com](http://www.headlam.com)

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# Our Performance

## Financial highlights

### Revenue £m

**603.1**

2012: 586.0  
+2.9%

2009	533.8
2010	535.7
2011	569.8
2012	586.0
2013	603.1

### Underlying Operating Profit £m

**27.7\***

2012: 29.3  
-5.4%

2009	24.8
2010	26.1
2011	28.1
2012	29.3
2013	27.7

### Operating Profit £m

**21.1**

2012: 29.3  
-28%

2009	24.8
2010	26.1
2011	28.1
2012	29.3
2013	21.1

### Underlying Earnings Per Share p

**24.5\***

2012: 25.3  
-3.2%

2009	19.1
2010	21.5
2011	24.6
2012	25.3
2013	24.5

### Earnings Per Share p

**18.0**

2012: 25.3\*\*  
-28.9%

2009	19.1
2010	21.5
2011	24.6
2012	25.3
2013	18.0

### Dividends Paid and Proposed p

**15.30**

2012: 14.85  
+3%

2009	11.00
2010	12.40
2011	14.15
2012	14.85
2013	15.30

\* Underlying numbers have been used in order to provide a better understanding of the business performance.

The non-underlying items relate to the impairment of intangible and tangible fixed assets, totalling £5.4 million, the details of which can be found in note 4 to the financial statements.

\*\* 2012 earnings per share has been restated to reflect the changes for revised IAS 19.

## Operational highlights

Further gains in UK market share, with like for like revenues increasing by 1.5% despite the difficult start to the year.

Our businesses in France and the Netherlands continue to face challenging markets and depressed profitability. As a consequence, an impairment of £5.4 million relating to intangible and tangible fixed assets has been recognised during the year.

Construction of the Coleshill distribution centre completed and fully operational from January 2014.

The group expands its UK presence with the acquisition of Hall's Flooring and Fells Carpets and the establishment of service centres in Coventry, Manchester and Sheffield.

The introduction of an integrated transport solution for the group's businesses located in Scotland enhances the efficiency and effectiveness of our customer service in the north east of the country.

The group continues to invest in external training programmes aimed at providing ongoing development for managers and sales representatives and introduces further enhancements to the customer relationship management, ("CRM"), app used on the iPad.



For further detail on our business please visit:

[www.headlam.com](http://www.headlam.com)



# Chairman's Statement

"The board is proposing an increase to the final dividend by 4.4% from 10.20p to 10.65p."

It is particularly pleasing for me, in my first statement as Chairman, to be able to report on a year in which we achieved further progress with group revenue rising to a record level. This result was achieved despite the trading challenges and uncertainty encountered during the first half of 2013.

## Overview

2013 has been a story of continued improvement in operating performance set against a background of uncertainty, variable trading patterns and a continuing competitive environment.

The first half of the year was particularly difficult with trading undermined by unfavourable weather across certain parts of the UK and the Netherlands. At the time, this only served to exacerbate the fragile nature of the market and was the key cause of revenues contracting during the first six months.

However, a much stronger second half, particularly during the important months of August, November and December, enabled the group to recover the first half revenue deficit and end the year with a positive performance for the year as a whole.

The result for the year provides further confirmation that the decision to maintain our strategy, structure and range of businesses has placed the group in an advantageous position and allowed it to respond positively to improvements in the market.

The board remains committed to investing in those areas of our business that will enable us to drive future growth and enhance market position.

## Earnings and dividend

Underlying profit before tax for the year, amounting to £26.4 million, was down by 5.1% on the previous year's result of £27.9 million and underlying earnings per share declined by 3.2% from 25.3p to 24.5p. The board is proposing to increase the final dividend by 4.4% from 10.20p to 10.65p resulting in a total dividend for the year of 15.30p, up 3.0% on 2012. The final dividend, if approved by shareholders at the Annual General Meeting ("AGM"), will be paid on 1 July 2014 to shareholders on the register at close of business on 6 June 2014.

## Governance and board

Excellent governance has its foundation in an effective board. Headlam seeks 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.

2013 was the year in which our previous Chairman, Graham Waldron, decided to retire from the board. Graham served as a director of Headlam for 22 years and, during that time, made a major contribution to the development and success of the group. We thank Graham for his dedicated service and wish him and his family well for the future.

## Employees

The board would like to thank all our employees for their contribution to the continued success of the group, particularly during a year which has required unrelenting determination and focus. Our businesses flourish as a result of their positive attitude.



**Dick Peters**

Chairman, 7 March 2014



# Business Model and Strategy

## Generating value for the long term

Headlam distributes a wide range of products, sourced from a variety of floorcovering suppliers located 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 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 local management teams. The autonomous operations are a key contributor to the group's success providing opportunity for experienced management teams to develop the individual identity, market presence and profitability of the business for which they are responsible.

This structure permits broad access to floorcovering markets, allows the group to react swiftly to emerging opportunities and assists with managing downside risks when trading environments are challenging. Whilst each business is encouraged to adopt an entrepreneurial style, they are operated within a well developed and consistently applied framework of operational and financial control.

Headlam's collection of businesses, assembled over many years, has allowed the group to continually outperform the floorcovering market through various economic cycles. This has been very evident in recent years when conditions have proved to be particularly demanding and during which time the group has consistently maintained its ability to achieve an increased market share.

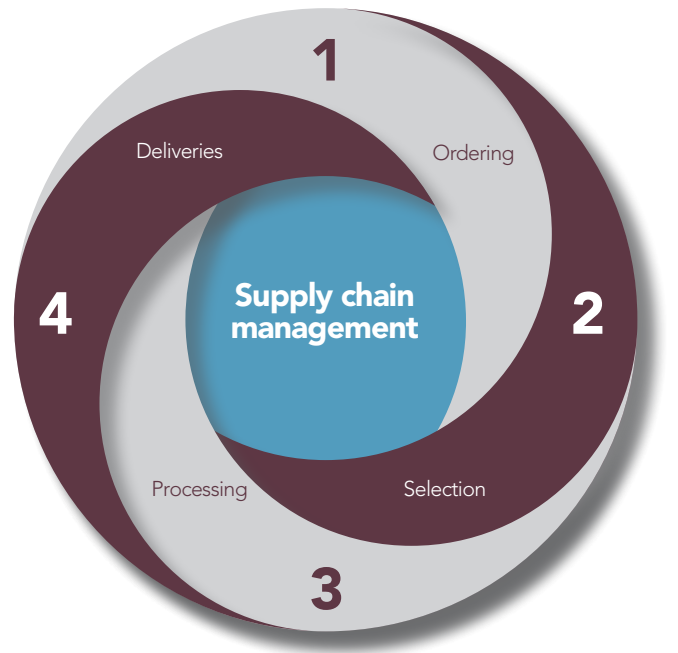
The group's strategy remains focused on developing its floorcovering distribution businesses in the UK and continental Europe and the continued improvement of the services provided to its customers. The group's size and structure provide it with a unique competitive advantage that enables it to deliver the benefits of product diversity, sustained product development and marketing and distribution services, all of which are aimed at supporting and enhancing its customers' market position.

Each business is supported by the group's commitment to continued investment in people, product, facilities and IT, the commitment providing the foundation underpinning growth and performance and, ultimately, the establishment of the group as Europe's leading floorcovering distributor.



# How we generate income

Essential to 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. 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 3,016 new product launches during the year, which were supported by 638,679 point of sale items being positioned with our customers.



<b>1</b> Ordering	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 customers’ requirements are properly recorded for subsequent processing.	4,331,886 orders placed in 2013
<b>2</b> Selection	The distribution centres maintain substantial investment in products to ensure that customers’ orders are swiftly processed and their delivery expectations fully satisfied.	57.3 million ft <sup>2</sup> warehouse capacity
<b>3</b> Processing	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.	36,088 UK cut length processing per week
<b>4</b> Deliveries	Virtually all our deliveries to customers are made on group vehicles. 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.	1,247,051 UK deliveries in 2013



# Continuing Commitment to Investment in the Group's Infrastructure

Investment in modern and efficient distribution centres has been a hallmark of the group's operational strategy since the mid 1990s. The most recent addition to the group's portfolio, the enlarged facility in Coleshill, which has been extended from 158,073 square feet to 300,373 square feet, will enable the group to broaden its product range cost effectively and improve the group's service capability.

More recently, the group has added a service centre network to widen its service offering to customers. During the year, we added additional centres in Coventry, Sheffield and Trafford Park, Manchester, and intend to add further centres during 2014 in locations which will help consolidate our service offering.

The combination of delivery from our distribution and service centres and the ability for our customers to collect from 40 trade counters located in our distribution and service centres across the UK and 21 in France provides the group with an unparalleled access to its core markets.









# Product

**During 2013, we launched 3,016 new products and 638,679 point of sale items.**

We continue to support and assist with the ongoing development and launch of new products into the market. The partnership between our management teams and suppliers forms a vital component of the group's ability to provide its customers with immediate access to new product ranges as they become available.

Lifestyle Floors continues to gain further traction in the UK market through ongoing investment. During 2013, we invested an additional £1.1 million in point of sale material.

## New products launched in the UK

2011	3,501
2012	2,855
2013	3,016

## Number of UK external sales people

2011	383
2012	399
2013	416

## Number of customer visits in the UK

2011	488,660
2012	515,339
2013	520,434

## Number of orders from UK customers

2011	3,877,835
2012	3,973,351
2013	4,331,886

## Number of active customer accounts in the UK

2011	43,347
2012	44,086
2013	45,720







# People and Training

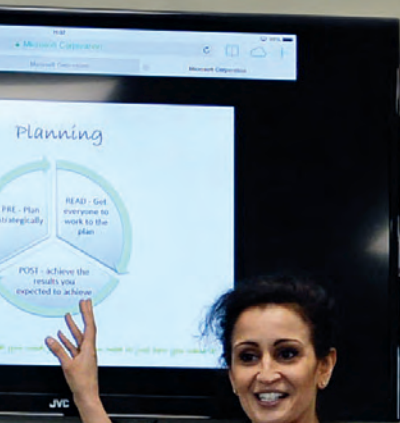
An important element essential to the group's ongoing success are the individual management teams that are responsible for running our autonomous businesses. The teams operate their individual businesses on a day-to-day basis and have primary responsibility for developing and maintaining the group's relationships with suppliers and customers. These relationships are one of the foundations of the group's business ethos and it is the hard work and commitment from our teams around the group that enable them to flourish and perpetuate.

In order to help advance the effectiveness of management teams, the group has continued to invest in the use of external training programmes to develop management, motivation and selling skills. We have also included our sales representatives in the training programme with the emphasis on improving their preparation, productivity and selling techniques.

In a wider context, the ongoing training across all the group's disciplines not only assists in allowing our people to develop and grow their careers but also ensures we have a suitable base of skilled and qualified individuals who are able to contribute to the operational needs of our businesses.









# Technologies

The iPad, launched to our sales teams in 2011, continues to contribute to improved working practices and enhanced customer information. The device allows us to run our bespoke CRM app and enables our sales people to be fully prepared prior to making their visits and as productive as possible whilst engaged with their customer. Given the competitive edge the CRM brings to our sales teams and the improvements it has brought to customer service, we intend to maintain its future development with further investment.

The utilisation of the iPad is now firmly established 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.



## Business-to-Business Websites

We are currently improving our business-to-business websites, originally launched in 2000, to allow independent flooring retailers and contractors access to our stock files and to place orders 24 hours a day seven days a week. The enhanced sites will create a bespoke business-to-business solution, each one reflecting the individual identity of our operating businesses and will provide our customers with superior sales and marketing visuals and improved navigation options.







# Our Marketplace

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.



# 1 Regional Multi-product Distribution

These 23 businesses, operating in both the residential and commercial markets, collectively provide a comprehensive national coverage.

○ Distribution Centre      ○ Service Centre





# Our Marketplace continued

## 2 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.

 Distribution Centre

 Distribution Hub

 Trans-shipping Location





### 3 Regional Commercial Distribution

Our Regional Commercial Distribution currently includes 23 operations based in five distribution and 17 service centres.

-  Distribution Centre
-  Service Centre
-  Shared Distribution Centre





# Our Marketplace continued

## 4 National Residential Specialist Products

These 12 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.

 Distribution Centre

### National Commercial Specialist Products



**florprotec**  
QUALITY TEMPORARY FLOOR PROTECTION



**clarendon**  
qualitycarpets



Creative Floorcoverings & Rugs by  
**CRUCIAL TRADING**

 **gaskell** WOOL RICH  
FINEST WOOL

  
**KINGSM EAD**  
CARPETS

### National Residential Specialist Products



  
**National Carpets**  
*When quality counts*

  
**BMK**  
FLOORING  
CARPET • WOOD • LAMINATE

 **Orientalweavers@bmk**

**Plantation Rug Company**

**Mr Tomkinson**  
*your carpet specialist*

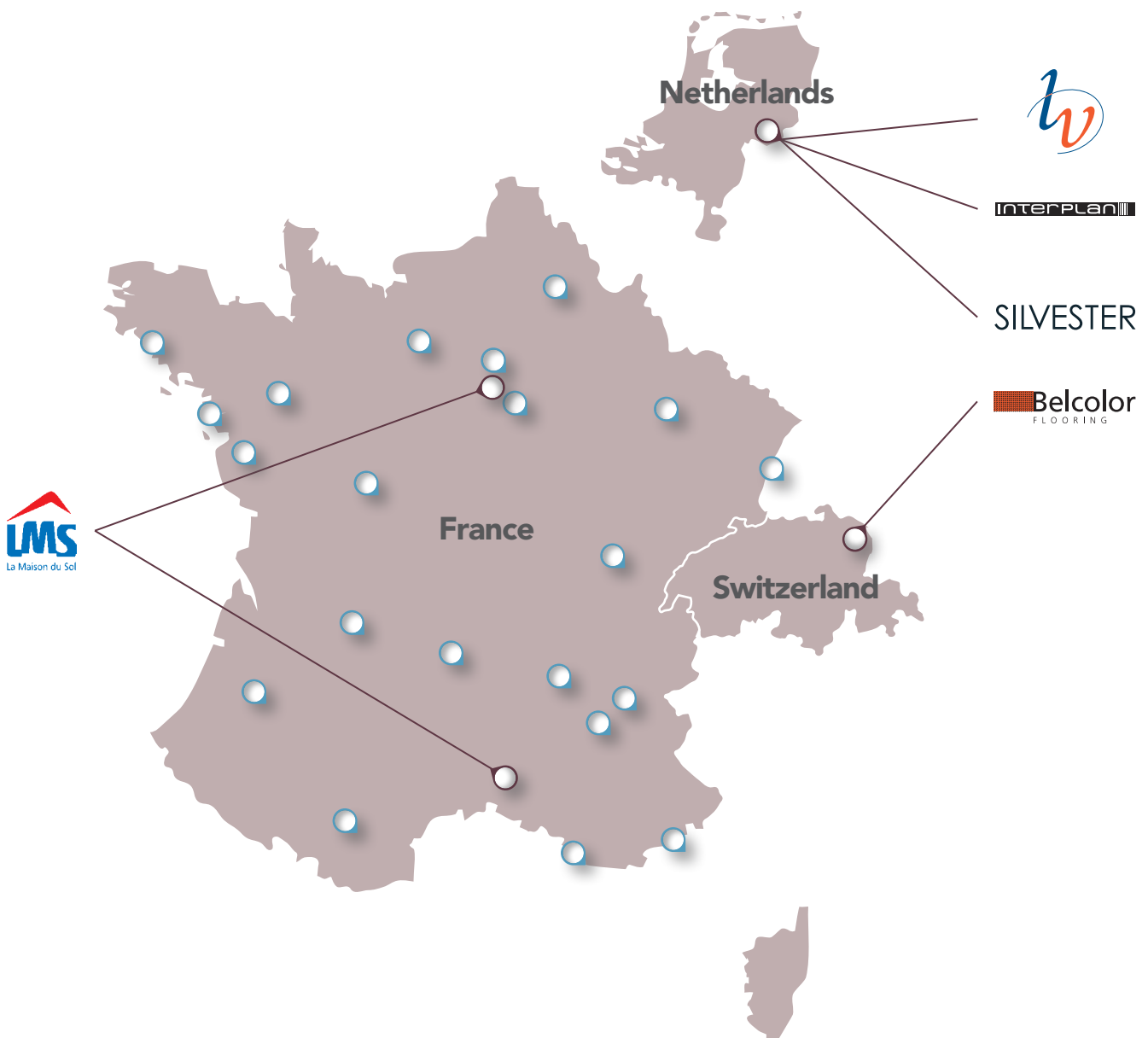
**manx**  




## 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.

 Distribution Centre    
  Service Centre



# Operating Review

## Maintaining investment for future growth and service enhancement

The emphasis this year has been directed at developing and completing a range of investments and initiatives aimed at improving the group's ability to enhance customer service and respond to opportunities for future growth.

"There are indications of a slight improvement in market conditions in the UK and a more stable market in continental Europe."



### Overview

Against a backdrop of continued market challenge, the group responded well as the year progressed, recovering from a difficult start and finishing with a strong performance. Notwithstanding the uncertainties that surrounded markets during 2013, we completed a number of investments aimed at improving product offering and market reach with the objective of improving the level of service we offer our customers.

### Investments

The construction project extending our Coleshill distribution hub was substantially completed on schedule by the end of the year and was fully operational from January 2014. The enlarged 300,073 square foot facility will allow us to enhance our supply chain and inventory management.

We have extended the number of service centres with the establishment of new locations in Coventry, Sheffield and Trafford Park, Manchester. Our network of service centres and trade counters, that now numbers 40 locations across the UK, allows us to support the large number of customers who prefer to collect their product needs rather than using our delivery service. Notwithstanding our existing coverage, we have a number of geographical voids and are currently exploring several locations across the UK which would complement our existing network and provide further opportunity to increase our market presence.

As reported previously, we completed the acquisition of the business and certain assets of Hall's Floorings Limited on 28 March 2013. Following the acquisition, the logistics operation of Hall's Floorings was immediately moved to Coleshill, whilst a base was retained in north London to enable the business to retain its autonomous identity and from which to develop its sales and marketing activity to independent flooring retailers throughout most of England.



On 29 November 2013, we then completed the acquisition of the business and certain assets of Roger Fell Limited, which trades as Fells Carpets. The business is a distributor of residential floorcovering, supplying independent floorcovering retailers throughout the north of England. Following completion, the sales, marketing and logistics activities were transferred from their former location in Whitley Bridge, Yorkshire to the group's existing facility in Gildersome, Leeds, without disturbing the autonomous identity of the Fells business.

We are also in the process of establishing a trans-shipping facility in north London. The facility, which should be fully operational from May 2014, will provide a base for Hall's Floorings, allow us to extend our collection service by creating a trade counter and enable our specialist Residential businesses to improve their service across the south-east of England.

### Customers

Whilst markets continue to present our customers with challenges, they have managed to maintain an improving trading trend as evidenced by the group's increase in revenue. Credit taken at 40.1 days (2012: 41.3), combined with a continued reduction in the incidence and cost of bad debts, points to a sector that remains financially robust and resourceful.

Contact with our customers is a vital aspect of our business and, during the year, our sales representatives collectively made 520,434 (2012: 515,339) customer visits. We also managed to increase the number of active accounts from 44,086 to 45,720 and, in return, our customers placed 4,331,886 (2012: 3,973,351) orders on our businesses across the UK.

### Marketing

Lifestyle Floors is now firmly established as the most comprehensive display and marketing concept within UK independent floorcovering retailers. The extensive product portfolio of carpet, vinyl, wood, laminate and luxury vinyl tile displayed within the various point of sale modules will be enhanced further during the spring of 2014, with the launch of additional products. This is another area where the group's investment continues to develop our relationship with independent floorcovering retailers and ultimately contributes to our mutual gains in market share.

During the autumn of 2013, we combined the sales and marketing activities of Kingsmead Carpets and Georgian Carpets in order to significantly increase the retail presence of their complementary product portfolio of wool and polypropylene carpets. During 2014, further investment in sales resource, display and marketing will elevate the combined business to be one of the most prominent carpet suppliers to independent retailers in the UK.

### Continental Europe

Our continental European businesses are also contending with challenging markets but, on a positive note, there appear to be tentative signs that the rate of decline in these markets may be slowing based on recent performance.

As reported previously, we have implemented limited restructuring in our Dutch businesses in order to improve efficiency and reduce the downside risk on declining performance arising from further market contraction.

With LMS, our business based in France, we continue to evaluate the revenue benefits that could arise as a result of training initiatives and the introduction of a CRM system based on the UK platform.

Belcolor continues to achieve a satisfactory performance but, as with our other businesses on the continent, is having to contend with a difficult market.

Our continental businesses are managed by experienced teams. As with the UK, the performance of their businesses would be elevated if markets resumed growth.

# Operating Review continued

## Revenue and operating profit

Group revenue increased during the year by 2.9% from £586.0 million to £603.1 million. UK like for like revenue increased by 1.5% from £491.5 million to £498.9 million and, on the continent, collective like for like performance declined by 3.7%. The revenue from acquisitions during the year amounted to £10.4 million compared with £0.7 million in the previous year.

The group's gross margin edged up during the year to 30.1% compared with 30.0% for the previous year. Achieving an increase in gross margin is one of the performance indicators targeted for improvement. Whilst gains were evident earlier in the year, they were substantially eroded due to shifts in product mix and sustained pricing pressure from the market. We will continue with our efforts and initiatives to maintain further progress in this area of the business.

Underlying overhead cost increased by 4.9% during the year to £153.6 million compared with £146.4 million in the previous year. As a percentage of revenue, underlying overhead cost increased to 25.5% compared with 25.0% for the previous year. The two key areas contributing to the movement were the incremental overhead costs arising from the businesses acquired during the year amounting to £3.3 million and the general cost of living increase for employees, implemented from 1 January 2013, amounting to 2.0%.

As mentioned above, the group continues to invest in the Lifestyle Floors concept. During the year, a further £1.1 million was incurred on providing additional marketing and point of sale material to support the ongoing development of the brand.

The group's underlying operating profit declined by £1.6 million from £29.3 million for the previous year to £27.7 million because the growth in underlying overhead costs outpaced the improvement in gross profit.

Whilst additional overhead cost increases are anticipated for 2014, principally due to the continued investment in the group's distribution capability and Lifestyle Floors, growth in employment cost will be substantially less than 2013 and the contribution from the acquisitions completed during 2012 and 2013 should move from earnings diluting to enhancing.

## Non-underlying items

As a consequence of the ongoing challenges associated with the floorcovering markets in France and the Netherlands, our businesses in these two countries have continued to experience a decline in profitability. The impairment test conducted during the year for these entities has revealed a shortfall in their recoverable value when compared with their carrying value. This has resulted in the goodwill attaching to the French business, amounting to £3.2 million, being written down in full and the freehold distribution centre in the Netherlands being impaired by £2.2 million.

The non-underlying items are non-cash items and have been excluded from the group's underlying profit and earnings measures.

## IAS 19

Following the introduction of the amendment to IAS 19, notably relating to the measurement of the expected return on assets, we have restated the result for the 2012 12-month period. In the Consolidated Income Statement, the restatement relates to net finance cost and taxation. The net adjustment to the Consolidated Income Statement is matched by an equal and opposite adjustment relating to the re-measurement of defined benefit plans in the Consolidated Statement of Comprehensive Income. As a result of these changes, basic earnings per share for 2012 reduced from 25.8p to 25.3p.

