Financial review

Overview and Group results

Turnover grew in the year to £191.7m from £162.6m, with sales attributable to the acquisition of the Gaskell Carpet Tile Division, now named Bonar Tiles, being £19.5m. The sales on a like for like basis were £172.2m compared to £162.6m with the impact of foreign exchange accounting for £7.6m of the increase.

The operating profit before exceptional items was £11.1m compared with £7.7m the previous year. The positive contribution of the acquisition and progress in our other businesses partially offset by an increase in central costs has seen the Group improve its performance. Central costs have increased with the UK pension scheme costs continuing to rise and we have consciously invested in central resource to enhance financial control and support business growth. A part of the increase is also due to a charge of £0.5m made to cover the cost of the 2003 Long-Term Incentive Plan ("the 2003 LTIP") approved by shareholders in February 2003.

Exceptional items this year related to the costs identified at the time of the acquisition of Bonar Tiles of £491,000 which have assisted us in achieving the expected cost synergies of £500,000 per annum. As reported at the time of our interim results announcement in July 2003, action was taken in our original Floors operations to reduce many cost elements resulting in a one off cost of £434,000.

Interest increased in the year to £1.0m from £0.2m the previous year. The year saw the facilities renegotiated in order to finance the acquisition of Bonar Tiles. As a consequence, in contrast to the prior year the Group was in a net debt position for the majority of the year.

Taxation

The tax charge was £3.2m (2002: £2.4m). On a pre-exceptional basis the effective rate is 34% (2002: 35%). The rate reflects the higher tax rates we incur in many of our overseas operations.

Earnings and dividends

Earnings per share were 6.05p (2002: 2.08p). Earnings per share before exceptional items and goodwill were 6.69p (2002: 4.88p).

Preference dividends of £23,000 (2002: £23,000) were paid in the year. Ordinary dividends, both paid and proposed, for the year amount to £4.2m (2002: £4.0m).

Cash balance and cash flow

The Group started the year with net cash of £18.2m and ended the year with £10.4m. This is after having made the acquisition which cost £19.3m. As part of the acquisition we renegotiated our bank facilities. A £15m, five year loan with quarterly repayments was specifically entered into to fund the acquisition. We also have a three year facility for £15m to fund other acquisition opportunities.

Pensions

The Group has accounted for pensions under SSAP 24 "Accounting for Pension Costs" and has included disclosure in the Notes as required by the transitional rules of FRS 17 "Retirement Benefits".

SSAP 24 accounting has been based on the most recent formal actuarial valuations, which for the main UK scheme was performed at 31 March 2002. With the deterioration in stock market conditions, a revised schedule of contributions was agreed with the Trustee based on a more up to date and less favourable set of circumstances. The result is that the Group has increased its cash contributions significantly with contributions of £1.3m paid in the year with an additional £1m agreed to be paid in a lump sum in March every year.

The FRS 17 disclosure in the Notes shows a deficit of £31.9m (2002: £26.4m) which increased in the year due mainly to falling bond yields. As stated last year the Group has reviewed its pension arrangements including benefits and contribution rates.

The UK defined benefit scheme is now closed to new members and new employees will be invited to participate in a defined contribution scheme.

The profit and loss impact of contributions to Group pension schemes in 2003 was £2.5m (2002: £2.4m) and is expected to increase in 2004.

Treasury

Policies and controls Low & Bonar maintains the key relationships with external debt providers centrally. There remain some external debts in the Group subsidiaries which arose in some instances at acquisition or through major investment programmes before 2001. Treasury policies are approved by the Board and cover the nature of the exposure to be hedged, the types of financial instruments that may be employed and the criteria for investing and borrowing cash. No transactions of a speculative nature are undertaken. As part of the continuous improvement programme across all disciplines in the Group we have commissioned a review of our operations' foreign exchange hedging policies and also a review of our overall cash pooling across Europe. The latter is intended to maximise efficiency of cash across the many operations whilst maintaining borrowing capacity to fund future acquisition opportunities.

Liquidity risk The objective is to maintain a balance between the continuity of funding and flexibility. The acquisition was specifically funded by a senior loan in order to preserve additional flexibility and net cash for future opportunities when they arise. The bank facilities have tenures ranging from one to four years.

At 30 November 2003 available undrawn bank facilities totalled £26.4m, with net cash balances of £10.4m in addition to the undrawn facilities. The Group maintains uncommitted overdraft facilities to maintain short-term flexibility.

Foreign currency risk The Group has net assets in the UK, Europe and North America. The Group policy is to partially limit the translational exposure and resulting impact on shareholders' funds by borrowing in the respective currency. This has been reduced substantially in the last three years and will be revisited should the next acquisition arise outside of the UK.

The majority of the Group's transactions are carried out in the functional currency of the Group's operations and as such transactional exposures are limited. Where they do occur the Group policy is to hedge exposures as soon as they are committed using forward foreign exchange contracts.

Interest rate risk The Group has not entered into specific instruments to mitigate the impact of interest rate changes. The Group has some euro borrowing at fixed interest rates but the other borrowings are at variable rates.

International Financial Reporting Standards The Group is intending to apply International Financial Reporting Standards during the year ending 30 November 2006. The Group has commenced work to ensure information is available for future disclosure as and when the relevant standards are finalised.

Jon Kempster *Group Finance Director*

Turnover grew in the year to £191.7m from £162.6m, with £19.5m of sales attributable to the acquisition of the Gaskell Carpet Tile Division.