The net effect to comprehensive income attributable to the equity shareholders for the period was nil.





## Net finance costs

Net finance costs reduced during the year by £0.3 million from £1.5 million to £1.2 million. There was a gain on net bank interest with cost reducing by £292,000 and an increased cost of £70,000 attributable to the net movement in cash flow and interest rate hedges and the defined benefit plan obligation.

## Taxation

The effective underlying rate of taxation reduced to 23.25% during the year, reflecting the decrease in UK headline corporation tax rate and also the further future reductions, already enacted, that impact upon deferred taxation. The anticipated effective underlying rate for 2014 is expected to reduce to 21.5% due to further UK rate reductions which have now been enacted.

## Earnings per share

Underlying basic earnings per share declined by 3.2% during the year from 25.3p to 24.5p. The underlying diluted earnings per share declined by 3.6% from 25.2p to 24.3p.

## Dividends

Total dividends paid and proposed for 2013 have increased by 3.0% from 14.85p to 15.30p. Dividend cover reduced to 1.3 times but, when measured against underlying basic earnings per share, dividend cover is 1.6 times. This is a small reduction compared with the sustained position over the last few years, but a ratio the board feels comfortable with maintaining in the future.

## Cash flows

### Net cash flow from operating activities

Net cash flow from operating activities decreased during the year by £1.9 million from £25.9 million to £24.0 million.

The two key items contributing to the decline are profit before tax, which reduced by £6.8 million year on year, and the adjustments for depreciation, amortisation and impairment which increased by £5.5 million with the common cause for the two large movements being the inclusion of the non-underlying items. Adjusting for the total underlying amount of £5.4 million gives a decline of £1.4 million for profit before tax which, net of the reduction in depreciation, £0.1 million, gives rise to a movement of £1.3 million.

The remainder of the annual movement is principally attributable to a reduction in share-based payments, £0.9 million, which, when netted with the decrease in interest and tax paid, totalling £0.5 million, gives a movement of £0.4 million.

The net reduction in working capital of £2.2 million was broadly in line with last year. The year-on-year movements for each individual component of working capital were a reduction of £2.5 million for inventory, an increase in trade and other receivables of £12.6 million and an increase in trade and other payables of £10.2 million, with the movements in all three elements related to the increasingly buoyant trading during the final quarter of the year.



# Operating Review continued

## Cash flows from investing and financing activities

The net cash movement for the year in relation to property, plant and equipment was a £12.8 million cash outflow. This compares with a net cash outflow for the previous year of £6.5 million. The additional outflow during the current year occurred because of the extension to the Coleshill distribution centre.

The acquisition of Hall's Floorings and Fells Carpets amounting to £2.0 million exceeded the £0.8 million invested during the previous year for Flooring Accessories and C K Davie.

Cash outflows from financing activities increased by £1.3 million due to a smaller release of treasury shares as a result of a reduction in the exercise of SAYE options and a modest increase in dividends paid during the year.

## Net debt

Group net funds at the end of the year reduced by £2.2 million compared with the previous year, from £16.2 million to £14.0 million, as detailed in the table below.

	At 1 January 2013 £000	Cash flows £000	Foreign exchange translation £000	At 31 December 2013 £000
Cash at bank and in hand	49,798	(2,402)	81	47,477
Debt due within one year	(213)	–	(5)	(218)
Debt due after one year	(33,371)	223	(91)	(33,239)
	16,214	(2,179)	(15)	14,020

## Funding and going concern

The group maintains sufficient banking facilities to fund its operations and investments and, as illustrated below, at 31 December 2013, 61.5% of the group's facilities were undrawn.

Barclays Bank and The Royal Bank of Scotland have each provided the group with a £20.0 million facility which will fall due for renewal during March 2017. As at 31 December 2013, the utilisation of the group's total facilities was as follows.

	Drawn £000	Undrawn £000	Total facility £000
Less than one year	–	43,386	43,386
Over one year and less than five years	31,092	10,000	41,092
Over five and less than seven years	2,366	–	2,366
	33,458	53,386	86,844

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





## Employee benefits

As at 31 December 2013, the group's net pension liabilities totalled £15.6 million, representing a decrease of £1.8 million on the previous year. The reduction in the deficit is due to the growth in plan assets during the year outpacing the rise in the value of the plan obligations. The value of the plan obligations has been affected by an adverse movement in the inflation rate assumption, but this has been partly offset by an increase in the discount rate assumption.

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 remain at £2.8 million for 2014. However a triennial review of the UK defined benefit plan as at 31 March 2014 may have a bearing on the amount due for 2014 and future periods.

## Outlook

The final months of 2013 showed progressive improvement and this momentum has carried forward into the first two months of 2014. Whilst January and February are relatively lower trading months and compared against weaker comparatives from 2013, both months have produced a positive result. Furthermore, there are indications of a slight improvement in market conditions in the UK and a more stable market in continental Europe.

This trading improvement has coincided with the increased investment across the various group initiatives aimed at providing our customers with an ever improving overall service proposition and the group with a strong platform for future growth.

Therefore, we enter the typically stronger spring selling period in a good position. Whilst the first two months are a welcome improvement, we believe that given a normal seasonal cycle and a maintained focus on the continued development of the quality of our businesses, we can look forward with cautious optimism to a resumption of profitable growth from the group in 2014.



# Measuring our Performance

The group uses the following indicators when assessing annual progress 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.

### Like For Like Revenue Growth %

**0.7**

2012: 3.7



## 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.

### Gross Profit Margin %

**30.1**

2012: 30.0



## 3 Underlying Operating Profit

### > Measurement

Underlying operating profit is determined by adding back finance, income and expense and non underlying items 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.

### Underlying Operating Profit £m

**27.7**

2012: 29.3  
-5.4%





## 4 Underlying Earnings Per Share<sup>r</sup>

### > 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.

Underlying EPS is calculated by adjusting for non-underlying items.

<sup>r</sup> We use this measure as one of the key components of executive remuneration – see table on pages 52-54.

### > 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.

### Underlying Earnings Per Share p

**24.5** 2012: 25.3  
-3.2%

2009	19.1
2010	21.5
2011	24.6
2012	25.3
2013	24.5

## 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.

### Return on Capital Employed %

**13.25** 2012: 14.39

2009	12.91
2010	13.48
2011	14.08
2012	14.39
2013	13.25

## 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.

### UK Credit Taken days

**40.1** 2012: 41.3  
-2.9%

2009	44.3
2010	42.0
2011	40.9
2012	41.3
2013	40.1

### Bad Debt %

**0.25** 2012: 0.34  
-26.5%

2009	0.47
2010	0.40
2011	0.46
2012	0.34
2013	0.25

### > 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 that may affect or influence the conduct of the business.

Area of risk	Description	Potential impact	Mitigation
<p>› Market demand</p>	<p>A significant proportion of the group's revenue arises from 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.</p>	<p>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.</p>	<p>Market activity is monitored daily in each individual business and collectively at group level. 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.</p>
<p>› Competitor risk</p>	<p>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.</p>	<p>The emergence of a competitor with a strong business model could undermine the group's growth objectives.</p>	<p>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.</p>
<p>› Technology</p>	<p>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.</p>	<p>Given its importance, any prolonged system failure has the potential to adversely affect business performance.</p>	<p>Each business has its own dedicated hardware and failure in one will not interrupt another. Furthermore, the group operates well defined backup procedures and has contingency plans in place to enable swift recovery from a failure of this nature.</p>



Area of risk	Description	Potential impact	Mitigation
> 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

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](http://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 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, 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 2014 we have continued the bespoke training programme for our managers and sales representatives, further detail of which has been provided earlier in this Annual Report.

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.

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 2014.

Our externally sourced driver training team continues to deliver the driver Certificate of Professional Competence (CPC) to all of our commercial drivers. It is on schedule for meeting the statutory requirement of 35 hours' CPC training for every driver by September 2014 with a total of 472 drivers each receiving seven hours' training in 2013. Training is facilitated using our distribution facilities with course material including safe and fuel-efficient driving, health and safety, customer care and drivers' EU working hours. The 2014 training programme is following a similar approach to that in 2013 albeit with different subject matter. We continue to offer the opportunity for class 2 driver training to drivers where changes in business need require a heavy goods vehicle to be used.

### 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 advisers. 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 coordinated 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.

# Managing Responsibility continued

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 advisers 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. In 2013 there were 18 reportable incidents, compared to 14 in 2012, none of which had resulted in a serious injury or fatality. 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 has been improved, training and awareness increased and special containers sited at least five metres from the main buildings for the storage of flammable products. Bespoke provision for such aspects of the business are incorporated within the design of the new distribution facilities.

## 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 water, electricity or gas.

## Water

Water consumption arises predominantly in respect of employee welfare and commercial vehicle washing. The majority of our water charges are in respect of water supplied and used. We encourage our drivers to keep the commercial vehicles clean and tidy. To assist them, we have a combination of jet wash machines and, at four of the distribution facilities from which a significant number of commercial vehicles operate, specialist truck washes. Each truck wash utilises 100% recycled water, helping with conservation.

We seek to reduce charges by analysing invoices received in respect of water, through the installation of water meters and by reducing consumption through repair, renewal or installation of equipment to improve efficiency.

Our water consumption in cubic metres has been fairly consistent, 32,660 in 2013, 31,731 in 2012, the increase in 2013 on prior year being due in the main to the extension to the Coleshill distribution facility but also to the C K Davie premises and service centres acquired during the year.

## Electricity

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.

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 a further distribution facility, which is both more efficient than that which it is replacing and movement sensitive, automatically switching off during periods of inactivity. This lighting was also installed in the Coleshill extension and, by way of replacement, in the original Coleshill distribution premises. Photovoltaic panels are soon to be installed on the roof of the Coleshill facility,



the capacity of which is designed to match the electricity requirements of the site. Consideration will be given to further similar installations following a period of evaluation. Future construction projects will similarly incorporate intelligent lighting systems and, where practical, renewable energy solutions. During 2013 we completed the installation of 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 and gas in 2013 amounted to 0.2% of revenue, which is the same as in the prior year.

## Gas

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. It is expected that the installation of a sophisticated heating control system in the newly constructed Coleshill facility will result in lower consumption. Consideration will be given to installing such control systems in other premises if considered viable.

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.

## Carbon reporting

We are required to report on all the measured emissions sources under The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. Data has been collected in accordance with the Carbon Reduction Commitment Energy Efficiency Scheme. Conversion factors for electricity, gas and fuel are those published by the Carbon Trust and Defra in 2013.

Fuel type	2013 CO <sub>2</sub> /tonnes	2012 CO <sub>2</sub> /tonnes
Electricity and gas	5,710	5,640
Commercial vehicle and car fuel	28,205	25,886
Total	33,915	31,526
Tonnes per £1 million turnover	56	53

The increases have been incurred in respect of volume-related factors.

In late 2013, a trans-shipping facility in north London became operational facilitating improved efficiency in deliveries to the south-east. A similar change has been made in Scotland through trans-shipping. Both of these changes have resulted in reduced fuel costs and as a consequence, lower CO<sub>2</sub> emissions.

These changes are estimated to save over 452 CO<sub>2</sub>/tonnes on an annualised basis.

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, with effect from the end of 2013, all of our commercial vehicles comply with Euro 5 emission standards which further reduced the levels of carbon monoxide, hydrocarbon, nitrogen oxide and particulate emissions. We periodically review our fleet requirements to ensure the optimum design to maximise capacity and improve aerodynamics.

## Waste

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.

# Board of Directors and Senior Management Team

## Directors

### **R W Peters**

#### Non-executive Chairman

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. He was appointed Chairman on 1 September 2013 following the resignation of Graham Waldron, at which time he resigned as Chairman of the Audit Committee, to be succeeded by Andrew Eastgate.

Committees – Audit, Nominations, Remuneration

### **A J Brewer**

#### Group Chief Executive

Tony was appointed an executive director in June 1991, becoming Managing Director of the Floorcoverings Division in January 1992, and was appointed Group Chief Executive in November 2000. He has 36 years' experience in the floorcovering industry.

Committees – Nominations

### **S G 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. With effect from 31 January 2014, Steve was appointed a non-executive director of Conviviality Retail Plc.

### **M K 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)

### **A K 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 a broad experience of advising quoted companies, particularly in connection with transactions and compliance issues. He is a non-executive director of Pentwin Limited, a private investment company. He was appointed Chairman of the Audit Committee on 1 September 2013 following the resignation of Dick Peters.

Committees – Audit (Chairman), Nominations, Remuneration



## Company Secretary

### **G M 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

### **G B 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.

### **A R Judge**

#### **Commercial Director, Coleshill and Tamworth businesses**

Tony joined the company in May 1992, 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 33 years' experience in the floorcovering industry.

### **K R 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 31 years' experience in the floorcovering industry.

### **M W McMaster**

#### **Commercial Director, selected UK Operations**

Mike joined the company in July 1984 and was appointed to the Senior Executive Management in January 2009 with operational responsibility for 17 of the UK businesses. Mike has 43 years' experience in the floorcovering industry.

# Corporate Governance Report

## Chairman's message on corporate governance

On behalf of the board, we are pleased to present the Corporate Governance Report for the year ended 31 December 2013.

The board of directors is responsible for both the stewardship and governance of your company. As part of this, it sets the company's strategic aims and values and oversees the executive management who carry out the operational running of the business. The board is also charged with reporting to shareholders on the company's performance in compliance with the revised requirements of the UK Corporate Governance Code (the "Code") to make the Annual Report fair, balanced and understandable. The company is also required to comply with corporate governance rules contained in the FCA Disclosure and Transparency Rules as well as certain related provisions in the Companies Act 2006.

We continue to believe that our board has the diversity and mix of skills, experience, independence and knowledge of the company to enable it to discharge its responsibilities successfully.

In presenting this report, we seek to explain how your company is directed and controlled, by describing the membership and work of the board and its committees, the approach to ensuring board members have an appropriate understanding of the business and how the board considers its effectiveness. The report also explains the executive direction and control and our corporate governance structures and procedures. While the directors believe that the group's corporate governance policies continue to be robust, changes have been and will continue to be made in light of the rules that are in place at any point in time.

This report sets out how the principles of 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 2013 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 Strategic Report on pages 2 to 33.

During the year, the company announced my appointment as Chairman following the resignation of Graham Waldron on 31 August 2013. On my appointment, I was succeeded as Chairman of the Audit Committee by Andrew Eastgate.



**Dick Peters**

Chairman, 7 March 2014

## 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 control which:

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

As at 31 December 2013 the board consisted of two executive directors, Tony Brewer, Group Chief Executive, and Steve Wilson, Group Finance Director, and three independent non-executive directors, Dick Peters, Chairman, Mike O'Leary and Andrew Eastgate.

The board is supported in its role by the Audit, Nominations and Remuneration Committees, all of which have written terms of reference, the details of which are set out below.

The directors' roles and membership of the committees are as set out on pages 34 and 35 in the directors' and Senior Executive Management team biographies. The biographies also document each director's significant other commitments and any changes to these commitments that occurred during the year.

Directors' attendance during the year at board meetings, meetings of the Audit, Nominations and Remuneration Committees and at the Annual General Meeting (AGM) was as set out in the table on page 39.

The board considers that it is beneficial for the executive directors to hold an external directorship to broaden their experience and normally this would be limited to one company. With effect from 31 January 2014, Steve Wilson was appointed a non-executive director of Conviviality Retail Plc.

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 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.

Through the Nominations Committee, the board ensures that plans are in place for the succession of the executive and non-executive directors.



# Corporate Governance Report continued

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

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.

In order to fulfil their duties, procedures are in place for directors to seek both independent advice and the advice and services of the Company Secretary who is responsible for advising the board, through the Chairman, on all governance matters.

The non-executive directors periodically meet without the Chairman present, and also meet with the Chairman without management present.

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.

## 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:

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

The board reviews the key activities of the business, receiving papers and presentations from executives and senior 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.

This enables the directors to promote the success of the company for the benefit of its shareholders as a whole, while having regard to, among other matters, the interests of employees, the fostering of business relationships with customers, suppliers and others, and the impact of the company's operations on the communities and environment in which the business operates.

## 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 below and committee meeting attendance is given in the relevant committee report.

Graham Waldron	4/6
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 2013 there were two meetings which approved the 2013 Interim and 2012 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.

# Corporate Governance Report continued

## 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 Directors' 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.

## Induction and training

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.

## Performance evaluation

During the year, an evaluation of the board's effectiveness, including the effectiveness of the board committees, was undertaken internally. This included consideration on how well the board measured against boardroom best practice, enhancing the effectiveness of the board, an evaluation of the performance of the board throughout the year and how the board perceived it had performed. It also included risk management and succession planning. In respect of the committees, the questionnaire considered the performance of the respective committees throughout the year, whether agendas covered the remits of the committees and the appropriateness of the respective committees remit. It concluded that the board and its committees continued to operate effectively, meeting the requirements and spirit of the Code. The Nominations Committee has access to the performance evaluation process and the Chairman has confirmed that Tony Brewer and Andrew Eastgate, the two directors standing for re-election at this year's AGM, continue to perform effectively and demonstrate commitment to their roles. The board will continue to review its performance and that of its committees and individual directors on an annual basis and for 2014 the process will include externally facilitated evaluation.

## 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, 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](http://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.

## Board committees

The board has established Audit, Nominations and Remuneration 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 established Audit, Nominations and Remuneration Committees, whose membership is comprised of the three independent non-executive directors, with the Group Chief Executive additionally serving on the Nominations Committee, are set out below.

### Audit Committee

The Audit Committee is comprised of the three non-executive directors and was chaired by Dick Peters until 1 September 2013 when he was succeeded by Andrew Eastgate. The Company Secretary acts as secretary to the committee. Dick Peters continues as a member of the Audit Committee, is a chartered accountant with considerable financial and audit experience and, for the purposes of the Code, is considered by the board to be independent and have recent and relevant financial experience.

Further information on the activities of the committee is given in the Audit Committee Report on pages 44 to 49 which should be read in conjunction with this report.

### 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, approves specific arrangements for the Chairman and the executive directors, and reviews and comments upon the proposed arrangements for senior management so as to ensure consistency within the overall remuneration policy and group strategy. Further information on the activities of the committee is given in the Directors' Remuneration Report on pages 50 to 66 which should be read in conjunction with this report.

The Directors' 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 managers' remuneration, benefits, share scheme entitlements and pension arrangements. 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. The Chief Executive may, by invitation, attend Remuneration Committee meetings, except when his own remuneration is discussed. 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 Directors' 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 and 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, experience and independence of the non-executive directors, and makes recommendations to the board with regard to any changes.

The committee meets when required and met twice 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.

# Corporate Governance Report continued

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 re-appointment or re-election.

New directors are appointed by the board and, in accordance with the company's articles of association, they must be elected at the next AGM to continue in office. Existing directors retire by rotation in accordance with article 89 of the articles of association which requires them to retire from office, and if eligible for re-appointment, at the third AGM at which they were appointed or last re-appointed.

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 Tony Brewer and Andrew Eastgate under the retirement by rotation provisions. It also considered proposals relating to the appointment of Dick Peters who succeeded Graham Waldron as Chairman on his resignation as a director on 31 August 2013, on the appointment of Andrew Eastgate as Chairman of the Audit Committee on 1 September 2013 in succession to Dick Peters and an external appointment in respect of Steve Wilson as a non-executive director of Conviviality Retail Plc with effect from 31 January 2014.

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 was one change to the directors' external commitments during the year, as detailed above. Appointments to the committee are made by the board.

## Risk management and internal controls

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 have been identified in the Managing our Risk Report on pages 28 and 29.

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 and 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, 7 March 2014



# Audit Committee Report

## Composition

The committee is comprised of the three non-executive directors and was chaired by Dick Peters until 1 September 2013 when he was succeeded by Andrew Eastgate. The Company Secretary acts as secretary to the committee.

## Committee meetings

The committee has an agenda linked to events in the group's financial calendar, normally meeting at least twice a year before the annual and interim results announcements. The committee met three times in the year, the three members attending all meetings, during which it discharged its responsibilities as set out in the terms of reference and schedule of business for the year. Whilst only members of the committee are entitled to be present at meetings, the external auditor, Group Chief Executive and Group Finance Director may attend by invitation. The committee has authority to investigate any matters within its terms of reference, access resources, call for information and obtain external professional advice at the cost of the company.

## Role of the committee

The committee is responsible for monitoring and reviewing:

- the effectiveness of the group's systems of internal control and risk management and control over financial reporting;
- 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 effectiveness of the external audit process;
- the external auditors' plan for the audit of the group's accounts, confirmation of the external auditors' 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;
- the company's relationship with the external auditor and management's response to any major external audit recommendations;
- the appointment, reappointment or dismissal of the external auditor;
- non-audit services and fees;
- 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 appropriateness of an internal audit function; and
- the group's overall approach to securing compliance with laws, regulations, governance and company policies in areas of risk arrangements by which staff may in confidence raise concerns about possible improprieties in matters of financial reporting and other matters including the group's policies and practices concerning business conduct and ethics.

The committee periodically reviews its terms of reference and its effectiveness and recommends to the board any changes required as a result of its review.

## Key activities of the committee during the year

The committee works to specific agendas for each meeting, developed from its terms of reference, with items that the committee considers at each meeting in addition to any specific matters arising and topical items on which the committee has chosen to focus.

The work of the committee during the year principally fell under three main areas and is summarised in the table below.

Internal controls and risk	External auditors	Accounting, tax and financial reporting
<p>➤ Considered reports from the external auditors on their assessment of the control environment.</p>	<p>Considered and approved the audit approach and scope of the audit work to be undertaken by the external auditors and the fees for the same.</p>	<p>Reviewed the half year and annual financial statements and the significant financial reporting judgements.</p>
<p>➤ Assessed the effectiveness of the group's internal control environment.</p>	<p>Reviewed reports on audit findings.</p>	<p>Considered the liquidity risk and the basis for preparing the group half yearly and full year accounts on a going concern basis and reviewed the related disclosures in the Annual Report and Accounts.</p>
<p>➤ Assessed the need for a group internal audit function.</p>	<p>Considered the independence of the external auditor and their effectiveness, taking into account:</p> <ul style="list-style-type: none"> <li>• non-audit work undertaken by the external auditors and compliance with the policy;</li> <li>• feedback from management; and</li> <li>• the committee's own assessment.</li> </ul>	<p>Reviewed disclosures in the Annual Report and Accounts in relation to internal controls, risk management, principal risks and uncertainties and the work of the committee.</p>
<p>➤ Reviewed matters reported to the whistleblowing hotline.</p>	<p>Considered the recommendations in the UK Corporate Governance Code regarding the tender of the external audit contract.</p>	<p>Reviewed the Annual Report and considered whether the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for shareholders to assess the company's performance, business model and strategy.</p>
	<p>Considered and approved letters of representation issued to the external auditors.</p>	
	<p>Met privately with the external auditors to discuss their audit findings and the nature of the audit relationship.</p>	

# Audit Committee Report continued

## Significant issues considered by the committee

After discussion with both management and the external auditor, the committee determined that the key risks of misstatement of the group's financial statements related to:

- impairment of goodwill;
- impairment of property;
- inventory valuation; and
- valuation of employee benefit liabilities.

These issues were discussed with management during the year and with the external auditor at the time the committee reviewed and agreed the external auditors' group audit plan and also at the conclusion of the audit of the financial statements.

## Impairment of goodwill

As more fully explained in note 1 to the financial statements, the group's principal non-financial assets are grouped into cash-generating units ("CGUs") for the purpose of assessing the recoverable amount.

The group's CGUs represent individual operating businesses, either in the UK or in continental Europe. As set out in note 12 to the financial statements, all CGUs to which goodwill is allocated, in accordance with the requirements of IFRS, are tested for impairment on an annual basis.

This year, the outcome of the impairment review concluded that the carrying value of the assets of the LMS CGU were less than their recoverable amount by £3.2 million, equivalent to the goodwill attributed to the CGU. This is a reflection of the ongoing challenging market conditions in France. As a consequence, a £3.2 million impairment loss has been recognised in the income statement during the year and disclosed as a non-underlying item. The impairment reviews for the other CGUs to which goodwill is allocated did not result in an impairment loss.

In performing their impairment tests, management determined the recoverable amount of each CGU and compared this to the carrying amount. Management reported to the committee the results of its impairment assessment, noting to the committee that future cash flows for each CGU had been estimated based on the most up to date business forecasts or actual financial results and discounted using discount rates that reflected current market assessments of the time value of money and risks specific to the assets. Management highlighted to the committee how they arrived at the key assumptions to estimate future cash flows for the CGUs, specifically future growth rates and discount rates.

Management also brought to the attention of the committee the sensitivity analysis to be disclosed in note 12 to the financial statements with regard to the recoverable amount of the CGUs' goodwill that had not been impaired.

The committee interrogated management's key assumptions to understand their impact on the CGUs recoverable amounts. The committee was satisfied that the significant assumptions used for determining the recoverable amount of CGUs to which goodwill is allocated had been appropriately scrutinised, challenged and were sufficiently robust. The committee was further satisfied with the impairment disclosures set out in note 12 to the financial statements, and the disclosure of the loss as a non-underlying item.

The external auditor explained their audit procedures to test management's impairment assessment and considered the group's disclosures on the subject. On the basis of their audit work, the external auditor has not identified any additional impairments to the carrying value, at 31 December 2013, of the CGUs to which goodwill is allocated that were material in the context of the financial statements as a whole.

## Impairment of property

As set out in note 11 to the financial statements, the carrying value of freehold and long leasehold property in the group's statement of financial position as at 31 December 2013 amounted to £79.3 million.

As set out in note 1 to the financial statements, the group has a policy of formally assessing the market value, using independent, external valuation experts, of the UK property portfolio every three years. The valuation performed in 2013 indicated that the carrying value of the entire portfolio exceeded the market value, by £14.7 million. Market value equates to fair value as defined by the Valuation – Professional Standards 2014 published by The Royal Institute of Chartered Surveyors.



Across the portfolio there were circumstances where the market values of individual properties were higher or lower than the carrying value, dependent on the condition and location of each individual property. Where the carrying value of a property exceeded the market value, management considered this to represent an indicator of impairment and accordingly performed an impairment review for each CGU to which those properties belonged. The outcome of the impairment reviews indicated that the carrying value of those CGUs were supported by their ongoing value in use, and accordingly, no impairment adjustment was required.

In the Netherlands, management obtain an annual market value of the property for local rates purposes. The latest valuation obtained indicated that the carrying value of the property exceeded its market value. As with the UK properties, management considered this to represent an indicator of impairment and therefore performed an impairment review for the Dutch CGU. The outcome of the impairment review concluded that the carrying value of the assets of the Dutch CGU were less than their recoverable amount by £2.2 million which was not less than the amount by which the market value of the property exceeded its carrying value. This is a reflection of the ongoing challenging market conditions in the Netherlands. As a consequence, a £2.2 million impairment loss has been recognised in the income statement during the year and disclosed as a non-underlying item.

The properties in France and Switzerland are attributable to CGUs which also contain goodwill and accordingly had been tested for impairment as part of the annual goodwill impairment review as noted above.

In performing their impairment tests, management determined the recoverable amount of each CGU and compared this to the carrying amount. Management reported the results of its impairment assessment to the committee, noting that future cash flows for each CGU had been estimated based on the most up to date business forecasts or actual financial results and discounted using discount rates that reflected current market assessments of the time value of money and risks specific to the assets. Management highlighted to the committee how they arrived at the key assumptions to estimate future cash flows for the CGUs, specifically future growth rates and discount rates.

The committee interrogated management's key assumptions to understand their impact on the CGUs' recoverable amounts. The committee was satisfied that the significant assumptions used for determining the recoverable amount of the relevant CGUs had been appropriately scrutinised, challenged and were sufficiently robust. The committee was further satisfied with the impairment disclosures set out in note 4 to the financial statements and the disclosure of the impairment of the Netherlands property as a non-underlying item.

The external auditor explained their audit procedures to test management's impairment assessment and considered the group's disclosures on the subject. On the basis of their audit work, the external auditor has not identified any additional impairments to the carrying value at 31 December 2013, of the relevant CGUs that were material in the context of the financial statements as a whole.

## Inventory valuation

As set out in the statement of financial position, inventory amounts to £115.7 million and represents the group's second largest asset class. Inventory is held across a broad and diverse product range which is subject to a risk that changes in consumer tastes and demand result in some inventory lines becoming slow moving or obsolete, such that the recoverable amount is less than the carrying value.

The committee discussed the group's management of its inventory position and gave careful consideration to the gross carrying value and related provisions. Management explained to the committee that the process of determining the appropriate valuation of inventory entailed close monitoring of inventory levels, review of the ageing profile and consideration of inventory sold for less than its carrying value. These three measures are reported to senior management on a monthly basis by individual businesses. Management use this information to determine the provisions to be made against inventory.

The committee reviewed the valuation basis and challenged management's assumptions. The committee also discussed the valuation basis with the external auditor, who reported that they had not identified any additional provision requirements that were material in the context of the financial statements taken as a whole.

## Valuation of employee benefit liabilities

In the UK, the group operates a defined benefit pension plan, further details of which are set out in note 21 to the financial statements. At 31 December 2013, the scheme had assets of £73.7 million and liabilities, measured on an IAS 19 basis, of £87.1 million, with a net deficit of £13.4 million.

# Audit Committee Report continued

As set out in note 1 to the financial statements, the plan liabilities are calculated by estimating the amount of benefit that employees have earned for their service in current and future periods. This estimation requires making certain assumptions notably in relation to inflation rates, mortality rates and the discount rate to apply to determine present value. The selection of these assumptions is subjective and small changes in these assumptions can materially impact the net IAS 19 deficit reported in the statement of financial position. The assumptions adopted by management are set out in note 21 to the financial statements.

In selecting the assumptions, management took advice from the group's external actuary and considered the appropriateness of this advice in light of the specific circumstances of the UK plan. Management highlighted to the committee how they arrived at the key assumptions.

The committee reviewed management's assumptions and were satisfied that they had been appropriately scrutinised, challenged and were robust. The committee also reviewed the sensitivity analysis set out in note 21 to the financial statements and consider it to be appropriate.

The committee also considered the views and procedures of the external auditor, which entailed a benchmarking of management's assumptions with the external auditor's own expectations. The external auditor considered that they had not identified any assumptions adopted by management that were inappropriate for the UK plan in the context of the financial statements taken as a whole.

## Misstatements

Management reported to the committee that they were not aware of any material misstatements or immaterial misstatements made intentionally to achieve a particular presentation. The external auditors reported to the committee the misstatements that they had found in the course of their work and no material amounts remain unadjusted. The committee confirmed that it was satisfied that the external auditors had fulfilled their responsibilities with diligence and professional scepticism.

After reviewing the presentations and reports from management and consulting, where necessary, with the external auditors, the committee was satisfied that the financial statements appropriately addressed the critical judgements and key estimates, both in respect to the amounts reported and the disclosures. The committee was also satisfied that the significant assumptions used for determining the value of assets and liabilities had been appropriately scrutinised, challenged and were sufficiently robust.

## Internal audit

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 group's control systems and associated procedures are adequate for the business and therefore does not currently propose to introduce a group internal audit function. The committee will continue to keep the matter under review.

## External audit

The committee reviews annually the appointment of the external auditor and, based on the committee's recommendation, the board agreed to recommend to shareholders at the AGM in 2013, the re-appointment of the external auditor for a period of one year. The current overall tenure of the external auditor dates from 1992. Any decision to open the external audit to tender is taken on the recommendation of the committee. There are no contractual obligations that restrict the company's current choice of external auditor.

Following a review of KPMG's performance and independence in 2013, including compliance with rules on non-audit services, the committee was satisfied with the external auditor's effectiveness and independence and has recommended to the board that KPMG be re-appointed as the company's external auditor for the year ending 31 December 2014. The committee will continue to review the performance of the external auditors on an annual basis and consider their independence and objectivity taking into account all appropriate guidelines.

The committee assessed the ongoing effectiveness of the external auditor and audit process on the basis of meetings with executive directors. In reviewing the independence of the external auditor, the committee considered a number of factors which included the standing, experience and tenure of the external audit partner, the nature and level of services provided by the external auditor and confirmation from the external auditor that it had complied with relevant regulatory requirements.

The committee has the specific task of keeping the nature and extent of non-audit services provided by the external auditor under review in order to ensure that objectivity and independence are maintained. The external auditor has processes in place to ensure independence is maintained when providing non-audit services and has written to the committee confirming that, in its opinion, they remain independent within the meaning of the regulation on this matter and their professional standards.

In addition, the fees and objectivity of the external auditor were considered by the committee. The committee recognises that there are occasions when it is advantageous to use the external auditor to undertake non-audit services, where they are best placed to do so. The policy states that non-audit fees paid to the 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 audit and non-audit fees is provided in note 3 to the financial statements.

The committee has independent access to the external auditor and the external auditor has direct access to the Chairman of the committee outside formal committee meetings. At each meeting, there is an opportunity for the external auditor to discuss matters with the committee without executive management being present.

### Audit tender

The committee has reviewed the changes to the Code introduced by the FRC in September 2012 in respect of the Guidance to Audit Committees that encourages the external audit contract to be tendered for at least every ten years.

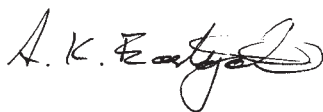
Based on internal assessments of the efficiency and effectiveness of the audit, the committee is satisfied with the quality of the work undertaken by the external auditor and to date, has considered a tender process unnecessary.

Furthermore, the committee seeks to balance the benefits of audit personnel continuity with the need to maintain independence by agreeing staff rotation policies with the auditor. Whilst KPMG has been an external auditor to the group since 1992, audit partner rotation every five years maintains objectivity and independence without the need and expense arising from a tender process. The last audit partner rotation occurred during 2011.

KPMG Audit Plc informed the company that they wished to formally change the entity which conducts the company's audit from KPMG Audit Plc to KPMG LLP. KPMG Audit Plc has indicated therefore that it will not stand for re-appointment at the company's 2014 AGM. However, KPMG LLP will seek election at this meeting. The committee recommends that shareholders appoint KPMG LLP as the group's external 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.

### Summary

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 fulfilled its responsibilities. The Chairman of the committee will be available at the AGM to answer any questions on the work of the committee.



### Andrew Eastgate

Chairman of the Audit Committee, 7 March 2014



# Directors' Remuneration Report

## The Chairman's annual statement

Dear Shareholder

On behalf of the board, I am pleased to present the Directors' Remuneration Report, which sets out the remuneration policy for Headlam's directors and the amounts earned in respect of 2013.

The last few years have witnessed increased scrutiny of executive pay and this has led to changes in the reporting requirements brought about by the Regulations.

The Remuneration Committee ("committee") has prepared an annual report on remuneration which will be subject to an advisory shareholder vote at the proposed AGM to be held on 21 May 2014, and a policy report taking effect from the conclusion of the AGM, which will be subject to a binding shareholder vote at the AGM.

The committee 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 and, as its Chairman, I will be present at the AGM to answer any questions.

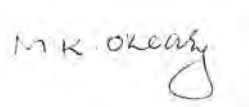
Headlam's remuneration policy has been designed to incentivise performance through effective and appropriate reward. Levels of remuneration must allow the company to attract, retain and motivate high calibre executive managers and link their rewards to business performance, aligning their interests with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

When reviewing the appropriateness of the remuneration framework for 2014, the committee considered the incentive arrangements that had applied in 2013. Examination of current business strategy and guidelines for executive remuneration led to the conclusion that the existing framework remains appropriate. We have, though, reduced the maximum awards in respect of both the annual performance related bonus scheme and the long term incentive scheme. The maximum performance related bonus has reduced from 150% to 125% of base salary, the relative outperformance required remaining the same. The maximum long term incentive award has reduced from 200% to 75% of base salary.

There have been no increases in directors' base salary for 2014 and the committee is not proposing any changes in respect of the annual bonus or other benefits for 2014.

Despite the continuation of difficult trading conditions, the committee remains satisfied that overall progress has continued in the delivery of the medium term operating strategy. Assessment of progress included review of the 2013 Financial Statements and took into account the reporting of the auditors to the audit committee.

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



**Mike O'Leary**

Chairman of the Remuneration Committee, 7 March 2014

The information provided in this part of the Directors' Remuneration Report is not subject to audit.

## Introduction

This report is on the activities of the committee for the year ended 31 December 2013. It sets out the companies' remuneration policy and remuneration details for the executive and non-executive directors. It has been prepared in accordance with Schedule 8 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended in August 2013 ("Regulations").

The report is split into three main areas, these being:

- the statement by the Chairman of the Committee;
- the policy report; and
- the annual report on remuneration.

The policy report will be subject to a binding shareholder vote at the 2014 AGM and the policy will take effect from the conclusion of the AGM. The annual report on remuneration provides details on remuneration in the year and includes other information required by the Regulations. It will be subject to an advisory shareholder vote at the 2014 AGM.

The Companies Act 2006 requires auditors to report to the shareholders on certain parts of the Directors' Remuneration Report and to state if, in their opinion, those parts of the report have been properly prepared in accordance with the Regulations. The parts of the annual report on remuneration that are subject to audit are identified as such. The statement by the Chairman of the committee and the policy report are not subject to audit.

## Policy report

This part of the report sets out the company's policies on directors' remuneration which will be subject to a binding vote at the 2014 AGM and take effect from the conclusion of the AGM. It will be subject to approval by shareholders by an ordinary resolution every three years, or sooner where the policy is revised.

The remuneration policy applied in the current year is the same as the policy to be approved under the new requirements and then adhered to for the next three years, the objectives of which continue to be:

- to ensure that the business strategy is supported by the remuneration structure;
- 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 directors' 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 2014, 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. When reviewing base salaries, the committee takes account of the current economic climate, challenges facing the business and pay environment for employees in general.

# Directors' Remuneration Report continued

The committee is committed to open dialogue and receives periodic feedback from major shareholders and shareholder representatives which is considered as part of its annual review of remuneration policy and, if any material changes to the remuneration policy are contemplated, the committee would seek the views of major shareholders about these in advance.

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 with those of shareholders. During the year the committee did not consult with shareholders.

## 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	Purpose and link to strategy	Operation	Opportunity	Performance metrics, purpose and link to business strategy
> Base salaries	<p>Core fixed remuneration reflecting the responsibility and scope of the role.</p> <p>Competitive salaries help the group to recruit, retain and motivate the best talent.</p>	<p>Reviewed annually and usually fixed for 12 months commencing 1 January, although there is no entitlement to an increase.</p> <p>Influenced by role, experience, individual's contribution, overall performance and value to the business.</p> <p>Employees are not consulted when setting directors' remuneration.</p>	<p>Movements determined by reference to cost of living increases to the workforce, prevailing market conditions, similar roles in companies of a comparable size, complexity and risk and increases in individual's responsibility.</p>	<p>Any increase is only implemented after careful consideration of individual contribution and performance.</p>
> Annual performance bonus	<p>Rewards performance against stretching annual group profit before tax target which is aligned with the group's strategic objectives.</p>	<p>Target is set annually and any payout is determined by the committee after the period end based on relative performance.</p>	<p>Maximum bonus opportunity is 125% of base salary.</p>	<p>No bonus award for performance below 90% of target.</p> <p>Bonus award of 10% of base salary if actual performance is 90% of the target.</p> <p>Bonus of 75% of base salary is attainable on achieving target.</p> <p>Maximum of 125% of base salary for achieving a performance of 18% or more above the target.</p> <p>No discretion to make bonus awards for further over or under performance.</p>



Component	Purpose and link to strategy	Operation	Opportunity	Performance metrics, purpose and link to business strategy
<p>➤ Share related benefits – 2008 Co-Investment Plan (“CIP”)</p>	<p>Incentivises delivery against company strategy over the medium term and aligns executives’ interests with strategic objectives.</p> <p>Medium term performance targets and share-based remuneration support the creation of sustainable shareholder value and growth.</p>	<p>The committee intends to make any future long term incentive awards through the CIP.</p> <p>Under the CIP, nil cost option awards may be made with vesting dependent on the achievement of performance conditions, normally over a three-year period.</p> <p>Awards may vest early on a change of control or other relevant event subject to satisfaction of the performance conditions and pro-rating for time and may also vest early in “good leaver” circumstances, although the committee has discretion to increase the extent of vesting having due regard to performance over the period.</p>	<p>Maximum award of 75% of annual bonus in respect of any financial year with up to two for one matching.</p>	<p>Vesting is dependent on achievement of the performance targets with straight line matching between median (30%) and upper quartile (100%) for the TSR condition and between RPI +3%p.a. (30%) and RPI+6%p.a. (100%) for the EPS condition.</p> <p>80% of the award is subject to the EPS target and 20% to the TSR target.</p> <p>The committee reviews the performance conditions prior to making an award to ensure they are aligned to the group’s strategy, remain challenging and are reflective of commercial expectations.</p>
<p>➤ Other benefits</p>	<p>Ensure the overall package is competitive.</p> <p>Assist the group to recruit, retain and motivate.</p>	<p>The group provides a company car, medical insurance and life assurance cover to its executive directors.</p>	<p>Set at a level that the committee considers appropriate against the market and provides a sufficient level of benefit based on individual circumstances.</p>	<p>Not applicable.</p>
<p>➤ Save as You Earn scheme</p>	<p>Participation in the Save as You Earn option scheme (SAYE) promotes a sense of ownership and aligns interests with the group.</p>	<p>The SAYE is a HMRC-approved monthly savings scheme facilitating the purchase of shares at a discount by eligible employees.</p>	<p>SAYE contribution as permitted in accordance with relevant tax legislation.</p>	<p>Not applicable.</p>

## Directors' Remuneration Report continued

Component	Purpose and link to strategy	Operation	Opportunity	Performance metrics, purpose and link to business strategy
> Shareholding guideline	Provides alignment of executive directors' interests with shareholders and promotes share ownership.	In line with best practice, there are formal share ownership guidelines for executive directors. By the fifth anniversary of their appointment to the board, executive directors are required to have a holding of Headlam shares equivalent to not less than 100% of the value of their base salary.	Not applicable.	Not applicable.
> Retirement benefits	The group has not provided pension benefits to the executive directors in the year.  The group will not be making any future payments.	Not applicable.		Not applicable.

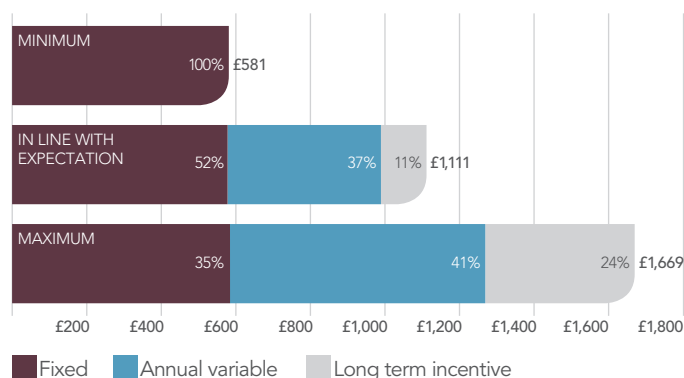
The following table provides a summary of the key components of the remuneration package for non-executive directors.

Component	Purpose and link to strategy	Operation	Opportunity	Performance metrics, purpose and link to business strategy
> Fees	Sole element of non-executive directors' remuneration.	Reviewed by the board annually.  Non-executive directors are not involved in any discussion or decision about their own remuneration.  Non-executive directors do not participate in any of the company's share schemes, incentive plans or pension schemes.  Non-executive directors do not receive any other benefits.	Reviewed 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.  Consideration is given to the level of fees paid to non-executive directors serving on boards of similar sized UK listed companies and the time commitment and contribution expected for the role.  Non-executive directors receive a basic fee and an additional fee for further duties such as chairmanship of committees.	Not applicable.

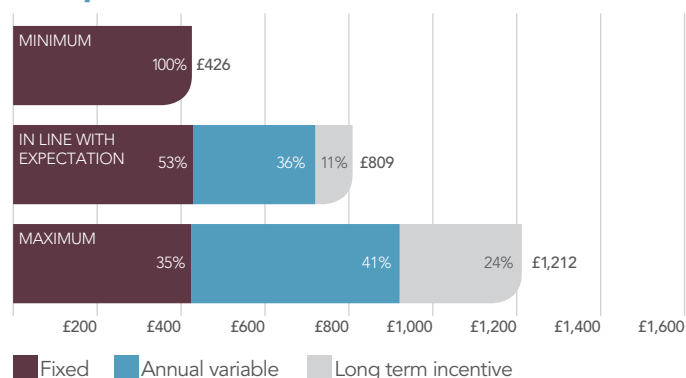
## Illustration of application of remuneration policy

The charts below show the relative split of remuneration between fixed pay, comprising base salary and benefits, and variable pay, comprising annual bonus and CIP awards, for each executive director on the basis of minimum remuneration, remuneration receivable for performance in line with the company's expectations, and maximum remuneration, not allowing for any share price appreciation.

### Chief Executive Officer



### Group Finance Director



In illustrating the potential award, the following assumptions have been made.

	Fixed pay	Annual bonus	CIP
> Minimum performance	Fixed elements of remuneration are base salary and benefits.	No bonus.	No CIP vesting.
> Performance in line with expectations	Base salary is the latest known salary effective from 1 January 2014 and the value of benefits has been assumed to be equivalent to that included in the single figure calculation on page 57.	75% of base salary awarded for achieving target performance.	30% of maximum award vesting for achieving threshold performance.
> Maximum performance	Base salary is the latest known salary effective from 1 January 2014 and the value of benefits has been assumed to be equivalent to that included in the single figure calculation.	125% of salary awarded for delivering at or above the highest performance in respect of target.	100% of award vesting delivered for achieving the most stretching level of performance measures attached to the CIP awards.

Awards under the CIP are stated by reference to the share price at the 2013 year end.

No assumption as to share price growth is made in either the on target or the maximum scenarios.

## Approach to recruitment remuneration

The principles which the company would apply when agreeing the various components of a remuneration package for the appointment of a new director, would typically be to use the policy detailed in the table above to determine the executive directors' ongoing remuneration package. In determining appropriate remuneration, the committee will take into consideration all relevant factors including the quantum and nature of remuneration to ensure the arrangements are in the best interests of the company and its shareholders.



# Directors' Remuneration Report continued

## Service contracts and policy on payment for loss of office

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.

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. All appointments and subsequent re-appointments are subject to approval by shareholders.

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

The principles on which the determination of benefits on loss of office will be approached are summarised below.

Provision	Treatment on loss of office
> Payment in lieu of notice	Payments to executive directors upon termination of their contracts will be equal to base salary plus the value of core benefits for the duration of the notional notice period. Benefits may include but are not limited to legal fees.
> Annual bonus	Payments to current executive directors upon the company terminating their contracts, other than in bad leaver cases such as gross misconduct, dishonesty, bankruptcy, failure to perform duties, will be equal to the average performance related bonus calculated by reference to the two immediately preceding financial years. The committee will, though, take note of the circumstances of their departure and their contribution to the business during the period in question. Any bonus amounts paid, as estimated by the committee, will typically be pro-rated for time in service to termination and will, subject to performance, be paid at the usual time. Contracts for future appointees will not include bonus within the termination provisions.
> CIP	Any award under the CIP would be determined based on the leaver provisions contained within the CIP rules. For good leavers, CIP awards will usually vest at the ordinary vesting point, be subject to performance conditions and pro-rated for time. Good leavers are participants who leave as a result of fatality, ill health, injury or disability. In other circumstances CIP awards will lapse upon the cessation of employment. The committee retains the discretion to accelerate vesting and to waive pro-rating for time.
> Change of control	Upon a change of control, incentive awards will usually vest and be subject to performance conditions and pro-rated for time. The committee reserves the discretion to waive pro-rating for time.
> Mitigation	Payments upon the termination of executive directors' contracts will be equal to base salary and other benefits for the duration of the notice period together with the average performance related bonus calculated by reference to the immediately preceding financial years. 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. Full compensation, due to being a long-standing employee of the company, may however be merited in the event of unilateral termination of employment.

## 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, however Steve Wilson was appointed as a non-executive director of Conviviality Retail Plc with effect from 31 January 2014.

## Annual report on remuneration

The remuneration policy is designed to ensure that executive directors are aligned to pursuing the company's medium term strategic objectives.

Certain information provided in this part of the Directors' Remuneration Report is subject to audit. This is annotated as audited. Any information not annotated as audited is unaudited.

### Single total figure of remuneration for each director

The table below reports the total remuneration receivable in respect of qualifying services by each of the executive directors for the years 2013 and 2012.

#### Executive directors' remuneration as a single figure – 2013 (audited)

Executive directors	Base salary and fees 2013 £000	Non-salary benefits 2013 £000	Annual performance bonus 2013 £000	Share-based incentive schemes 2013 £000	Pension related benefits 2013 £000	Total 2013 £000
Tony Brewer	544	35	348	–	–	927
Steve Wilson	393	33	251	–	–	677
Graham Waldron <sup>1</sup>	80	15	–	–	–	95
	<b>1,017</b>	<b>83</b>	<b>599</b>	<b>–</b>	<b>–</b>	<b>1,699</b>

#### Executive directors' remuneration as a single figure – 2012 (audited)

Executive directors	Base salary and fees 2012 £000	Non-salary benefits 2012 £000	Annual performance bonus 2012 £000	Share-based incentive schemes 2012 £000	Pension related benefits 2012 £000	Total 2012 £000
Tony Brewer	533	29	524	261	–	1,347
Steve Wilson	385	32	378	188	–	983
Graham Waldron <sup>1</sup>	118	22	–	–	–	140
	<b>1,036</b>	<b>83</b>	<b>902</b>	<b>449</b>	<b>–</b>	<b>2,470</b>

<sup>1</sup> Graham Waldron resigned as a director on 31 August 2013 following which he was succeeded as Chairman by Dick Peters.

# Directors' Remuneration Report continued

The table below reports the total remuneration receivable in respect of qualifying services by each of the non-executive directors for the years 2013 and 2012.

## Non-executive directors' remuneration as a single figure – 2013 (audited)

Non-executive directors	Base salary and fees 2013 £000	Non-salary benefits 2013 £000	Annual performance bonus 2013 £000	Share-based incentive schemes 2013 £000	Pension related benefits 2013 £000	Total 2013 £000
Andrew Eastgate	38	–	–	–	–	38
Mike O'Leary	42	–	–	–	–	42
Dick Peters	49	–	–	–	–	49
	129	–	–	–	–	129

## Non-executive directors' remuneration as a single figure – 2012 (audited)

Non-executive directors	Base salary and fees 2012 £000	Non-salary benefits 2012 £000	Annual performance bonus 2012 £000	Share-based incentive schemes 2012 £000	Pension related benefits 2012 £000	Total 2012 £000
Andrew Eastgate	36	–	–	–	–	36
Mike O'Leary	41	–	–	–	–	41
Dick Peters	41	–	–	–	–	41
	118	–	–	–	–	118

The figures in the single figure table are derived from the following.

Base salary and fees	The amount of salary/fees received in the period.
Non-salary benefits	The taxable value of benefits received in the period. These are car benefit, car fuel benefit and private medical insurance.
Performance related pay	The amount of performance related bonus received in the period.
Pension related benefits	There was no provision.
Share-based incentive schemes	The value of CIP awards that vest in respect of the financial period and the value of SAYE options granted in the financial period. CIP awards granted in 2010 were calculated to be part vested, however no options or awards were granted in the year.



## Individual elements of remuneration

### Base salaries and fees

Base salaries for individual executive directors are reviewed annually by the committee and are set with reference to individual performance, experience and responsibilities as well as with reference to similar roles in comparable companies. For 2013, executive directors received a 2% increase in base salaries which was in line with the average salary increase across the group. For 2014, there is no increase, which is in line with the average salary increase across the group.

The base salaries for 2013 and 2014 are set out as below.

	2013 £000	2014 £000	Increase %
Tony Brewer	544	544	–
Steve Wilson	393	393	–

Non-executive directors' fees are reviewed annually and reflect the responsibilities and duties placed on them whilst also having regard to market practice. The increases in 2013 reflected a 2% increase in fees and a change in responsibilities and duties. There is no increase in respect of 2014. The non-executive directors do not participate in any of the group's share incentive plans nor do they receive any benefits or pension contributions.

	2013 £000	2014 £000	Increase %
Basic fee	35	35	–
Additional fee for			
Chairmanship of the company	28	28	–
Chairmanship of the Remuneration Committee	7	7	–
Chairmanship of the Audit Committee	7	7	–
Senior Independent Director	–	–	–

### Performance related pay

Payments are calculated based upon achievement or exceeding a pre-set target for group profit before tax. For 2013, executive directors could earn a bonus equivalent to 75% of base salary on attainment of on target performance which increased on a broadly linear basis up to a maximum of 150% of base salary for achieving a performance of 28% or more above the target. If actual performance is 90% of the financial target, a bonus of 10% of base salary will be awarded, however a bonus is not awarded for performance below 90% of target.

A change is proposed in respect of the annual bonus scheme for 2014 whereby the maximum award under the annual bonus will be reduced to 125% of base salary for achieving a performance of 18% or more above target, on the same broadly linear basis that has applied in previous years, with 75% earned for on target performance. Performance targets are set at the challenging levels of previous years with performance based upon group profit. The committee considers that the performance targets are commercially sensitive and should therefore remain confidential to the company.

# Directors' Remuneration Report continued

## Share-based incentive schemes

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, the committee has not yet implemented either the PSP or the ESOS and does not intend to do so during 2014. 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 and, 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 currently being a minimum of £10 and a maximum of £250, although the maximum is to increase to £500 effective from April 2014. Options may be granted at a price which represents a discount to market price at the date of grant of up to 20%. On 10 May 2013, options were granted over 216,531 shares to 221 employees for savings terms of either three or five years at an option price of 274p 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 37.5% 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.

No share-based awards were made to the executive or non-executive directors in the year.

CIP awards granted in October 2010 were subject to growth in performance conditions over a three-year period, 80% in respect of EPS and 20% in respect of TSR. Awards vest on a sliding scale. If EPS growth is less than 3%, none of the EPS tranche shall vest, with 30% becoming exercisable if EPS growth over the three-year period is equal to 3% and for 100% of an award to vest, EPS growth must be equal to or exceed 6%, with straight line vesting between 30% and 100%.

With respect to TSR, vesting is determined by reference to the company's position in the FTSE Small Cap indices. None of the TSR tranche shall vest if the company is ranked below the median level, with 30% vesting if the company is ranked at or immediately above the median level and 100% vesting if the company is ranked within the top quartile, with straight line vesting between 30% and 100%.

EPS growth over the three-year performance period ending 31 December 2013 exceeded 6% resulting in 80% of the CIP awards granted in October 2010 vesting. The company's total shareholder return, when compared to the FTSE SmallCap Index was below median over the three-year performance period ending 31 December 2013 resulting in the 20% of the CIP awards granted in October 2010 subject to TSR lapsing.

The extent to which the CIP awards granted in August 2011 and October 2012 will vest will not be determined by the committee until October 2015.

### **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 ten-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 0.7% 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 22 to the financial statements.

### **Pension related benefits**

No executive director has received any pension benefit during the current or prior year.

### **Payments to past directors**

No payments were made to past directors in the current or prior year.

### **Payments for loss of office**

No payments were made to directors in the current or prior year.



# Directors' Remuneration Report continued

## Statement of directors' shareholding and share interests (audited)

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, excluding matching share awards granted in respect of the CIP, equivalent in value to their annual base salary. Newly appointed directors are expected to build their interest over a five-year period. Executive directors' shareholdings throughout the year complied with the shareholding requirement holding in excess of 100% of base salary.

Details of executive directors' share interests are set out below, a description of which, together with relevant performance conditions, is given on pages 60 to 61:

	Granted in the year				Exercised in the year				Earliest exercise date	Latest exercise date
	At 1 Jan 2013	Number	Option price (p)	Lapsed during the year	Number	Market price on exercise	At 31 Dec 2013	Exercise price pence		
<b>Tony Brewer</b>										
<b>Owned</b>										
Owned outright	519,942	–	–	–	–	–	519,942			
<b>Vested but not exercised</b>										
1998 ESOS (i)	7,142	–	–	–	–	7,142	420.00	Aug 2008	Aug 2015	
CIP (v)	98,859	–	–	(19,772)	–	79,087	nil	Oct 2013	Oct 2020	
<b>Options not yet vested</b>										
Sharesave (ii)	7,043	–	–	–	–	7,043	222.20	Jul 2014	Jan 2015	
CIP (v)	100,000	–	–	(100,000)	–	0	nil	Aug 2014	Aug 2021	
CIP (v)	90,838	–	–	–	–	90,838	nil	Oct 2015	Oct 2022	
	<b>823,824</b>	<b>–</b>	<b>–</b>	<b>(119,772)</b>	<b>–</b>	<b>704,052</b>				
<b>Steve Wilson</b>										
<b>Owned</b>										
Owned outright	450,770	–	–	–	–	–	450,770			
<b>Vested but not exercised</b>										
1998 ESOS (ii)	7,142	–	–	–	–	7,142	420.00	Aug 2008	Aug 2015	
CIP (v)	71,388	–	–	(14,278)	–	57,110	nil	Oct 2013	Oct 2020	
<b>Options not yet vested</b>										
Sharesave (iii)	7,043	–	–	–	–	7,043	222.20	Jul 2014	Jan 2015	
CIP (v)	72,212	–	–	(72,212)	–	0	nil	Aug 2014	Aug 2021	
CIP (v)	65,614	–	–	–	–	65,614	nil	Oct 2015	Oct 2022	
	<b>674,169</b>	<b>–</b>	<b>–</b>	<b>(86,490)</b>	<b>–</b>	<b>587,679</b>				
<b>Graham Waldron (i)</b>										
<b>Owned</b>										
Owned outright	379,755	–	–	–	–	–	379,755			
<b>Options not yet vested</b>										
Sharesave (iv)	3,781	–	–	–	–	3,781	238.00	Jul 2015	Jan 2016	
	<b>383,356</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>383,356</b>				

(i) Graham Waldron resigned as a director on 31 August 2013.

(ii) Headlam Group Approved Executive Share Option Scheme 1998 (1998 ESOS), subject to performance conditions.

(iii) Headlam Group Sharesave Scheme 2009 (Sharesave), not subject to performance conditions.

(iv) Headlam Group Sharesave Scheme 2012 (Sharesave), not subject to performance conditions.

(v) Headlam Group Co-Investment Plan 2008 (CIP), subject to performance conditions.

The mid-market closing price of a Headlam Group plc ordinary share on 31 December 2013, the last trading day of the financial year, was 405.50p and the price range during the year was 320p to 415p, with an average price of 367.58p. There were no changes in the shareholdings or share options held by the directors between 31 December 2013 and 7 March 2014. The company's register of directors' interests, which is open to inspection, contains full details of directors' share interests.

The text and table below comprise information required by the UKLA listing Rules 9.8.6 and 9.8.8 that is not found elsewhere in the remuneration report.

Details of executive directors' share-based awards which represent the maximum aggregate number of shares to which an individual could become entitled together with individual interests under the SAYE scheme are set out below (audited).

	Awards granted	Maximum award	Awards vested	Awards lapsed	Maximum outstanding awards at 31 Dec 2013	Option price (p)	Market price at date of grant (p)	Maximum award £	Earliest vesting date	Expiry
<b>Tony Brewer</b>										
CIP (v)	7 Oct 2010	98,859	(79,087)	(19,772)	–	nil	312	–	Oct 2013	Oct 2020
CIP	23 Aug 2011	100,000	–	(100,000)	–	nil	274	–	Aug 2014	Aug 2021
CIP	5 Oct 2012	90,838	–	–	90,838	nil	300	272,514	Oct 2015	Oct 2022
1998 ESOS (ii)	22 Aug 2005	7,142	–	–	7,142	420	424	286	Aug 2008	Aug 2015
SAYE (iv)	11 May 2009	7,043	–	–	7,045	222.2	297	5,268	Jul 2014	Jan 2015
<b>Steve Wilson</b>										
CIP (v)	7 Oct 2010	71,388	(57,110)	(14,278)	–	nil	312	–	Oct 2013	Oct 2020
CIP	23 Aug 2011	72,212	–	(72,212)	–	nil	274	–	Aug 2014	Aug 2021
CIP	5 Oct 2012	65,614	–	–	65,614	nil	300	196,842	Oct 2015	Oct 2022
1998 ESOS (ii)	22 Aug 2005	7,142	–	–	7,142	420	424	286	Aug 2008	Aug 2015
SAYE (iii)	11 May 2009	7,043	–	–	7,045	222.2	297	5,268	Jul 2014	Jan 2015
<b>Graham Waldron</b>										
SAYE (iv)	11 May 2012	3,781	–	–	3,781	238	306	2,571	Jul 2015	Jan 2016

(i) Graham Waldron resigned as a director on 31 August 2013.

(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).

## Gains made by directors (audited)

The aggregate amount of gains made by executive directors on the exercise of share options was £nil (2012: £2,256).

The information provided in this part of the Directors' Remuneration Report is not subject to audit.

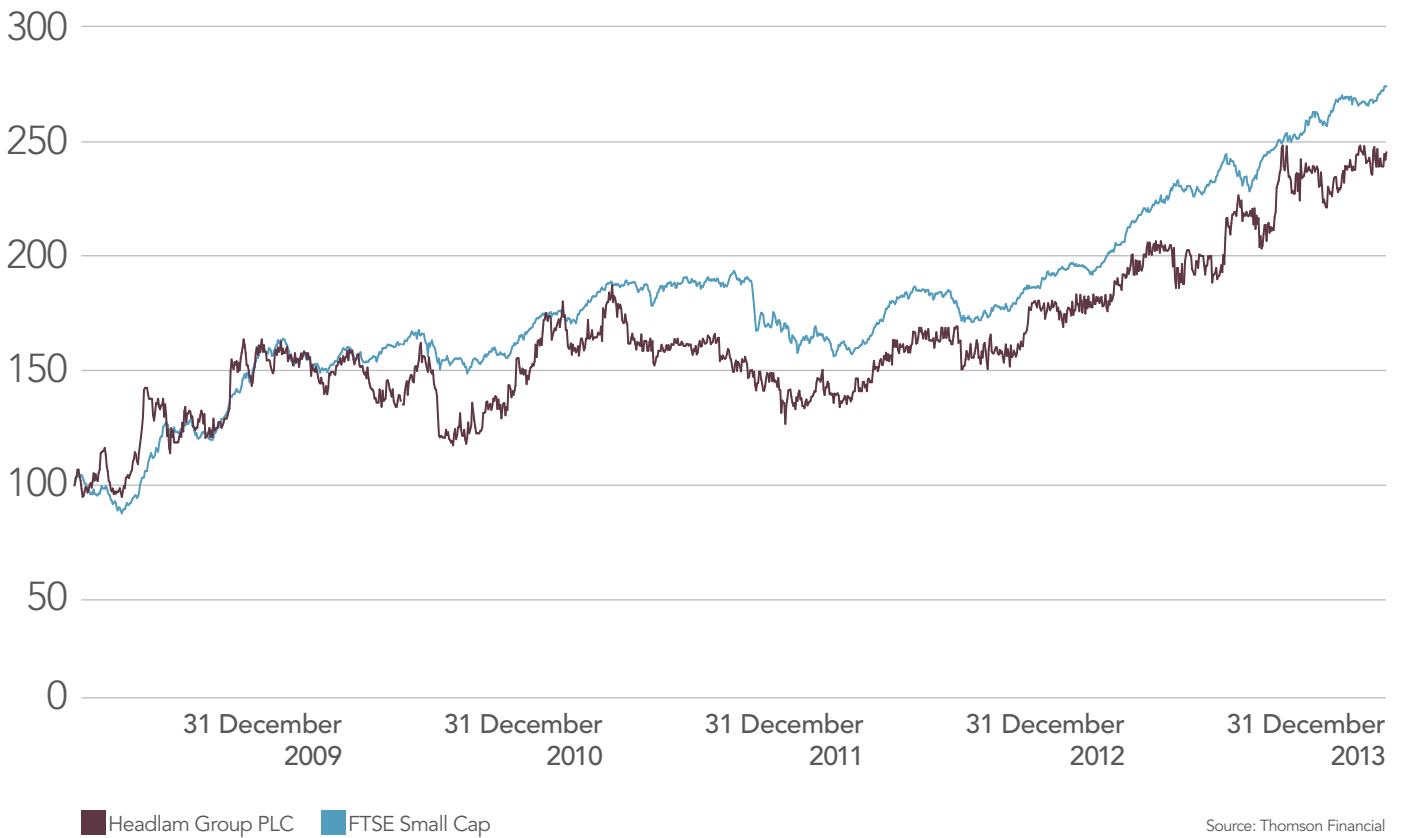
# Directors' Remuneration Report continued

## Performance graph

The graph below shows value at 31 December 2013 of £100 invested in the company on 1 January 2008 compared to the value of £100 invested in the FTSE Small Cap index, making the assumption that dividends are reinvested to purchase additional equity.

The FTSE Small Cap 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 2013





### Chief Executive Officer remuneration table (audited)

The table below sets out the remuneration of the chief executive officer for the previous five years.

Year	CEO single figure of total remuneration £000	Annual bonus (% of maximum opportunity) %	Long term incentive vesting rates against maximum opportunity %
2009	1,027	77.0	n/a
2010	1,179	97.0	n/a
2011	1,095	99.7	n/a
2012	1,347	98.3	n/a
<b>2013</b>	<b>927</b>	<b>64.0</b>	<b>n/a</b>

### Percentage change in Chief Executive Officer remuneration (audited)

The table below shows the percentage change in the chief executive officers remuneration and the company's employees as a whole between the year 2013 and 2012.

Percentage increase in remuneration in 2013 compared with 2012	CEO	Total employees
Salary and fees	2%	2%
All taxable benefits	21%	–
Annual bonuses	-34%	-5%

Car allowances were unchanged year on year and the related taxable benefits were amended in accordance with HM Revenue & Customs guidance. Private medical insurance premiums decreased marginally for all eligible members of the scheme including the CEO. The average percentage change in taxable benefits does not produce a meaningful comparison.

### Relative importance of spend on pay

The graph below sets out the percentage change in dividends and the overall expenditure on pay as a whole across the group.

	2013 £000	2012 £000	% change
Dividends	12,300	11,663	5.5
Overall expenditure on pay	82,701	80,839	2.3

### Statement of implementation of remuneration policy in the following financial year

As this is the first year the group is preparing the Directors' Remuneration Report in accordance with the amended Regulations there is nothing yet to report. The remuneration policy that will be applied in practice in the current year is the same as the policy to be approved under the new requirements that will be adhered to for the next three years.

# Directors' Remuneration Report continued

## Consideration by the directors of matters relating to directors' remuneration

The committee comprises the three independent non-executive directors and met three times during the year, with all three members present at each meeting. By invitation, the Group Chief Executive and Group Finance Director may attend meetings. No one attending a committee meeting may participate in discussions relating to their own terms and conditions of service or remuneration.

The committee is responsible for selecting the framework and policy for executive directors' remuneration and determining the remuneration packages for the executive directors and Chairman. In doing so, it takes note of any major changes in employee benefit structures throughout the group and ensures that executive director remuneration practice is consistent with any such changes. It is also responsible for monitoring the level and structure of remuneration for senior executive management and approving bonus payments.

Committee members 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. The Company Secretary acts as secretary to the committee.

## Statement of voting at the last AGM

The following table sets out actual voting outcome in respect of the advisory resolution to approve the Directors' Remuneration Report at the company's AGM held on Friday 24 May 2013.

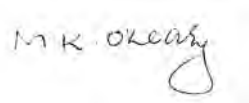
	For %	Against %	Withheld %
Of issued share capital	82.14	0.25	5.67
Of votes cast	99.70	0.30	0.00
	Number	Number	Number
Number of votes cast	68,623,042	204,782	3,900,457

The issued share capital on the date of the AGM was 85,363,743.

At the proposed AGM on Wednesday 21 May 2014, shareholders are asked to vote on the Directors' Remuneration Report, on an advisory basis, and on a binding resolution to approve the directors' remuneration policy.

## Approval

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



## Mike O'Leary

Chairman of the Remuneration Committee, 7 March 2014

# Other Statutory Disclosures

The requirements of the Strategic Report are covered in pages 2 to 33.

## 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 129. Further details of the group's activities and future plans are set out in the Operating Review on pages 20 to 25.

## Results and dividends

The results for the year and financial position at 31 December 2013 are shown in the Consolidated Income Statement on page 76 and Statements of Financial Position on page 78.

An interim dividend of 4.65p per share (2012: 4.65p) was paid on 2 January 2014 to shareholders on the register at the close of business on 6 December 2013. The directors propose a final dividend of 10.65p per ordinary share (2012: 10.20p), to be paid on 1 July 2014 to shareholders on the register of members at the close of business on 6 June 2014, the associated ex-dividend date being 4 June 2014.

This would bring the total dividend for the year to 15.30p per ordinary share (2012: 14.85p). The payment of the final dividend is subject to shareholder approval at the Annual General Meeting ("AGM").

## Directors and officers indemnity insurance

The articles entitle the directors of the company, to the extent permitted by the Companies Act 2006, 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 7 March 2014.

## 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.

There was one change to the board in the year, being the resignation of Graham Waldron on 31 August 2013. 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, Tony Brewer and Andrew Eastgate, 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. The company does not seek to comply with the provision in the UK Corporate Governance Code which requires the annual re-election of all 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.

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
<b>Executive directors</b>		
Tony Brewer	June 1991	June 2011
Steve Wilson	December 1991	June 2012
<b>Non-executive directors</b>		
Dick Peters	December 2005	June 2013
Mike O'Leary	March 2006	June 2012
Andrew Eastgate	May 2010	June 2011

# 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 lender may cancel all or any part of the facility and/or declare that all amounts outstanding under the 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 taking place.

Matching share awards granted under the 2008 CIP 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.

Details regarding directors' service agreements are included within the Directors' Remuneration Report.

## Fixed assets

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

## Acquisitions

Details of acquisitions made in the year are set out in note 25.

## 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 Managing Responsibility on pages 30 to 33, and the average number of employees and their remuneration are shown in note 5 to the Financial Statements.

The company has communicated an internally operated whistleblowing 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.

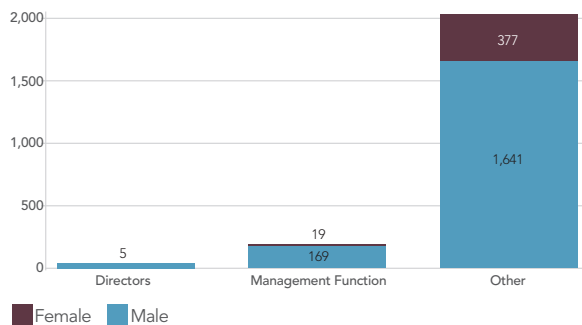
Employees are encouraged to own shares in the company and the group operates an HMRC Approved Savings Related Share Option Scheme (SAYE). Those employees who choose to take up the option to purchase shares in the company may enter into a savings arrangement for either a three- or five-year period, with 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.

The company considers that diversity, including gender diversity, is essential to good business and measures are in place to ensure all appointments are made on merit. Currently there are no female directors out of a total of five board members. Without seeking to set a specific goal for female representation on the board, the company is committed to maintain diversity, including gender diversity, appropriate to and reflecting the nature and strategic aims of the company. This similarly applies to women in leadership positions in the company.

As at 31 December 2013 we had 2,211 employees of which 18% are female. The significant majority of our employees work regular full time hours with a minority working flexible hours.



## Gender of Group Employers



## Political donations and expenditure

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 (2012: £nil).

## Charitable contributions

Charitable donations made during the year in support of charitable causes in the local communities in which the group operates and those of interest to employees amounted to £36,722 (2012: £35,192). Of the contributions made in 2013, £23,050 related to GNO, a Birmingham-based charity which supports a number of children's charities predominantly within the West Midland Region. In addition, employees participated in a variety of fundraising activities and supported charities local to their businesses.

## Share capital

As at 31 December 2013, the issued share capital of the company comprised a single class of ordinary shares of 5p 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 1,827,794 shares held in treasury at the start of the year, 90,274 were transferred of treasury in connection with the SAYE and executive share option schemes leaving 1,737,520 at the year end representing 2.04% of the issued share capital. Proceeds received in respect of the 90,274 shares were £243,000. Details of the company's share capital are set out in note 23 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 Coleshill on Wednesday 21 May 2014 at 10.00 a.m. The notice convening this meeting is set out within this Annual Report and Accounts on page 131, along with explanatory notes regarding the resolutions that will be proposed at the meeting on pages 133 to 134. 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

Our auditors, KPMG Audit Plc, have instigated an orderly wind-down of the business and have notified the company that they are not seeking re-appointment. The Board has decided to put KPMG LLP forward to be appointed as auditors and resolution concerning their proposed appointment will be put to the forthcoming AGM of the company.

The auditor's responsibilities are set out on pages 73 to 75 and should be read in conjunction with those of the directors as set out at the end of this report.

# Other Statutory Disclosures continued

## Authority to allot shares and disapply statutory pre-emption rights

Subject to certain limits, at the AGM on 24 May 2013, 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 24 May 2013, 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.

## Rights under employees' share schemes

As at 31 December 2013, 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 was 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 Headlam Group Employee Trust Company Limited 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 interests in voting rights

As at 31 December 2013 and unchanged at 6 March 2014, being as at the end of the financial year and a date not more than one month before the date of notice of the AGM, in accordance with the requirements of the Listing Rules and the disclosure and transparency rules of the Financial Conduct Authority, the company had been notified of the following interests exceeding the 3% notification threshold in the ordinary share capital of the company.

## Ordinary shares of 5p each

Shareholder	31 December 2013 aggregate voting rights	%	28 February 2014 aggregate voting rights	%	Indirect/direct
Franklin Templeton Institutional, LLC	15,066,975	18.02	15,066,975	18.02	indirect
Tweedy, Browne Company LLC	4,523,274	5.41	4,523,274	5.41	direct
Heronbridge Investment Management LLP	4,209,552	5.04	4,209,552	5.04	direct
JO Hambro Capital Management Limited	4,190,972	5.01	4,190,972	5.01	direct
Threadneedle Investments	4,154,941	4.97	4,154,941	4.97	indirect and direct
Schroders plc	4,119,581	4.93	4,119,581	4.93	indirect
Rathbone Brothers plc	4,070,078	4.87	4,070,078	4.87	indirect
Kames Capital	3,305,204	3.95	3,305,204	3.95	indirect and direct
Investmentaktiengesellschaft fuer langfristige Investoren TGV	2,773,093	3.32	2,773,093	3.32	direct
Legal & General Investment Management Limited	2,580,698	3.08	2,580,698	3.08	direct

### 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 138 to 139.

### 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.

### Statement of directors' responsibilities in respect of the Annual Report and financial statements

The statement of directors' responsibilities in respect of the Annual Report and financial statements can be found on page 72.

### 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 its work on the UK Corporate Governance Code in the Corporate Governance Report on pages 36 to 43. The Code is available to view at [www.frc.org.uk](http://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 auditors' report of which the auditors are unaware and each director has taken all the steps that 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 7 March 2014 and signed on its behalf by



### Geoff Duggan

Company Secretary, 7 March 2014

# 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 Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

## Responsibility statement of the Directors in respect of the Annual Report and Accounts and the financial statements

Each of the directors of Headlam Group plc, confirms that to the best of his knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards and contained in this Annual Report and Accounts, give a true and fair view of the assets, liabilities, financial position and profit of the company and the undertakings included in the consolidation taken as a whole;
- the Strategic Report, included in this Annual Report and Accounts, includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company's performance, business model and strategy.



# Independent Auditor's Report

## to the members of Headlam Group plc only

### Opinions and conclusions arising from our audit

#### 1 Our opinion on the financial statements is unmodified

We have audited the financial statements of Headlam Group plc for the year ended 31 December 2013 set out on pages 76 to 128. 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 2013 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent company financial statements have been properly prepared in accordance with 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.

#### 2 Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements the risks of material misstatement that had the greatest effect on our audit were as follows:

##### Carrying amount of goodwill (£10.0 million):

Refer to page 46 (Audit Committee Report), page 83 (accounting policies) and pages 92 and 100 (financial disclosures).

- *The risk* – The determination of the recoverable amount of goodwill is a key judgement area as small changes in assumptions, notably in respect of forecast growth and discount rates, can result in materially different outcomes. This is particularly the case in respect of the goodwill allocated to the group's business in France where there are ongoing challenging market conditions impacting business performance.
- *Our response* – Our audit procedures in this area included, among others, testing of the group's budgeting procedures upon which the forecasts are based and the principles and integrity of the group's discounted cash flow model. We compared the group's assumptions to the group's internal data, such as historic growth rates, as well as our own assessments in relation to key inputs such as forecast revenue and profit growth and the discount rate applied. We used our own valuation specialist to assist us in evaluating the discount rate applied in the UK and continental Europe. We performed break even analysis in

relation to key assumptions and considered whether the group's disclosures regarding the sensitivity of the outcome of the impairment review to changes in key assumptions appropriately reflected the subjectivity in the valuation. We also performed a review of the disclosures relating to the impairment charge recognised during the year.

##### Carrying amount of freehold property (£79.3 million):

Refer to page 46 (Audit Committee Report), page 82 (accounting policies) and pages 92 and 97 (financial disclosures).

- *The risk* – The group holds a number of freehold properties which are used for operational purposes in the UK and in continental Europe. The carrying amount of the freehold property represents original cost less accumulated depreciation. The aggregate carrying value of the property portfolio exceeds its current market value indicating that there is a risk that the carrying amount of the property may be impaired.
- *Our response* – Our audit procedures included, among others, comparing the carrying value of the group's freehold properties to recent external market valuations prepared for the group by an independent expert. We use our valuation specialist to assist us in evaluating the external market valuations. Where the carrying amount of a property exceeded the external market valuation we assessed the directors' determination of the value to be recovered through ongoing use of the property within the business unit to which it belongs, including testing the principles and integrity of the model used to determine value in use. We compared the group's assumptions to the group's internal data, such as historic growth rates, as well as our own assessments in relation to key inputs such as profit growth and the discount rate applied. We also performed break even analysis in relation to key assumptions and considered whether the group's disclosures regarding the outcome of the impairment review were appropriate.

##### Carrying amount of inventory (£115.7 million):

Refer to page 47 (Audit Committee Report), page 86 (accounting policies) and page 104 (financial disclosures).

- *The risk* – The group holds a significant amount of inventory across a broad and diverse product range which is subject to a risk that changes in consumer tastes and demand could result in some products becoming slow-moving or obsolete, such that they cannot be sold or sales prices are discounted to less than the current carrying value. This could result in a material provision against the carrying amount of inventory.

# Independent Auditor's Report continued

- *Our response* – Our audit procedures in this area included, among others, determining the ageing profile of inventory and the inventory lines sold at a loss during the year. We used our own IT specialist to perform data analytics to assess the accuracy of the ageing profile of inventory by analysing data extracted from the group's accounting system. We assessed the adequacy of the group's provisions against inventory by assessing the appropriateness of group's assumptions by reviewing the carrying amount and ageing profile of inventory as well as the historic value of inventory sold at a loss or written off. We also considered the adequacy of the group's disclosures about the degree of estimation involved in arriving at the provision.

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

The materiality for the group financial statements as a whole was set at £1.9m. This has been determined using a benchmark of group profit before taxation which we believe is one of the principal considerations for members of the company in assessing the financial performance of the group. Materiality represents 8.9% of group profit before taxation and 7.1% of underlying group profit before taxation as disclosed on the face of the income statement.

We agreed with the Audit Committee to report to it all corrected and uncorrected misstatements we identified through our audit with a value in excess of £94,000, in addition to other audit misstatements below that threshold that we believe warranted reporting on qualitative grounds.

Audits for group reporting purposes were performed at the key reporting components in France and Switzerland and by the group team in the UK. In addition, specified audit procedures were performed by the group audit team in the Netherlands. Together these covered in excess of 90% of total group revenue, 95% of underlying group profit before taxation and 90% of total group assets.

The audits undertaken for group reporting purposes at the key reporting components of the group were all performed to materiality levels set by, or agreed with, the group audit team. These materiality levels were set individually for each component and ranged from £0.2 million to £1.4 million.

Detailed audit instructions were sent to all the auditors in these locations. These instructions covered the significant audit areas that should be covered by these audits (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported back to the group audit team. The group audit team visited the reporting components as appropriate.

### *4 Our opinion on other matters prescribed by the Companies Act 2006 is unmodified*

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the Corporate Governance Statement set out on pages 36 and 43 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the group financial statements.

### *5 We have nothing to report in respect of the matters on which we are required to report by exception*

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

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

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
- 1. 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
- 2. 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
- a Corporate Governance Statement has not been prepared by the company.

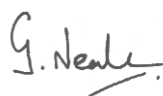
Under the Listing Rules we are required to review:

- the directors' statement, set out on page 24, in relation to going concern; and
- the part of the Corporate Governance Statement on pages 36 relating to the company's compliance with the nine provisions of the 2010 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

### Scope of report and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 72, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. 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](http://www.frc.org.uk/auditscopeukprivate). This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at [www.kpmg.com/uk/auditscopeukco2013a](http://www.kpmg.com/uk/auditscopeukco2013a), which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.



**Graham Neale**  
(Senior Statutory Auditor)

for and on behalf of KPMG Audit Plc, Statutory Auditor  
Chartered Accountants  
One Snowhill  
Snowhill Queensway  
Birmingham  
B4 6HG  
7 March 2014

# Consolidated Income Statement

## for the year ended 31 December 2013

	Note	Underlying 2013 £000	Non-underlying items* (note 4) 2013 £000	Total 2013 £000	Restated± 2012 £000
<b>Revenue</b>	2	603,051	–	603,051	585,984
Cost of sales		(421,796)	–	(421,796)	(410,251)
<b>Gross profit</b>		181,255	–	181,255	175,733
Distribution expenses		(115,067)	–	(115,067)	(109,621)
Administrative expenses		(38,508)	(5,352)	(43,860)	(36,798)
<b>Operating profit</b>	2	27,680	(5,352)	22,328	29,314
Finance income	7	629	–	629	783
Finance expenses	7	(1,870)	–	(1,870)	(2,246)
<b>Net finance costs</b>		(1,241)	–	(1,241)	(1,463)
<b>Profit before tax</b>	3	26,439	(5,352)	21,087	27,851
Taxation	8	(6,146)	–	(6,146)	(6,939)
<b>Profit for the year attributable to the equity shareholders</b>		20,293	(5,352)	14,941	20,912
<b>Dividend paid per share</b>	23			14.85p	14.15p
<b>Earnings per share</b>					
Basic	10	24.5p	–	18.0p	25.3p
Diluted	10	24.3p	–	17.9p	25.2p

\* Non-underlying items comprise the impairment of intangible and tangible fixed assets.

± Restated to reflect the changes for revised IAS 19.

All group operations during the financial years were continuing operations.



# Consolidated Statement of Comprehensive Income

## for the year ended 31 December 2013

	Note	2013 £000	Restated± 2012 £000
<b>Profit for the year attributable to the equity shareholders</b>		<b>14,941</b>	20,912
Other comprehensive income:			
<i>Items that will never be reclassified to profit or loss</i>			
Remeasurement of defined benefit plans	21	450	(4,984)
Related tax		(529)	928
		(79)	(4,056)
<i>Items that are or may be reclassified to profit or loss</i>			
Foreign exchange translation differences arising on translation of overseas operations		397	(389)
Effective portion of changes in fair value of cash flow hedges		115	(383)
Transfers to profit or loss on cash flow hedges		137	44
Related tax		(65)	86
		584	(642)
<b>Other comprehensive income/(expense) for the year</b>		<b>505</b>	(4,698)
<b>Total comprehensive income attributable to the equity shareholders for the year</b>		<b>15,446</b>	16,214

± Restated to reflect the changes for revised IAS 19.

# Statements of Financial Position

at 31 December 2013

	Note	Group		Company	
		2013 £000	2012 £000	2013 £000	2012 £000
<b>Assets</b>					
<b>Non-current assets</b>					
Property, plant and equipment	11	103,079	96,182	88,061	79,672
Intangible assets	12	10,013	13,210	–	–
Investments in subsidiary undertakings	13	–	–	88,431	88,136
Deferred tax assets	14	2,388	2,376	1,051	1,294
		<b>115,480</b>	<b>111,768</b>	<b>177,543</b>	<b>169,102</b>
<b>Current assets</b>					
Inventories	15	115,678	115,332	–	–
Trade and other receivables	16	119,488	108,070	15,452	15,121
Cash and cash equivalents	17	47,477	49,798	32,231	28,763
Assets held for sale	18	–	212	–	212
		<b>282,643</b>	<b>273,412</b>	<b>47,683</b>	<b>44,096</b>
<b>Total assets</b>		<b>398,123</b>	<b>385,180</b>	<b>225,226</b>	<b>213,198</b>
<b>Liabilities</b>					
<b>Current liabilities</b>					
Other interest-bearing loans and borrowings	19	(218)	(213)	–	–
Trade and other payables	20	(164,519)	(153,755)	(39,116)	(39,653)
Employee benefits	21	(2,842)	(2,754)	(2,842)	(2,754)
Income tax payable	9	(7,022)	(7,117)	(3,508)	(2,988)
		<b>(174,601)</b>	<b>(163,839)</b>	<b>(45,466)</b>	<b>(45,395)</b>
<b>Non-current liabilities</b>					
Other interest-bearing loans and borrowings	19	(33,239)	(33,371)	(30,000)	(30,000)
Employee benefits	21	(12,780)	(14,641)	(11,089)	(12,590)
		<b>(46,019)</b>	<b>(48,012)</b>	<b>(41,089)</b>	<b>(42,590)</b>
<b>Total liabilities</b>		<b>(220,620)</b>	<b>(211,851)</b>	<b>(86,555)</b>	<b>(87,985)</b>
<b>Net assets</b>		<b>177,503</b>	<b>173,329</b>	<b>138,671</b>	<b>125,213</b>
<b>Equity attributable to equity holders of the parent</b>					
Share capital	23	4,268	4,268	4,268	4,268
Share premium		53,512	53,512	53,512	53,512
Other reserves	23	(4,742)	(5,812)	9,671	8,998
Retained earnings		124,465	121,361	71,220	58,435
<b>Total equity</b>		<b>177,503</b>	<b>173,329</b>	<b>138,671</b>	<b>125,213</b>

These financial statements were approved by the board of directors on 7 March 2014 and were signed on its behalf by:



**Tony Brewer**  
Director



**Steve Wilson**  
Director

Company Number: 460129

# Statement of Changes in Equity – Group

## for the year ended 31 December 2013

	Share capital £000	Share premium £000	Capital redemption reserve £000	Translation reserve £000	Cash flow hedging reserve £000	Treasury reserve £000	Restated± retained earnings £000	Total equity £000
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	–	–	–	–	–	–	20,912	20,912
Other comprehensive income	–	–	–	(389)	(339)	–	(3,970)	(4,698)
<b>Total comprehensive income for the year</b>	–	–	–	(389)	(339)	–	16,942	16,214
<b>Transactions with equity shareholders, recorded directly in equity</b>								
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
<b>Balance at 1 January 2013</b>	<b>4,268</b>	<b>53,512</b>	<b>88</b>	<b>5,768</b>	<b>(339)</b>	<b>(11,329)</b>	<b>121,361</b>	<b>173,329</b>
Profit for the year attributable to the equity shareholders	–	–	–	–	–	–	14,941	14,941
Other comprehensive income	–	–	–	397	252	–	(144)	505
<b>Total comprehensive income for the year</b>	–	–	–	397	252	–	14,797	15,446
<b>Transactions with equity shareholders, recorded directly in equity</b>								
Share-based payments	–	–	–	–	–	–	288	288
Share options exercised by employees	–	–	–	–	–	421	(178)	243
Deferred tax on share options	–	–	–	–	–	–	497	497
Dividends to equity holders	–	–	–	–	–	–	(12,300)	(12,300)
Total contributions by and distributions to equity shareholders	–	–	–	–	–	421	(11,693)	(11,272)
<b>Balance at 31 December 2013</b>	<b>4,268</b>	<b>53,512</b>	<b>88</b>	<b>6,165</b>	<b>(87)</b>	<b>(10,908)</b>	<b>124,465</b>	<b>177,503</b>

± Restated to reflect the changes for revised IAS 19.

# Statement of Changes in Equity – Company

## for the year ended 31 December 2013

	Share capital £000	Share premium £000	Capital redemption reserve £000	Special reserve £000	Cash flow hedging reserve £000	Treasury reserve £000	Restated± retained earnings £000	Total equity £000
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	–	–	–	–	–	–	14,248	14,248
Other comprehensive income	–	–	–	–	(339)	–	(4,044)	(4,383)
<b>Total comprehensive income for the year</b>	–	–	–	–	(339)	–	10,204	9,865
<b>Transactions with equity shareholders, recorded directly in equity</b>								
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
<b>Balance at 1 January 2013</b>	<b>4,268</b>	<b>53,512</b>	<b>88</b>	<b>20,578</b>	<b>(339)</b>	<b>(11,329)</b>	<b>58,435</b>	<b>125,213</b>
Profit for the year attributable to the equity shareholders	–	–	–	–	–	–	25,343	25,343
Other comprehensive income	–	–	–	–	252	–	(550)	(298)
<b>Total comprehensive income for the year</b>	–	–	–	–	252	–	24,793	25,045
<b>Transactions with equity shareholders, recorded directly in equity</b>								
Share-based payments	–	–	–	–	–	–	288	288
Share options exercised by employees	–	–	–	–	–	421	(178)	243
Deferred tax on share options	–	–	–	–	–	–	182	182
Dividends to equity holders	–	–	–	–	–	–	(12,300)	(12,300)
Total contributions by and distributions to equity shareholders	–	–	–	–	–	421	(12,008)	(11,587)
<b>Balance at 31 December 2013</b>	<b>4,268</b>	<b>53,512</b>	<b>88</b>	<b>20,578</b>	<b>(87)</b>	<b>(10,908)</b>	<b>71,220</b>	<b>138,671</b>

± Restated to reflect the changes for revised IAS 19.



# Cash Flow Statements

## for the year ended 31 December 2013

	Note	Group		Company	
		2013 £000	Restated± 2012 £000	2013 £000	Restated± 2012 £000
<b>Cash flows from operating activities</b>					
Profit before tax for the year		21,087	27,851	1,596	1,090
Adjustments for:					
Depreciation, amortisation and impairment		10,136	4,695	1,458	1,468
Finance income	7	(629)	(783)	(663)	(759)
Finance expense	7	1,870	2,246	1,203	1,533
Profit on sale of property, plant and equipment		(177)	(185)	(148)	(133)
Share-based payments	22	288	1,183	(7)	388
<b>Operating cash flows before changes in working capital and other payables</b>		<b>32,575</b>	<b>35,007</b>	<b>3,439</b>	<b>3,587</b>
Change in inventories		1,967	(491)	–	–
Change in trade and other receivables		(9,114)	3,498	(506)	25
Change in trade and other payables		9,421	(819)	824	2,972
<b>Cash generated from the operations</b>		<b>34,849</b>	<b>37,195</b>	<b>3,757</b>	<b>6,584</b>
Interest paid		(1,565)	(1,682)	(839)	(897)
Tax (paid)/received		(6,344)	(6,766)	284	3,295
Additional contributions to defined benefit plan	21	(2,913)	(2,839)	(2,913)	(2,839)
<b>Net cash flow from operating activities</b>		<b>24,027</b>	<b>25,908</b>	<b>289</b>	<b>6,143</b>
<b>Cash flows from investing activities</b>					
Proceeds from sale of property, plant and equipment		479	1,530	360	1,391
Interest received		613	768	452	453
Dividends received		–	–	23,999	13,299
Acquisition of subsidiaries, net of cash acquired	25	(1,974)	(771)	–	–
Acquisition of property, plant and equipment	11	(13,267)	(7,999)	(9,575)	(5,697)
<b>Net cash flow from investing activities</b>		<b>(14,149)</b>	<b>(6,472)</b>	<b>15,236</b>	<b>9,446</b>
<b>Cash flows from financing activities</b>					
Proceeds from the issue of treasury shares		243	916	243	916
Repayment of borrowings		(223)	(213)	–	–
Dividends paid	23	(12,300)	(11,663)	(12,300)	(11,663)
<b>Net cash flow from financing activities</b>		<b>(12,280)</b>	<b>(10,960)</b>	<b>(12,057)</b>	<b>(10,747)</b>
Net (decrease)/increase in cash and cash equivalents		(2,402)	8,476	3,468	4,842
Cash and cash equivalents at 1 January		49,798	41,494	28,763	23,921
Effect of exchange rate fluctuations on cash held		81	(172)	–	–
<b>Cash and cash equivalents at 31 December</b>	17	<b>47,477</b>	<b>49,798</b>	<b>32,231</b>	<b>28,763</b>

± Restated to reflect the changes for revised IAS 19.

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 7 March 2014.

### 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 company'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 Operating Review on pages 3 to 25.

The financial position of the group, its cash flows, liquidity position and borrowing facilities are described in the Operating Review on pages 20 to 25. In addition, note 24 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. The group's long term banking arrangements run to March 2017, its level of committed funds are £40 million. The group also has short term 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:

## 1 ACCOUNTING POLICIES continued

### *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 occasion 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.

At the latest review, carried out at 31 December 2013, the 2013 carrying value of UK freehold and long leasehold land and buildings would have exceeded market value (on an existing use basis) by £14,737,000. 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 2013 or 2012.

A review of the properties held in continental Europe has resulted in an impairment provision for the group's property held in the Netherlands, see note 4.

### *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. For the year ended 31 December 2013 it was considered necessary to impair the goodwill held for the group's French subsidiary LMS SA, see note 4. No impairment resulted from the annual impairment test for 2013 in the UK.

### *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.

### *Inventory*

Inventories are valued at the lower of cost and net realisable value. Provision is calculated based on the ageing profile and consideration of inventory sold for less than its carrying value.

### *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 principal assumptions are set out in note 21. 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*

With the exception of the amendments to IAS 19 and IAS 1 as described below, 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 2013.

### *Amendment to IAS 19*

As a result of the amendments to IAS 19, "Employee Benefits", the group has changed its accounting policy with respect to determining the income or expense related to its defined benefit pension plan. The standard prescribes that an interest expense or income is calculated on the net defined benefit liability/(asset) by applying the discount rate to the net defined benefit liability/(asset). This replaces the interest expense on the defined benefit obligation and the expected return on plan assets. The revised standard requires retrospective application, therefore the table overleaf reflects the adjustments made to the comparative amounts for the year to 31 December 2012.

These comprise the reversal of the interest income on pension plan assets at 31 December 2012 of £3,693,000 and the interest expense on the defined benefit obligation £3,628,000 to be replaced by a net interest expense of £545,000. The associated income tax has been restated accordingly.

Actuarial losses recognised in the Consolidated Statement of Comprehensive Income of £5,595,000 at 31 December 2012 have been restated into a re-measurement loss of £4,985,000 with the associated income tax also restated.

# Notes to the Financial Statements continued

## 1 ACCOUNTING POLICIES continued

	Year ended 31 December 2012 £000
<b>Consolidated Income Statement</b>	
Decrease in finance income	(3,693)
Decrease in finance expense	3,083
Decrease in income tax expense	153
<b>Decrease in profit for the period</b>	<b>(457)</b>
Decrease in basic and diluted earnings per share	(0.5p)
	£000
<b>Consolidated Statement of Comprehensive Income</b>	
Other comprehensive income:	
Decrease in re-measurement of defined benefit plans	610
Decrease in income tax on other comprehensive income	(153)
<b>Increase in other comprehensive income</b>	<b>457</b>

The impact on the current year Consolidated Income Statement and Consolidated Statement of Comprehensive Income would not be materially different from that in the prior year as set out above.

The revised standard stipulates that remeasurement gains and losses are recognised immediately in the periods in which they occur. The group already adopted this policy and therefore there are no changes to the Consolidated Statement of Financial Position and Consolidated Cash Flow Statement.

### Amendment to IAS 1

IAS 1, "Presentation of Items of Other Comprehensive Income" increases the required level of disclosure within the statement of comprehensive income. The amendment requires items within the statement of comprehensive income to be analysed between items that will not be reclassified subsequently to profit or loss and items that may be reclassified subsequently to profit or loss in accordance with the respective IFRS to which the item relates. The amendment has been applied retrospectively and hence the presentation of items in the statement of comprehensive income has been restated to reflect the change. The amendment to IAS 1 has had no impact on profit, earnings per share or net assets in the year ended 31 December 2013

### (d) IFRS not yet applied

The following standards and interpretations, which were not effective as at 31 December 2013 and have not been early adopted by the group, will be adopted in future accounting periods:

- International Financial Reporting Standard (IFRS) 9 "Financial instruments"
- 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".

None of the standards above are expected to have a material impact on the group.

### 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.

### 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.



## 1 ACCOUNTING POLICIES *continued*

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 24 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 market price at the Statement of Financial Position date, being the present value of the 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. Self-constructed assets begin to be depreciated from the date they become available for 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.

## 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.

# Notes to the Financial Statements continued

## 1 ACCOUNTING POLICIES continued

### *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.

### *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.

## 1 ACCOUNTING POLICIES *continued*

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 immediately.

To the extent that any benefits vest immediately, the expense is recognised directly 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.

Further details of the share plans are given in the Remuneration Report on pages 60 to 61.

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.

# Notes to the Financial Statements continued

## 1 ACCOUNTING POLICIES continued

### 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 group determines the net interest expense on the net defined benefit liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then net defined benefit liability, taking into account any changes in the net defined benefit liability during the period as a result of contributions and benefit payments.

### 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.



## 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	
	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000
<b>Revenue</b>						
External revenues	509,340	492,256	93,711	93,728	603,051	585,984
<b>Reportable segment operating profit</b>	<b>26,877</b>	28,275	<b>1,678</b>	2,036	<b>28,555</b>	30,311
Reportable segment assets	233,913	226,595	35,708	39,583	269,621	266,178
Reportable segment liabilities	(148,457)	(137,563)	(15,975)	(15,853)	(164,432)	(153,416)

During the year there are no inter-segment revenues for the reportable segments (2012: £nil).

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

	2013 £000	Restated± 2012 £000
<b>Profit for the year</b>		
Total profit for reportable segments	28,555	30,311
Impairment of intangibles and assets	(5,352)	–
Unallocated expense	(875)	(997)
Operating profit	22,328	29,314
Finance income	629	783
Finance expense	(1,870)	(2,246)
Profit before taxation	21,087	27,851
Taxation	(6,146)	(6,939)
<b>Profit for the year</b>	<b>14,941</b>	20,912

± Restated to reflect the changes for revised IAS 19.

# Notes to the Financial Statements continued

## 2 SEGMENT REPORTING continued

	2013 £000	2012 £000
<b>Assets</b>		
Total assets for reportable segments	269,621	266,178
Unallocated assets:		
Properties, plant and equipment	93,883	87,651
Deferred tax assets	2,388	2,376
Assets held for sale	–	212
Cash and cash equivalents	32,231	28,763
Total assets	398,123	385,180
<b>Liabilities</b>		
Total liabilities for reportable segments	(164,432)	(153,416)
Unallocated liabilities:		
Employee benefits	(15,622)	(17,395)
Other interest-bearing loans and borrowings	(33,457)	(33,584)
Income tax payable	(7,022)	(7,117)
Derivative liabilities	(87)	(339)
Total liabilities	(220,620)	(211,851)

	UK £000	Continental Europe £000	Reportable segment total £000	Unallocated £000	Consolidated total £000
<b>Other material items 2013</b>					
Capital expenditure	3,043	649	3,692	9,847	13,539
Depreciation	2,171	666	2,837	1,797	4,634
Amortisation	–	–	–	150	150
Impairment of assets	–	–	–	2,155	2,155
Impairment of intangible assets	–	–	–	3,197	3,197
<b>Other material items 2012</b>					
Capital expenditure	2,008	271	2,279	5,720	7,999
Depreciation	2,193	648	2,841	1,764	4,605
Amortisation	–	–	–	90	90

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.

## 2 SEGMENT REPORTING *continued*

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:

Revenue by principal product group and geographic origin is summarised below:

	UK		Continental Europe		Total	
	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000
<b>Revenue</b>						
Residential	350,020	337,569	47,608	43,959	397,628	381,528
Commercial	159,320	154,687	46,103	49,769	205,423	204,456
	<b>509,340</b>	<b>492,256</b>	<b>93,711</b>	<b>93,728</b>	<b>603,051</b>	<b>585,984</b>

## 3 PROFIT BEFORE TAX

The following are included in profit before tax:

	2013 £000	2012 £000
Depreciation on property, plant and equipment	4,634	4,605
Amortisation of intangible assets	150	90
Impairment of intangible and tangible fixed assets	5,352	–
Profit on sale of property, plant and equipment	(177)	(185)
Operating lease rentals		
Plant and machinery	9,580	9,821
Land and buildings	2,573	1,814

Auditor's remuneration:

	2013 £000	2012 £000
Audit of these financial statements	74	68
Amounts received by the auditors and their associates in respect of:		
Audit of financial statements of subsidiaries of the company	165	155
Other tax advisory services	3	3
All other services	20	14
	<b>262</b>	<b>240</b>

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

# Notes to the Financial Statements continued

## 4 NON-UNDERLYING ITEMS

Non-underlying items charged through administrative expenses comprise:

	2013 £000	2012 £000
Impairment of property held in fixed assets	2,155	–
Impairment of goodwill held in intangible assets	3,197	–
	<b>5,352</b>	–

The group presents underlying measures of performance in order to better reflect the financial performance of the group over time.

### *Impairment of property, plant and equipment*

In the Netherlands, management obtain an annual market value of the property for local rates purposes. The latest valuation obtained indicated the carrying value of the property exceeded its market value. Management considered this to represent an indicator of impairment and therefore performed an impairment review to establish the value in use for the Dutch cash-generating unit ("CGU") which represents an operating segment. The future cash flows used in the value in use calculation were based on forecast operating results per the 2014 approved business plan with a growth rate assumption of 2.5% over a period of five years. These were discounted at a pre-tax discount rate of 13.3%.

The outcome of the impairment review concluded that the carrying value of the assets of the Dutch CGU were less than their recoverable amount by £2,155,000 which was not less than the amount by which the market value of the property exceeded its carrying value. This is a reflection of the ongoing challenging market conditions in the Netherlands. As a consequence, a £2,155,000 impairment loss has been recognised in the income statement during the year and disclosed as a non-underlying item. Non-underlying items are not attributable to reportable segments. If they were, the impairment would be attributable to the continental Europe segment.

### *Impairment of goodwill*

In line with the requirements of IAS 36, impairment reviews are required to be completed annually for CGUs to which goodwill is allocated. In performing these impairment reviews management assesses the value in use for each CGU based on actual reported results for 2013 with a growth rate assumption of 0% over a period of five years. These were discounted at a pre-tax discount rate of 13.3%.

The outcome of the impairment review concluded that the carrying value of the assets of the LMS CGU in France, which represents an operating segment, were less than their recoverable amount by £3,197,000, equivalent to the goodwill attributed to the CGU. This is a reflection of the ongoing challenging market conditions in France. As a consequence, a £3,197,000 impairment loss has been recognised in the income statement during the year and disclosed as a non-underlying item. Non-underlying items are not attributable to reportable segments. If they were, the impairment would be attributable to the continental Europe segment.



## 5 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	
	2013	2012
By sector:		
Floorcoverings	2,172	2,098
Central operations	9	9
	<b>2,181</b>	<b>2,107</b>
By function:		
Sales and distribution	2,014	1,947
Administration	167	160
	<b>2,181</b>	<b>2,107</b>

The aggregate payroll costs were as follows:

	£000	£000
Wages and salaries	68,729	67,188
Equity settled share-based payment expense	288	1,183
Social security costs	8,947	8,805
Pension costs ( <i>note 21</i> )	4,737	3,663
	<b>82,701</b>	<b>80,839</b>

## 6 EMOLUMENTS OF KEY MANAGEMENT PERSONNEL

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

	2013 £000	2012 £000
Short term employee benefits	1,830	2,137
Equity settled share-based payment expense	–	312
	<b>1,830</b>	<b>2,449</b>

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

# Notes to the Financial Statements continued

## 7 FINANCE INCOME AND EXPENSE

	2013 £000	Restated± 2012 £000
Interest income:		
Bank interest	629	783
Finance income	629	783
Interest expense:		
Bank loans, overdrafts and other financial expenses	(1,044)	(1,490)
Net change in fair value of cash flow hedges transferred from equity	(137)	(44)
Net interest on defined benefit plan obligation	(578)	(545)
Other	(111)	(167)
Finance expenses	(1,870)	(2,246)

± Restated to reflect the changes for revised IAS 19.

During the year interest costs of £273,000 were capitalised as assets in the course of construction. The amount capitalised was determined by applying the group's UK borrowing rate to the expenditure incurred on assets under construction. Tax relief on capitalised borrowing costs for the year amounted to £64,000.

## 8 TAXATION

### Recognised in the income statement

	2013 £000	Restated± 2012 £000
Current tax expense:		
Current year	6,151	6,806
Adjustments for prior years	100	253
	6,251	7,059
Deferred tax expense:		
Origination and reversal of temporary differences	152	377
Effect of change in UK tax rate	(159)	(126)
Adjustments for prior years	(98)	(371)
	(105)	(120)
Total tax in income statement	6,146	6,939

± Restated to reflect the changes for revised IAS 19.

## 8 TAXATION continued

	2013 £000	Restated± 2012 £000
<b>Tax relating to items (charged)/credited to equity</b>		
Current tax on:		
Income and expenses recognised directly in equity	(4)	8
Deferred tax on:		
Share options	497	134
Deferred tax on other comprehensive income:		
Defined benefit plans	(529)	928
Cash flow hedge	(61)	78
<b>Total tax reported directly in reserves</b>	<b>(97)</b>	<b>1,014</b>

± Restated to reflect the changes for revised IAS 19.

### Factors that may affect future current and total tax charges

Reductions in the UK corporation tax rate from 26% to 24% (effective from 1 April 2012) and to 23% (effective 1 April 2013) were substantively enacted on 26 March 2012 and 3 July 2012 respectively. Further reductions to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the company's future current tax charge accordingly. The deferred tax asset at 31 December 2013 has been calculated based on the rates of 20% and 21% substantively enacted at the balance sheet date.

### Reconciliation of effective tax rate

	2013		Restated± 2012	
	%	£000	%	£000
Profit before tax		21,087		27,851
Add back non-underlying items*		5,352		–
Underlying profit before tax		26,439		27,851
Tax using the UK corporation tax rate	23.2	6,146	24.5	6,819
Effect of change in UK tax rate	(0.8)	(161)	(0.4)	(118)
Profit on sale of non-qualifying fixed assets	(0.1)	(26)	(0.2)	(68)
Non-deductible expenses	0.8	167	1.5	427
Effect of tax rates in foreign jurisdictions	0.1	18	(0.1)	(4)
Over provided in prior years	0.0	2	(0.4)	(117)
<b>Total tax in income statement on underlying items</b>	<b>23.2</b>	<b>6,146</b>	<b>24.9</b>	<b>6,939</b>

± Restated to reflect the changes for revised IAS 19.

\* Non-underlying items were non-deductible for tax.

## 9 CURRENT TAX LIABILITIES

The group's current tax liability of £7,022,000 (2012: £7,117,000) 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 £3,508,000 (2012: £2,988,000) represents the amount of income tax payable in respect of current and prior year periods which exceed any amounts recoverable.

# Notes to the Financial Statements continued

## 10 EARNINGS PER SHARE

	2013 £000	Restated± 2012 £000
<b>Earnings</b>		
Earnings for underlying basic and underlying diluted earnings per share	<b>20,293</b>	–
Earnings for basic and diluted earnings per share	<b>14,941</b>	20,912
	2013	2012
<b>Number of shares</b>		
Issued ordinary shares at 31 December	<b>85,363,743</b>	85,363,743
Effect of shares held in treasury	<b>(2,383,937)</b>	(2,672,553)
Weighted average number of ordinary shares for the purposes of basic earnings per share	<b>82,979,806</b>	82,691,190
Effect of diluted potential ordinary shares:		
Weighted average number of ordinary shares at 31 December	<b>82,979,806</b>	82,691,190
Dilutive effect of share options	<b>646,209</b>	446,420
Weighted average number of ordinary shares for the purposes of diluted earnings per share	<b>83,626,015</b>	83,137,610

At 31 December 2013, the company held 2,337,520 (2012: 2,427,794) shares which have been disclosed in the treasury reserve and these are excluded from the calculation of earnings per share.

± Restated to reflect the changes for revised IAS 19.



## 11 PROPERTY, PLANT AND EQUIPMENT

Group	Land and buildings £000	Plant and equipment £000	Under construction £000	Total £000
<b>Cost</b>				
Balance at 1 January 2012	100,358	27,660	112	128,130
Acquisition	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
Balance at 1 January 2013	<b>99,754</b>	<b>28,281</b>	<b>4,756</b>	<b>132,791</b>
Acquisitions	–	39	–	39
Additions	408	3,411	9,720	13,539
Disposals	–	(953)	–	(953)
Effect of movements in foreign exchange	215	150	–	365
<b>Balance at 31 December 2013</b>	<b>100,377</b>	<b>30,928</b>	<b>14,476</b>	<b>145,781</b>
<b>Depreciation and impairment</b>				
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
Balance at 1 January 2013	<b>17,131</b>	<b>19,478</b>	<b>–</b>	<b>36,609</b>
Depreciation charge for the year	1,761	2,873	–	4,634
Disposals	–	(864)	–	(864)
Impairment (note 4)	(2,155)	–	–	(2,155)
Effect of movements in foreign exchange	60	108	–	168
<b>Balance at 31 December 2013</b>	<b>21,107</b>	<b>21,595</b>	<b>–</b>	<b>42,702</b>
<b>Net book value</b>				
At 1 January 2012	84,458	9,631	112	94,201
At 31 December 2012 and 1 January 2013	82,623	8,803	4,756	96,182
<b>At 31 December 2013</b>	<b>79,270</b>	<b>9,333</b>	<b>14,476</b>	<b>103,079</b>

At 31 December 2013 the cost less accumulated depreciation of long leasehold property held by the group was £8,152,000 (2012: £8,332,000).

# Notes to the Financial Statements continued

## 11 PROPERTY, PLANT AND EQUIPMENT continued

Company	Land and buildings £000	Plant and equipment £000	Under construction £000	Total £000
<b>Cost</b>				
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
Balance at 1 January 2013	<b>86,950</b>	<b>169</b>	<b>4,756</b>	<b>91,875</b>
Additions	10	117	9,720	9,847
Disposals	–	(115)	–	(115)
<b>Balance at 31 December 2013</b>	<b>86,960</b>	<b>171</b>	<b>14,476</b>	<b>101,607</b>
<b>Depreciation</b>				
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
Balance at 1 January 2013	<b>12,090</b>	<b>113</b>	<b>–</b>	<b>12,203</b>
Depreciation charge for the year	<b>1,423</b>	<b>35</b>	<b>–</b>	<b>1,458</b>
Disposals	–	(115)	–	(115)
<b>Balance at 31 December 2013</b>	<b>13,513</b>	<b>33</b>	<b>–</b>	<b>13,546</b>
<b>Net book value</b>				
At 1 January 2012	76,381	58	112	76,551
At 31 December 2012 and 1 January 2013	74,860	56	4,756	79,672
<b>At 31 December 2013</b>	<b>73,447</b>	<b>138</b>	<b>14,476</b>	<b>88,061</b>

At 31 December 2013 the cost less accumulated depreciation of long leasehold property held by the company was £8,152,000 (2012: £8,332,000).

## 12 INTANGIBLE ASSETS – GROUP

	Goodwill £000	Customer lists £000	Total £000
<b>Cost</b>			
Balance at 1 January 2012	13,210	4,142	17,352
Addition (note 25)	–	90	90
Balance at 31 December 2012	13,210	4,232	17,442
Balance at 1 January 2013	<b>13,210</b>	<b>4,232</b>	<b>17,442</b>
Addition (note 25)	–	150	150
<b>Balance at 31 December 2013</b>	<b>13,210</b>	<b>4,382</b>	<b>17,592</b>
<b>Amortisation</b>			
Balance at 1 January 2012	–	4,142	4,142
Charge for the year	–	90	90
Balance at 31 December 2012	–	4,232	4,232
Balance at 1 January 2013	–	<b>4,232</b>	<b>4,232</b>
Charge for the year	–	150	150
Impairment	<b>3,197</b>	–	<b>3,197</b>
<b>Balance at 31 December 2013</b>	<b>3,197</b>	<b>4,382</b>	<b>7,579</b>
<b>Net book value</b>			
At 1 January 2012 and 31 December 2012	13,210	–	13,210
<b>At 1 January 2013 and 31 December 2013</b>	<b>10,013</b>	<b>–</b>	<b>10,013</b>

Cumulative impairment losses recognised in relation to goodwill is £3,197,000 (2012: £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	2013 £000	2012 £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
Other	UK	954	954
		<b>10,013</b>	<b>13,210</b>

# Notes to the Financial Statements continued

## 12 INTANGIBLE ASSETS – GROUP continued

### 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, this resulted in an impairment charge on goodwill attributable to the LMS CGU, see note 4.

Value in use was determined by discounting the future cash flows generated from the continuing use of the CGU on a basis consistent with 2012, and applying the following key assumptions.

### Key assumptions

Cash flows were projected based on actual operating results, the approved 2014 business plan and management's assessment of planned performance in the period to 2018. For the purpose of impairment testing the cash flows were assumed to grow into perpetuity at a rate of 2.5% beyond 2018.

The main assumptions within the operating cash flows used for 2014 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 11.6% (2012: 12.3%) has been used for impairment testing, adjusted to 13.3% (2012: 14.1%) 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 2018.

With the exception of the goodwill attributed to the LMS CGU which was impaired during the year, see note 4, 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 which the group consider to be reasonable possible changes, would result in any impairment.

### 13 INVESTMENTS IN SUBSIDIARIES

Summary information on investments in subsidiary undertakings is as follows:

	£000
<b>Cost</b>	
Balance at 1 January 2012	87,341
Share options granted to employees of subsidiary undertakings	795
Balance at 31 December 2012	88,136
Balance at 1 January 2013	<b>88,136</b>
Share options granted to employees of subsidiary undertakings	<b>295</b>
<b>Balance at 31 December 2013</b>	<b>88,431</b>
<b>Carrying value</b>	
At 1 January 2012	87,341
At 31 December 2012	88,136
<b>At 31 December 2013</b>	<b>88,431</b>

The principal trading subsidiaries are listed on page 129. There were no impairments recognised on the company's investments in subsidiaries at the year ended 31 December 2013.



# Notes to the Financial Statements continued

## 14 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	
	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000
Property, plant and equipment	–	–	(2,166)	(2,661)	(2,166)	(2,661)
Intangible assets	–	–	(194)	(209)	(194)	(209)
Employee benefits	4,262	4,680	–	–	4,262	4,680
Hedging	17	78	–	–	17	78
Other items	469	488	–	–	469	488
Tax assets/(liabilities)	4,748	5,246	(2,360)	(2,870)	2,388	2,376
Set-off of tax	(2,360)	(2,870)	2,360	2,870	–	–
	2,388	2,376	–	–	2,388	2,376

### Movement in deferred tax during the year

	1 January 2013 £000	Recognised in income £000	Recognised in equity £000	31 December 2013 £000
Property, plant and equipment	(2,661)	495	–	(2,166)
Intangible assets	(209)	15	–	(194)
Employee benefits	4,680	(386)	(32)	4,262
Hedging	78	–	(61)	17
Other items	488	(19)	–	469
	2,376	105	(93)	2,388

### Movement in deferred tax during the prior year

	1 January 2012 £000	Recognised in 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

### Unrecognised deferred tax assets and liabilities

At the Statement of Financial Position date the group has unused capital losses of £10,055,000 (2012: £10,055,000) 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.

## 14 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	
	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000
Property, plant and equipment	–	–	(2,187)	(2,571)	(2,187)	(2,571)
Employee benefits	3,076	3,621	–	–	3,076	3,621
Hedging	17	78	–	–	17	78
Other items	145	166	–	–	145	166
Tax assets/(liabilities)	3,238	3,865	(2,187)	(2,571)	1,051	1,294
Set-off of tax	(2,187)	(2,571)	2,187	2,571	–	–
	1,051	1,294	–	–	1,051	1,294

### Movement in deferred tax during the year

	1 January 2013 £000	Recognised in income £000	Recognised in equity £000	31 December 2013 £000
Property, plant and equipment	(2,571)	384	–	(2,187)
Employee benefits	3,621	(331)	(214)	3,076
Hedging	78	–	(61)	17
Other items	166	(21)	–	145
	1,294	32	(275)	1,051

### Movement in deferred tax during the prior 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

### Unrecognised deferred tax assets and liabilities

At the Statement of Financial Position date the company has unused capital losses of £10,055,000 (2012: £10,055,000) 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

## 15 INVENTORIES

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Goods for resale	<b>115,678</b>	115,332	–	–

Cost of sales consists of the following:

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Material cost	<b>416,723</b>	407,223	–	–
Processing cost	<b>5,073</b>	3,028	–	–
	<b>421,796</b>	410,251	–	–

## 16 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Trade receivables	<b>92,614</b>	85,378	–	–
Prepayments and accrued income	<b>3,636</b>	3,425	<b>32</b>	47
Other receivables	<b>23,238</b>	19,267	<b>645</b>	177
Amounts due from subsidiary undertakings	–	–	<b>14,775</b>	14,897
	<b>119,488</b>	108,070	<b>15,452</b>	15,121

£1,516,000 (2012: £1,993,000) 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:

	2013 £000	2012 £000
UK	<b>1,175</b>	1,651
Continental Europe	<b>341</b>	342
	<b>1,516</b>	1,993

## 17 CASH, CASH EQUIVALENTS AND BANK OVERDRAFTS

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Cash and cash equivalents per Statement of Financial Position	47,477	49,798	32,231	28,763

## 18 ASSETS HELD FOR SALE

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Assets classified as held for sale:				
Property, plant and equipment	–	212	–	212

At 31 December 2013 there were no properties classified as held for sale. At 31 December 2012 the company held a freehold property in the West Midlands, UK that was being actively marketed for sale; this was later sold in April 2013 for £330,000.

## 19 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 24.

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
<b>Current liabilities</b>				
Interest-bearing loan	218	213	–	–
	218	213	–	–
<b>Non-current liabilities</b>				
Interest-bearing loans	33,239	33,371	30,000	30,000
	33,239	33,371	30,000	30,000

The group has undrawn borrowing facilities expiring in one year or less which, at 31 December 2013, amounted to £53,386,000 (2012: £53,294,000). 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 %	2013 £000	Interest rate %	2012 £000
	UK	1.92	45,000	2.04
Netherlands	1.72	1,248	1.61	1,217
France	0.97	3,744	0.86	3,650
Switzerland	1.50	3,394	1.50	3,427
		53,386		53,294

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.

# Notes to the Financial Statements continued

## 20 TRADE AND OTHER PAYABLES

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Trade payables	124,167	116,559	1,205	518
Taxation and social security	14,535	13,796	1,639	1,615
Non-trade payables and accrued expenses	25,608	23,050	4,301	3,579
Amounts due to subsidiary undertakings	–	–	31,884	33,602
Derivative liabilities used for economic hedging:				
Derivatives used for hedging	87	339	87	339
Other derivatives at fair value	122	11	–	–
	<b>164,519</b>	<b>153,755</b>	<b>39,116</b>	<b>39,653</b>

Included within non-trade payables and accrued expenses is an amount of £43,000 for accrued interest on unsecured bank loans (2012: £44,000).

The group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 24.

## 21 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.

### UK defined benefit plan

The Headlam Group plc Staff Retirement Benefits Scheme is the principal defined benefit plan which provides pensions in retirement and death benefits to members. The majority of members are entitled to receive pensions from age 65, equal to either  $\frac{1}{50}$  or  $\frac{1}{60}$  of final salary for each year of service that the employee provided, depending on which section of the plan the member is part of.

The plan is a registered scheme under UK legislation and is contracted out of the State Second Pension. The plan is legally separated from the company and assets are held independently of the company's finances.

The plan is subject to the scheme funding requirements outlined in UK legislation.

The company has a right to a refund of any surplus in the plan if the plan winds up, after payment of expenses, members benefits and any enhancements to the members' benefits as the Trustee sees fit. In addition, if the assets of the plan exceed the estimate by the actuary of the cost of buying out the benefits of all beneficiaries with an insurance company, including the associated expenses, and the plan is not being wound up, then the company may request a payment of the excess funds. There have been no payments made to the company out of the plan's assets over the year, and so no additional liability has been recognised on the balance sheet.

The plan was established from 11 February 1983 under trust and is governed by the plan's Trust Deed and Rules dated 29 March 2000. The Trustee of the plan comprises two employee representatives and four employer representatives. The Trustee of the plan is required by law to act in the best interests of the plan participants. The Trustee is responsible for the operation and the governance of the plan, including making decisions regarding the plan's funding and investment strategy in conjunction with the company.

The ultimate cost of the plan to the company will depend upon actual future events rather than the assumptions made. Many of the assumptions made are unlikely to be borne out in practice and as such the cost of the plan may be higher (or lower) than disclosed.



## 21 EMPLOYEE BENEFITS *continued*

The plan exposes the company to actuarial risks such as longevity risk, interest rate risk, market (investment) risk and currency risk. The risk to the company is that the assumptions underlying the disclosures, or the calculation of contribution requirements are not borne out in practice and the cost to the company is higher than expected. This could result in higher contributions required from the company and a higher deficit disclosed. More specifically, the assumptions not being borne out in practice could include:

- The return on the plan assets being lower than assumed, resulting in an unaffordable increase in the required company contribution rate.
- Falls in asset values not being matched by similar falls in the value of liabilities.
- Inflation being higher than that assumed, resulting in an increase in the value of the members' benefits and therefore a higher cost to the plan.
- Unanticipated future changes in mortality patterns leading to an increase in the plan's liabilities. Future mortality rates cannot be predicted with certainty.
- The potential exercise of options against the plan, for example taking early retirement or exchanging a portion of pension for a cash lump sum.

There have been no amendments, curtailments or settlements made to the plan during 2013.

The plan's investment strategy is to invest broadly 90% in return seeking assets and 10% in matching assets, mainly government bonds. This strategy reflects the plan's liability profile and the Trustee's and company's attitude to risk. The matching fund seeks to match the return achieved on the liabilities.

The plan's investments include interest rate and inflation hedging.

The plan holds a number of annuity policies which match a portion of the pensions in payment.

The scheme is funded partly by contributions from members and partly by contributions from the company at rates advised by professionally qualified actuaries. The last scheme funding valuation of the plan was as at 31 March 2011 and revealed a funding deficit of £11,543,000. 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.

In the recovery plan dated 29 July 2011 the company has agreed to pay contributions of £231,286 per month as at 31 December 2013, increasing by 3.2% each 1 April, with the view to eliminating the shortfall by 31 December 2015. The next actuarial valuation is due at 31 March 2014 and the opportunity will be used to reassess the recovery plan.

In accordance with the recovery plan, payments were made to the plan during 2013 of £2,747,000. The company is expected to pay contributions of £4,058,000 over the next accounting period. This includes £2,835,000 for payments under the recovery plan and £1,223,000 for the accrual of benefits.

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 £166,000 during 2013 (2012: £177,000).

In addition, the company is expected to meet the cost of administrative expenses and insurance premiums for the plan.

The liabilities of the plan are based on the current value of expected benefit payment cash flows to members of the plan over the next 60 years or more. The weighted average duration of the liabilities is approximately 20 years.

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.

# Notes to the Financial Statements continued

## 21 EMPLOYEE BENEFITS continued

### Swiss defined benefit plan

The plan provides occupational retirement, disability and survivors' benefits. The members are entitled to receive pensions from age 64 (female) or 65 (male), equal to the old age savings balance multiplied with a conversion rate of 6.8% for the mandatory part of the savings balance and 5.85% for the part beyond the mandatory part. The minimum interest rate on old age savings has legally been fixed.

The company is affiliated to the Columna Collective Foundation Client Invest. The plan is legally separated from the company. The executive body of the collective foundation is the board of trustees, which is elected directly by the insured of the affiliated companies/occupational benefits funds and functions independently of AXA. Its members include employer and employee representatives from a wide range of occupations and companies of different sizes. The board of trustees' responsibilities include, among other things, supervising compliance with legal provisions and issuing the regulations that govern the various activities. The company elects a occupational benefits fund commission (OBC). The Foundation was established on March 20, 1974 by Credit Suisse Ltd.

The collective foundation is reinsured for risk benefits with AXA Winterthur Life insurance company.

The plan exposes the company to the market (investment) risk. The risk to the company is that return on assets may be lower than legally required. This could result in higher contributions required from the company and a higher deficit disclosed.

There have been no amendments, curtailments or settlements made to the plan during 2013.

The occupational benefits fund commission (OBC) defines the investment strategy; the affiliated occupational benefits fund itself bears the investment risk. The investments are managed with Credit Suisse.

The last (provisional) scheme funding valuation of the plan was as at 31 December 2013 and revealed cover ratio of 115.41% (overfunding). This overfunding is appropriate to Swiss legislation and cannot be considered in the context of IAS 19. According to Swiss rules there is no need to evaluate the scheme using assumptions for future changes of salary increase, benefit increase, inflation.

The last IAS 19 valuation at year-end 2013 revealed a funding deficit of £1,415,000. The group is expected to pay £496,000 for future service costs over the next accounting period.

The liabilities of the plan are based on the current value of expected benefit payment cash flows to members of the plan over the next 50 years or more. The weighted average duration of the liabilities is approximately 14 years.

### Defined benefit obligation

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	
	2013 £000	2012 £000	2013 £000	2012 £000
Present value of funded defined benefit obligations	(97,085)	(93,499)	(87,111)	(82,735)
Fair value of plan assets	82,263	76,388	73,704	67,391
Net obligations	(14,822)	(17,111)	(13,407)	(15,344)
Recognised liability for defined benefit obligations	(14,822)	(17,111)	(13,407)	(15,344)
Other long term employee benefits	(800)	(284)	(524)	–
Total employee benefits	(15,622)	(17,395)	(13,931)	(15,344)
Analysed as:				
Current liabilities	(2,842)	(2,754)	(2,842)	(2,754)
Non-current liabilities	(12,780)	(14,641)	(11,089)	(12,590)
Total employee benefits	(15,622)	(17,395)	(13,931)	(15,344)

## 21 EMPLOYEE BENEFITS continued

### Movements in present value of defined benefit obligation

	Group		Company	
	2013 £000	Restated± 2012 £000	2013 £000	Restated± 2012 £000
At 1 January	93,499	84,923	82,735	74,737
Current service cost	1,553	1,546	1,056	1,040
Past service cost	307	–	307	–
Interest cost	3,531	3,628	3,342	3,404
Net remeasurement (gains)/losses – financial	1,285	6,674	1,744	6,004
Net remeasurement (gains)/losses – experience	(216)	(520)	381	19
Benefits paid	(3,384)	(2,925)	(2,652)	(2,681)
Contributions by members	404	412	198	212
Effect of movements in foreign exchange	106	(239)	–	–
At 31 December	97,085	93,499	87,111	82,735

± Restated to reflect the changes for revised IAS 19.

### Movements in fair value of plan assets

	Group		Company	
	2013 £000	Restated± 2012 £000	2013 £000	Restated± 2012 £000
At 1 January	76,388	70,692	67,391	62,202
Interest income on plan assets	2,953	3,083	2,793	2,892
Return on assets, excluding interest income	1,519	1,170	2,032	937
Contributions by employer:				
Future service contributions	1,535	1,297	1,185	971
Past service deficit contributions	2,581	2,662	2,581	2,662
Additional past service deficit contributions	166	177	166	177
Employer augmentations	10	19	10	19
Contributions by members	404	412	198	212
Benefits paid	(3,384)	(2,925)	(2,652)	(2,681)
Effect of movements in foreign exchange	91	(199)	–	–
At 31 December	82,263	76,388	73,704	67,391

± Restated to reflect the changes for revised IAS 19.

The fair value of the plan assets were as follows:

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Equities	35,410	17,158	33,391	15,178
Government debt	8,199	7,668	8,199	7,668
Corporate bonds	23,378	25,142	18,948	20,331
Annuities	4,875	4,951	4,875	4,951
Commodities	1,334	6,297	1,334	6,297
Hedge funds	(185)	7,067	(185)	7,067
Other	9,252	8,105	7,142	5,899
	82,263	76,388	73,704	67,391

# Notes to the Financial Statements continued

## 21 EMPLOYEE BENEFITS continued

Expense recognised in the income statement relating to defined benefit obligation

	Group	Restated±
	2013 £000	2012 £000
Service cost – including current and past service costs	1,860	1,546
Other long term employee benefits	524	–
Net interest on the net defined benefit liability (note 7)	578	545
<b>Total</b>	<b>2,962</b>	<b>2,091</b>

± Restated to reflect the changes for revised IAS 19.

The expense recognised in the following line items in the Consolidated Income Statement are:

	Group	Restated±
	2013 £000	2012 £000
Administrative expenses	2,384	1,546
Net financing income (note 7)	578	545
<b>Total</b>	<b>2,962</b>	<b>2,091</b>

± Restated to reflect the changes for revised IAS 19.

Remeasurement of the net defined benefit liability in the Statement of Comprehensive Income:

	Group	Restated±
	2013 £000	2012 £000
Net remeasurement – financial	1,285	6,674
Net remeasurement – experience	(216)	(520)
Return on assets, excluding interest income	(1,519)	(1,170)
<b>Total</b>	<b>(450)</b>	<b>4,984</b>

± Restated to reflect the changes for revised IAS 19.

## 21 EMPLOYEE BENEFITS continued

Principal actuarial assumptions are as follows:

	UK		Swiss	
	2013 %	2012 %	2013 %	2012 %
Discount rate	4.4	4.1	2.0	1.8
Future salary increases	5.0	4.5	2.0	2.0
Future pension increases	3.5	3.0	0.5	0.5
Inflation rate	3.5	3.0	2.0	1.0
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		Company	
	2013	2012	2013	2012
Non-pensioner male	23.7	23.6	23.7	23.6
Pensioner male	22.3	22.2	22.3	22.2
Non-pensioner female	25.6	25.5	25.6	25.5
Pensioner female	24.0	24.0	24.0	24.0

### Company

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

### Sensitivity analysis

The tables below for the UK and Swiss defined benefit plans, show the impact on the defined benefit obligation of changing each of the most significant assumptions in isolation.



# Notes to the Financial Statements continued

## 21 EMPLOYEE BENEFITS continued

### UK defined benefit plan

Effect in £000	Change in assumption	Impact on scheme liabilities 2013		Impact on scheme liabilities 2012	
		Increase	Decrease	Increase	Decrease
Discount rate	0.25% movement	(0.4)	4.3	(3.8)	4.1
Rate of inflation (RPI) *	0.25% movement	3.4	(3.2)	3.2	(3.0)
Salary increases	0.25% movement	0.9	(0.9)	0.9	(0.9)
Assumed life expectancy	one year movement	1.8	(2.1)	1.7	(2.0)

\* With corresponding changes to the salary and pension increase assumptions.

The figures in the table as at 31 December 2013 have been calculated using the same valuation method that was used to calculate the UK defined benefit obligation at the same date. The figures in the table as at 31 December 2012 have been calculated by applying the same percentage increase or decrease as at 31 December 2013.

Extrapolation of the sensitivity analysis beyond the ranges shown may not be appropriate.

### Swiss defined benefit plan

Effect in £000	Change in assumption	Impact on scheme liabilities 2013		Impact on scheme liabilities 2012	
		Increase	Decrease	Increase	Decrease
Discount rate	0.25% movement	(4.3)	4.6	(4.4)	4.3
Rate of inflation (RPI) *	0.25% movement	3.3	(3.1)	3.1	(3.2)
Salary increases	0.25% movement	0.6	(0.6)	0.4	(0.7)
Assumed life expectancy	one year movement	1.4	(1.5)	1.5	(1.7)

The figures in the table as at 31 December 2013 have been calculated using the same valuation method that was used to calculate the Swiss defined benefit obligation at the same date. The figures in the table as at 31 December 2012 have been calculated by applying the same percentage increase or decrease as at 31 December 2013.

Extrapolation of the sensitivity analysis beyond the ranges shown may not be appropriate.

### History of plans

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

#### Statement of Financial Position

Group	2013 £000	2012 £000	2011 £000	2010 £000	2009 £000
Present value of defined benefit obligation	(97,085)	(93,499)	(84,923)	(80,889)	(88,253)
Fair value of plan assets	82,263	76,388	70,692	68,451	65,803
Deficit	(14,822)	(17,111)	(14,231)	(12,438)	(22,450)

Company	2013 £000	2012 £000	2011 £000	2010 £000	2009 £000
Present value of defined benefit obligation	(87,111)	(82,735)	(74,737)	(71,713)	(81,412)
Fair value of plan assets	73,704	67,391	62,202	60,382	59,583
Deficit	(13,407)	(15,344)	(12,535)	(11,331)	(21,829)

## 21 EMPLOYEE BENEFITS *continued*

At 31 December 2013, the group had other long term employee benefits of £800,000 (2012: £284,000). During the year, the group provided for equalisation costs on the UK defined benefit plan of £524,000. 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 2013 is £276,000 (2012: £284,000).

### Total group pension costs

Included within the total staff costs as disclosed in note 5 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 £2,362,000 (2012: £2,117,000). Contributions amounting to £156,000 (2012: £143,000) in respect of December 2013 payroll were paid in January 2014.

The total group cost of operating the plans during the year was £4,737,000 (2012: £3,663,000) and, at 31 December 2013, there was an amount of £301,000 (2012: £286,000) owed to the plans, being employer and employee contributions due for December 2013, which was paid in January 2014.

## 22 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 10 May 2013 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 60 and 61.

# Notes to the Financial Statements continued

## 22 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		Vesting conditions	Contractual life of options
	2013	2012		
Approved 1998 scheme granted to key management 14 April 2003	–	5,000	Movement of the group's basic earnings per share exceeding RPI over the relevant period	14/04/06 – 14/04/13
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 8 May 2008	750	36,168	Continuous service	01/07/13 – 01/01/14
Three-year Sharesave scheme granted to other employees 19 May 2009	–	164	Continuous service	01/07/12 – 01/01/13
Five-year Sharesave scheme granted to other employees 19 May 2009	341,849	344,666	Continuous service	01/07/14 – 01/01/15
Three-year Sharesave scheme granted to other employees 21 May 2010	–	48,715	Continuous service	01/07/13 – 01/01/14
Five-year Sharesave scheme granted to other employees 21 May 2010	61,327	61,327	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	83,154	87,259	Continuous service	01/07/14 – 01/01/15
Five-year Sharesave scheme granted to other employees 11 May 2011	52,790	61,066	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	324,434	364,855	Continuous service	01/07/15 – 01/01/16
Five-year Sharesave scheme granted to other employees 11 May 2012	59,105	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	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
Three-year Sharesave scheme granted to other employees 10 May 2013	146,514	–	Continuous service	01/07/16 – 01/01/17
Five-year Sharesave scheme granted to other employees 10 May 2013	59,645	–	Continuous service	01/07/18 – 01/01/19
Total share options	2,532,846	2,491,770		

\* Further details are provided on pages 60 and 61 of the Remuneration Report.

## 22 SHARE-BASED PAYMENTS continued

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

	Weighted average exercise price 2013	Number of options 2013	Weighted average exercise price 2012	Number of options 2012
Outstanding at the beginning of the year	113.4	2,491,770	245.0	3,446,680
Exercised during the year	269.22	(90,274)	221.6	(413,403)
Granted during the year	274.0	216,531	121.8	903,291
Lapsed during the year	243.1	(85,181)	401.8	(1,444,798)
Outstanding at the end of the year	117.2	2,532,846	113.4	2,491,770
Exercisable at the end of the year	418.5	57,886	403.0	62,300

The weighted average share price for options exercised during the year was 367.7p (2012: 284.3p).

The options outstanding at the year end have an exercise price in the range of 0.0p to 420.0p and a weighted average contractual life of 1.7 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 2013 are shown below:

2013	Three-year Sharesave scheme	Five-year Sharesave scheme
Number of options	153,341	63,190
Fair value at measurement date:		
No performance conditions	69.5p	71.8p
Share price at 31 December	405.5p	405.5p
Exercise price	274.0p	274.0p
Expected volatility	29.5%pa	32.9%pa
Option life	three years	five years
Dividend yield	4.3%pa	4.3%pa
Risk-free rate of interest	0.5%pa	1.0%pa

# Notes to the Financial Statements continued

## 22 SHARE-BASED PAYMENTS continued

Details of share options granted during 2012 are shown below:

2012	Three-year Co-Investment Plan 2008	Three-year Sharesave scheme	Five-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%	–	–
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	three years	three years	five 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

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

	Group		Company		Subsidiaries	
	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000
Share options granted in 2008 under the SAYE five-year scheme	48	63	–	–	48	63
Share options granted in 2009 under the SAYE three-year scheme	–	54	–	–	–	54
Share options granted in 2009 under the SAYE five-year scheme	33	33	1	1	32	32
Share options granted in 2010 under the SAYE three-year scheme	10	27	–	–	10	27
Share options granted in 2010 under the SAYE five-year scheme	14	14	–	–	14	14
Headlam Group Co-Investment Plan 2008 (awarded 2010)	319	414	136	177	183	237
Share options granted in 2011 under the SAYE three-year scheme	41	41	–	–	41	41
Share options granted in 2011 under the SAYE five-year scheme	17	17	–	2	17	15
Headlam Group Co-Investment Plan 2008 (awarded 2011)	(286)	323	(133)	151	(153)	172
Share options granted in 2012 under the SAYE three-year scheme	87	56	2	1	85	55
Share options granted in 2012 under the SAYE five-year scheme	14	9	–	–	14	9
Headlam Group Co-Investment Plan 2008 (awarded 2012)	(32)	132	(13)	56	(19)	76
Share options granted in 2013 under the SAYE three-year scheme	18	–	–	–	18	–
Share options granted in 2013 under the SAYE five-year scheme	5	–	–	–	5	–
Total expense recognised	288	1,183	(7)	388	295	795



## 23 CAPITAL AND RESERVES

### Share capital

	Ordinary shares	
	2013	2012
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
	2013 £000	2012 £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 2013, the company held 2,337,520 (2012: 2,427,794) 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 2.7% (2012: 2.8%) of the issued share capital with a nominal value of £116,876 (2012: £121,390).

In the period from 31 December 2013 to 7 March 2014 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

	2013 £000	2012 £000
Interim dividend for 2012 of 4.65p paid 2 January 2013	3,850	–
Final dividend for 2012 of 10.20p paid 1 July 2013	8,450	–
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
	12,300	11,663

The final proposed dividend of 10.65p per share (2012: 10.20p per share) will not be provided for until authorised by shareholders at the forthcoming AGM. There are no income tax consequences.

Interim dividends of 4.65p per share (2012: 4.65p per share) are provided for when the dividend is paid. The dividend was paid on 2 January 2014 and totalled £3,856,000.

The total value of dividends proposed but not recognised at 31 December 2013 is £12,688,000 (2012: £12,300,000).

#### 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.

##### Capital redemption reserve

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

# Notes to the Financial Statements continued

## 23 CAPITAL AND RESERVES continued

### Translation reserve

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

### Cash flow hedging reserve

The 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 comprises 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.

## 24 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.

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

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Trade and other receivables (note 16)	115,852	104,645	15,420	15,074
Cash and cash equivalents (note 17)	47,477	49,798	32,231	28,763
	<b>163,329</b>	154,443	<b>47,651</b>	43,837

The fair values of the above financial assets at both 31 December 2013 and 2012, are deemed to approximate to carrying value due to the short term maturity of the instruments.

## 24 FINANCIAL INSTRUMENTS continued

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

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
UK	80,613	73,373	–	–
Continental Europe	12,001	12,005	–	–
	<b>92,614</b>	<b>85,378</b>	<b>–</b>	<b>–</b>

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

Group	2013		2012	
	Gross £000	Impairment £000	Gross £000	Impairment £000
Not past due	84,662	–	80,531	–
Past due 0–30 days	6,256	(487)	4,334	(156)
Past due 31–120 days	4,182	(1,999)	3,167	(2,498)
	<b>95,100</b>	<b>(2,486)</b>	<b>88,032</b>	<b>(2,654)</b>

All other receivables and derivative financial assets are not past due (2012: not past due).

The company had trade receivables of £nil (2012:£nil).

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

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Balance at 1 January	2,654	3,031	–	–
Amounts provided	1,516	1,993	–	–
Amounts utilised	(1,704)	(2,348)	–	–
Effect of movements in foreign exchange	20	(22)	–	–
Balance at 31 December	<b>2,486</b>	<b>2,654</b>	<b>–</b>	<b>–</b>

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 0.25% (2012: 0.34%).

### 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 2013 cash and cash equivalents covered the amounts of borrowings maturing in the next 12 months with a net positive liquidity of £47,259,000 (2012: £49,585,000). Details of the total facilities that the group has access to are given in note 19.

# Notes to the Financial Statements continued

## 24 FINANCIAL INSTRUMENTS continued

The following are the contractual maturities of financial liabilities:

31 December 2013 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
<b>Non-derivative financial liabilities</b>						
Unsecured bank loans	33,457	(36,305)	(1,080)	(1,076)	(31,740)	(2,409)
Trade and other payables	149,775	(149,775)	(149,775)	–	–	–
<b>Derivative financial liabilities</b>						
Interest rate swaps used for hedging	87	(87)	(88)	(12)	13	–
Forward exchange contracts used for hedging	122	(122)	(122)	–	–	–
	<b>183,441</b>	<b>(186,289)</b>	<b>(151,065)</b>	<b>(1,088)</b>	<b>(31,727)</b>	<b>(2,409)</b>

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
<b>Non-derivative financial liabilities</b>						
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)	–	–	–
<b>Derivative financial liabilities</b>						
Interest rate swaps used for hedging	339	(339)	(129)	(122)	(88)	–
Forward exchange contracts used for hedging	11	(11)	(11)	–	–	–
	<b>173,543</b>	<b>(177,255)</b>	<b>(140,827)</b>	<b>(1,197)</b>	<b>(32,622)</b>	<b>(2,608)</b>

31 December 2013 Company	Carrying amount £000	Contractual cash flows £000	1 year or less £000	1-2 years £000	2-5 years £000
<b>Non-derivative financial liabilities</b>					
Unsecured bank loans	30,000	(32,527)	(798)	(798)	(30,931)
Trade and other payables	37,390	(37,390)	(37,390)	–	–
<b>Derivative financial liabilities</b>					
Interest rate swaps used for hedging	87	(87)	(88)	(12)	13
	<b>67,477</b>	<b>(70,004)</b>	<b>(38,276)</b>	<b>(810)</b>	<b>(30,918)</b>

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

The value of the group's and company's financial liabilities as detailed above at 31 December 2013 and 2012 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.

## 24 FINANCIAL INSTRUMENTS continued

The table below sets out the group's accounting classification of each class of financial assets and liabilities at 31 December 2013 and 2012.

	Available for sale £000	Other derivatives at fair value £000	Amortised cost £000	Total carrying value £000
<b>31 December 2013</b>				
Cash and cash equivalents	47,477	–	–	47,477
Borrowings due within one year	–	–	(218)	(218)
Borrowings due after one year	–	–	(33,239)	(33,239)
Trade payables	–	–	(124,167)	(124,167)
Non-trade payables	–	–	(25,608)	(25,608)
Trade receivables	–	–	92,614	92,614
Other receivables	–	–	23,238	23,238
Derivative liabilities	–	(209)	–	(209)
	<b>47,477</b>	<b>(209)</b>	<b>(67,380)</b>	<b>(20,112)</b>
<b>31 December 2012</b>				
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)
	<b>49,798</b>	<b>(350)</b>	<b>(68,548)</b>	<b>(19,100)</b>

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 its 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 £87,000 derivative liability (2012: £339,000).



# Notes to the Financial Statements continued

## 24 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	
	2013 £000	2012 £000	2013 £000	2012 £000
<b>Variable rate instruments</b>				
Financial assets	47,477	49,798	32,231	28,763
Financial liabilities	(33,457)	(33,584)	(30,000)	(30,000)
	<b>14,020</b>	<b>16,214</b>	<b>2,231</b>	<b>(1,237)</b>

### 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 2012.

	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
<b>31 December 2013</b>								
Variable rate instruments	140	(140)	–	–	22	(22)	–	–
31 December 2012								
Variable rate instruments	162	(162)	–	–	(12)	12	–	–

### 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 2013 amounted to £122,000 (2012: Liability £11,000).

For the 12-month period to 31 December 2013, 7.3% (2012: 6.9%) of the group's operating profit was derived from overseas subsidiaries and at 31 December 2013, 18.8% (2012: 21.0%) 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.

## 24 FINANCIAL INSTRUMENTS continued

The exposure to foreign currency risk was as follows:

	Group			Company		
	Euro amount £000	Other amount £000	Total £000	Euro amount £000	Other amount £000	Total £000
<b>2013</b>						
Trade and other receivables	140	300	440	76	17	93
Cash and cash equivalents	298	468	766	44	–	44
Trade and other payables	(1,054)	(2,355)	(3,409)	–	–	–
	(616)	(1,587)	(2,203)	120	17	137

	Group			Company		
	Euro amount £000	Other amount £000	Total £000	Euro amount £000	Other amount £000	Total £000
<b>2012</b>						
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

### 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 2012.

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Euro	(62)	(65)	12	12
Other	(159)	(49)	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 2013 (2012: level 2) and forward currency contracts which were fair valued in accordance with level 2 (2012: level 2).

# Notes to the Financial Statements continued

## 24 FINANCIAL INSTRUMENTS continued

### *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.

### *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 primarily 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 2013 and 31 December 2012.

## 25 ACQUISITIONS

On 28 March 2013, a group subsidiary company acquired the trade and assets of Hall's Floorings Limited, a distributor of residential floorcovering, based in Edmonton, north London, and a supplier to independent floorcovering retailers throughout most of England. Cash consideration of £521,000 was paid. Since its acquisition the business has contributed revenue of £5,146,000 and a loss of £24,000 to the consolidated statement of comprehensive income for the year ended 31 December 2013. If the acquisition had occurred on 1 January 2013 group revenue would have been an estimated £610 million and profit after tax would have been an estimated £14.9 million.

On 29 November 2013, a group subsidiary company acquired the trade and assets of Roger Fell Limited (Fells Carpets), a distributor of residential floorcovering throughout the north of England, for a cash consideration of £1,453,000. The primary reason for this acquisition is for the group to enhance its position in the north of England. Since its acquisition the business has contributed revenue of £455,000 and a loss of £27,000 to the consolidated statement of comprehensive income for the year ended 31 December 2013. If the acquisition had occurred on 1 January 2013 group revenue would have been an estimated £609.5 million and profit after tax would have been an estimated £14.9 million.

	Acquiree's book value £000	Fair value adjustments £000	Acquisition amounts £000
<b>Acquiree's net assets at the acquisition date:</b>			
Intangible assets	–	150	150
Property, plant and equipment	39	–	39
Inventories	2,033	–	2,033
Trade and other receivables	1,962	–	1,962
Trade and other payables	(1,990)	–	(1,990)
Restructuring	(220)	–	(220)
Net identifiable assets and liabilities	1,824	150	1,974
Goodwill on acquisition			–
Consideration paid			1,974
Satisfied by:			
Cash			1,974
Analysis of cash flows:			
On completion			1,974
Costs of acquisition			110
			2,084

Professional fees of £110,000 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 represents 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 the trade and assets of Hall's Floorings Limited or Roger Fell 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.

# Notes to the Financial Statements continued

## 25 ACQUISITIONS continued

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.

	Acquiree's book value £000	Fair value adjustments £000	Acquisition amounts £000
<b>Acquiree's net assets at the acquisition date:</b>			
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.



## 26 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	2013			2012		
	Land and buildings £000	Plant and machinery £000	Total £000	Land and buildings £000	Plant and machinery £000	Total £000
Less than one year	1,695	9,405	11,100	1,989	8,748	10,737
Between one and five years	3,285	17,692	20,977	4,152	15,650	19,802
More than five years	2,275	–	2,275	2,628	–	2,628
	<b>7,255</b>	<b>27,097</b>	<b>34,352</b>	<b>8,769</b>	<b>24,398</b>	<b>33,167</b>

Company	2013			2012		
	Land and buildings £000	Plant and machinery £000	Total £000	Land and buildings £000	Plant and machinery £000	Total £000
Less than one year	39	7	46	77	7	84
Between one and five years	105	2	107	105	10	115
More than five years	1,907	–	1,907	1,933	–	1,933
	<b>2,051</b>	<b>9</b>	<b>2,060</b>	<b>2,115</b>	<b>17</b>	<b>2,132</b>

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 2013, total operating lease expense of £12,153,000 was recognised in the Consolidated Income Statement (2012: £11,635,000).

## 27 CAPITAL COMMITMENTS

### Group

During the year ended 31 December 2013, the group entered into commitments to purchase property, plant and equipment for £2,261,000 (2012: £11,268,000). These commitments are expected to be settled in the following financial year.

### Company

During the year ended 31 December 2013, the company entered into commitments to purchase property, plant and equipment for £2,014,000 (2012: £10,902,000). This commitment is expected to be settled in the following financial year.

# Notes to the Financial Statements continued

## 28 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 34.

As at 31 December 2013, directors of the company and their immediate relatives controlled 1.6% of the voting shares of the company (2012: 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 £nil (2012: £312,000).

### 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 2013 £000	Highest during the year £000	Balance at 31 December 2012 £000
Amounts due from subsidiaries	14,775	14,775	16,579	14,897
Amounts due to subsidiaries	(31,884)	(31,884)	(33,602)	(33,602)

Transactions with group companies typically comprise management, rent and interest charges during the period.

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 2013 £000	For year ended 31 December 2012 £000
Rental income	6,368	6,368
Dividends received	23,999	13,299
Recharge of operating expenses	2,318	2,241
Interest income	138	160
Pension recharge	166	177

## 29 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.

## Principal Trading Subsidiaries

	<b>Place of incorporation</b>
* 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

	2013 £000	Restated± 2012 £000	2011 £000	2010 £000	2009 £000
<b>Trading results</b>					
Revenue	603,051	585,984	569,795	535,690	533,793
Gross profit	181,255	175,733	175,739	164,959	162,260
Overheads	(153,575)	(146,419)	(147,687)	(138,893)	(137,502)
Underlying operating profit	27,680	29,314	28,052	26,066	24,758
Underlying profit before net financing costs	27,680	29,314	28,052	26,066	24,758
Net financing costs	(1,241)	(1,463)	(464)	(1,060)	(2,694)
Underlying profit on ordinary activities before tax	26,439	27,851	27,588	25,006	22,064
Taxation	(6,146)	(6,939)	(7,184)	(7,127)	(6,168)
Underlying profit on ordinary activities after taxation	20,293	20,912	20,404	17,879	15,896
<b>Shareholder value</b>					
Paid dividend per share	14.85p	14.15p	12.40p	11.00p	19.70p
Proposed dividend per share	15.30p	14.85p	14.15p	12.40p	11.00p
Underlying earnings per share	24.5p	25.3p	24.6p	21.5p	19.1p
<b>Net assets</b>					
<b>Non-current assets</b>					
Property, plant and equipment	103,079	96,182	94,201	97,215	96,530
Intangible assets	10,013	13,210	13,210	13,210	13,210
Deferred tax assets	2,388	2,376	962	896	4,731
	115,480	111,768	108,373	111,321	114,471
<b>Current assets</b>					
Inventories	115,678	115,332	114,196	105,694	99,637
Trade and other receivables	119,488	108,070	111,656	102,240	101,149
Cash and cash equivalents	47,477	49,798	41,494	44,758	45,737
Assets held for sale	–	212	362	362	2,275
	282,643	273,412	267,708	253,054	248,798
<b>Total assets</b>	<b>398,123</b>	<b>385,180</b>	<b>376,081</b>	<b>364,375</b>	<b>363,269</b>
<b>Current liabilities</b>					
Bank overdraft	–	–	–	–	(758)
Other interest-bearing loans and borrowings	(218)	(213)	(30,219)	(225)	(900)
Trade and other payables	(164,519)	(153,755)	(154,490)	(149,476)	(143,216)
Employee benefits	(2,842)	(2,754)	(2,669)	(2,586)	(2,506)
Income tax payable	(7,022)	(7,117)	(6,678)	(4,201)	(8,615)
	(174,601)	(163,839)	(194,056)	(156,488)	(155,995)
<b>Non-current liabilities</b>					
Other interest-bearing loans and borrowings	(33,239)	(33,371)	(3,691)	(34,011)	(34,392)
Employee benefits	(12,780)	(14,641)	(11,789)	(10,138)	(20,253)
	(46,019)	(48,012)	(15,480)	(44,149)	(54,645)
<b>Total liabilities</b>	<b>(220,620)</b>	<b>(211,851)</b>	<b>(209,536)</b>	<b>(200,637)</b>	<b>(210,640)</b>
<b>Net assets</b>	<b>177,503</b>	<b>173,329</b>	<b>166,545</b>	<b>163,738</b>	<b>152,629</b>

± Restated to reflect the changes for revised IAS 19.

# Notice of AGM

Notice is hereby given that the 66th Annual General Meeting of Headlam Group plc will be held at the group's distribution facility located at Gorse Lane, Coleshill, B46 1JU on Wednesday 21 May 2014 at 10.00 a.m. for the following purposes.

## As ordinary business

1. To receive, consider and adopt the Annual Report and Accounts, the reports of the directors and the Independent Auditor's Report for the year ended 31 December 2013.
2. To declare a final dividend for the year ended 31 December 2013 of 10.65p per ordinary share.
3. To re-elect as a director Tony Brewer who is retiring by rotation in accordance with the company's articles.
4. To re-elect as a director Andrew Eastgate who is retiring by rotation in accordance with the company's articles.
5. To appoint KPMG LLP 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 Directors' Remuneration Report for the year ended 31 December 2013.
8. To approve the Directors' remuneration policy to take effect from the conclusion of this AGM.

## As special business

To consider and, if thought fit, pass the following resolutions of which resolution 9 will be proposed as an ordinary resolution and resolutions 10 to 12 will be proposed as special resolutions:

### 9. 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 2015 AGM (or, if earlier, at the close of business on 30 June 2015), 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.

### 10. Disapplication of pre-emption rights

that, subject to the passing of resolution 9 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 9 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 2015 AGM if passed (or, if earlier, at the close of business on 30 June 2015), 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
- (b) shall be limited to:
  - (i) the allotment of equity securities in connection with an issue to holders of ordinary shares of 5p 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.



## Notice of AGM continued

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 9 in this Notice" were omitted.

### 11. 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 5p 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 5p;
- (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 2015 AGM or, if earlier, at the close of business on 30 June 2015 (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).

### 12. 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 2015 or 30 June 2015, whichever is the earlier.

By order of the board



**Geoff Duggan**

Company Secretary, 7 March 2014

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 Gorsey Lane, Coleshill, Birmingham B46 1JU on Wednesday 21 May 2014 at 10.00 a.m.

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

Resolutions 1 to 9 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 10 to 12 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 auditor's reports for the financial year ended 31 December 2013. Shareholders are invited to vote to receive and adopt the Annual Report and Accounts for the year ended 31 December 2013.

## Resolution 2 – Declaration of dividend

The directors recommend the payment of a final dividend of 10.65p on each of the ordinary shares entitled thereto, which together with the interim dividend of 4.65p, gives a total dividend of 15.30p for the year ended 31 December 2013. Subject to approval of the declaration of the final dividend at the AGM, the final dividend will be paid on 1 July 2014 to the holders of ordinary shares whose names are recorded on the register of members at the close of business on 6 June 2014.

## Resolution 3 – Re-election of Tony Brewer as a director

Tony Brewer is retiring by rotation in accordance with the company's articles and is offering himself for re-election by shareholders. Under the articles of association, directors are required to retire every three years. Tony was appointed an executive director in June 1991, becoming Managing Director of the Floorcoverings Division in 1992 and Group Chief Executive in November 2000. The board believes that Tony Brewer should be re-elected and makes such a recommendation to shareholders.

## Resolution 4 – Re-election of Andrew Eastgate as a director

Andrew Eastgate 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. Andrew was appointed a non-executive director in May 2010 at which time he joined the Nominations, Audit and Remuneration Committees, becoming Chairman of the Audit Committee on 1 September 2013. The board believes that Andrew Eastgate should be re-elected and makes such a recommendation to shareholders.

## Resolution 5 – 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 Audit Plc have notified the company that they are not seeking re-appointment. It is proposed that KPMG LLP be and are hereby appointed auditors of the company and will hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting at which accounts are laid before the company.

## 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 – Directors' Remuneration Report

Shareholders are being asked to approve the 2013 Directors' Remuneration Report, which gives details of the directors' remuneration for the period ended 31 December 2013 and is set out on pages 50 to 66 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. As required by the Directors' Remuneration Report Regulations 2002, KPMG Audit Plc have audited those parts of the Directors' Remuneration Report capable of being audited and their report can be found on pages 73 to 75 of the Annual Report and Accounts.

## Resolution 8 – Directors' remuneration policy

Changes made under the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and the Enterprise & Regulatory Reform Act 2013, require UK listed companies to put before shareholders a binding resolution inviting shareholders to approve the company's remuneration policy at least every three years (or when the policy changes). The directors' remuneration policy, which can be found on pages 50 to 66 of the company's Annual Report and Accounts sets out details of the company's proposed policy on directors' remuneration. Subject to approval at the AGM the policy will take effect from the conclusion of this AGM.

## Special Business – Resolutions 9 to 12

### Resolution 9 – 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,

# Explanatory Notes to the Proposed Resolutions

## continued

the proposed general authority, similar to last year, is to allot up to an aggregate nominal amount of £620,000 representing 12,400,000 ordinary shares (15% of the company's ordinary share capital (excluding treasury shares) in issue at 6 March 2014). As at 6 March 2014, the company held 1,737,520 treasury shares, which represented approximately 2.04% 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 2015, or, if earlier, on 30 June 2015. 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 10 – Disapplication 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 6 March 2014). The authority will lapse at the conclusion of the AGM to be held in 2015 or, if earlier, on 30 June 2015.

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](http://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 11 – 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 2013. The authority is in respect of 10% of the company's issued ordinary share capital as at 7 March 2014 and will lapse at the conclusion of the AGM to be held in 2015 or, if earlier, on 30 June 2015. 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 11, 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 22 and 23 to the Financial Statements.

### Resolution 12 – 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 12, the minimum notice period under the regulations would be 21 days. If resolution 12 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 12, which is a repeat of the same resolution passed at the AGM in 2013, 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 our registrars, Capita Asset Services, 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 Asset Services, 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](http://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.

## 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 19 May 2014 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.

# Explanatory Notes to the Notice of Meeting continued

## 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 6 March 2014, being the latest practicable date prior to the publication of this document, the company's issued share capital, including treasury shares, consisted of 85,363,743 ordinary shares of 5p ("shares"). Of these 1,737,520 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 83,626,223.

## 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: Gorse Lane, Coleshill, Birmingham, B46 1LW;
- or
- (b) by writing to: Capita Asset Services, 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 2013 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 Nominations 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](http://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](http://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 Asset Services ("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 Asset Services, The Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU.

Email: [ssd@capitaregistrars.com](mailto: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](http://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.capitaassetservices.com](http://www.capitaassetservices.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. 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](http://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](http://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](http://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 Conduct Authority (FCA) by calling 0800 111 6768 or by visiting [www.fca.org.uk](http://www.fca.org.uk) and contact the firm using the details on the register.
- Report the matter to the FCA by calling 0800 111 6768 or by visiting [www.fca.org.uk](http://www.fca.org.uk).

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 FCA website [www.moneydeclared.org.uk](http://www.moneydeclared.org.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 Advisors

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 Asset Services  
The Registry  
34 Beckenham Road  
Beckenham  
Kent BR3 4TU

# Financial Calendar

## Announcements

Interim Management Statement	16 May 2014
Annual General Meeting	21 May 2014
Interim results announced	22 August 2014
Interim Management Statement	18 November 2014
Full year results announced	March 2015

## Dividend Dates

Final dividend for 2013, if approved, payable to qualifying shareholders on the register as at 6 June 2014	1 July 2014
Interim dividend for 2014 announced	22 August 2014
Interim dividend for 2014 payable	2 January 2015



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Number 460129



For further detail on  
our business please visit:

**[www.headlam.com](http://www.headlam.com)**

