

Significant accounting policies

GENERAL INFORMATION

Low & Bonar PLC (the "Company") is a company domiciled in Scotland and incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is 50 Castle Street, Dundee, DD1 3RU. The management head office is 50 Seymour Street, London, W1H 7JG.

The consolidated financial statements of the Company for the year ended 30 November 2006 comprise the Company and its subsidiaries (together referred to as the "Group").

(A) BASIS OF PREPARATION

The financial statements are presented in pounds sterling, rounded to the nearest hundred thousand pounds. They are prepared on the historical cost basis except for the revaluation to fair value of certain financial instruments.

Both the parent Company financial statements and the Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU (adopted IFRS). At the date of authorisation of these financial statements there are a number of Standards and Interpretations in issue but not yet effective and have therefore not yet been applied in these financial statements. The Directors anticipate that adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group or the Company.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements and in preparing an opening IFRS balance sheet at 1 December 2004 for the purposes of transition to adopted IFRS. As more fully explained below, accounting for financial instruments was determined on different bases in the year ended 30 November 2005 and the year ended 30 November 2006 due to the transitional provisions of IAS 32 "Financial Instruments Presentation and Disclosure" and IAS 39 "Financial Instruments Measurement and Recognition". The Company has elected to apply UK GAAP to its comparative accounts (i.e. 1 December 2004 to 30 November 2005) and implement IAS 32 and IAS 39 at 1 December 2005. On 1 December 2005 in accordance with IAS 32 and IAS 39 all derivative financial instruments were recorded at their fair value and preference shares with a nominal value of £0.4m were reallocated to non current liabilities, interest bearing borrowings. The net adjustment to equity at 1 December 2005 was a decrease of £0.1m (note 26). This adjustment has no impact on the basic and diluted earnings per share for the year ended 30 November 2006.

(B) FIRST TIME ADOPTION OF IFRS

The financial statements for the year ended 30 November 2006 are the first to be prepared by the Group in accordance with adopted IFRS and consequently the Group has applied IFRS 1 "First Time Adoption of IFRS" in the financial statements.

IFRS 1 permits companies adopting IFRS for the first time to take exemptions from the full requirements of IFRS in the transition period. In these financial statements the following permitted exemptions have been applied.

- (a) Business combinations prior to 1 December 2004 have not been restated to comply with IFRS 3 "Business Combinations".
- (b) Cumulative translation differences on foreign operations are deemed to be zero at 1 December 2004. Any gains and losses recognised in the consolidated income statement on subsequent disposals of foreign operations will therefore exclude translation differences arising prior to the transition date.
- (c) IAS 32 and IAS 39 have been adopted from 1 December 2005, with no restatement of comparative information. (Comparative information has been prepared and disclosed in accordance with UK GAAP.)
- (d) Only share based payment awards made after 7 November 2002 have been measured in accordance with IFRS 2 "Share Based Payment".

The Group has adopted early the amendments to IAS 19 "Employee Benefits".

(C) BASIS OF CONSOLIDATION

(i) Subsidiaries

Subsidiaries are those entities controlled by the Company. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Investments in subsidiaries are carried at cost less impairment.

The interest of minority shareholders is initially stated at the minority's share of the fair values of the identifiable assets and liabilities recognised on the date of acquisition.

(ii) Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

(iii) Transactions eliminated on consolidation

Intra-Group balances and transactions and any unrealised gains arising from intra-Group transactions are eliminated in preparing consolidated financial statements.

Significant accounting policies continued

(D) FOREIGN CURRENCY

(i) 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 balance sheet date are translated into pounds sterling 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 denominated in foreign currencies that are stated at fair value are translated into pounds sterling at foreign exchange rates ruling at the date the fair values were determined. Non monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using exchange rate at the date of transaction.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated at foreign exchange rates ruling at the balance sheet date. The income statements of foreign operations are translated at an average rate for the period where this rate approximates to the foreign exchange rates ruling at the date of the transactions. Exchange differences arising from this translation of foreign operations, and of related qualifying hedges are taken directly to the translation reserve within equity. They are released to the income statement upon disposal.

The Group has taken advantage of the relief available in IFRS 1 to deem the cumulative translation differences for all foreign operations to be zero at the date of transitions to IFRS, 1 December 2004.

(ii) Hedging of risks

In order to hedge its exposure to certain foreign exchange risks, the Group enters into forward exchange contracts (see accounting policies E and F).

(E) DERIVATIVE FINANCIAL INSTRUMENTS

The Group uses derivative financial instruments to hedge its exposure to foreign exchange risks arising from operational and investment activities. The Group does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments are recognised initially at fair value. Derivative financial instruments are subsequently remeasured to their fair value with the resultant gain or loss being recognised in income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged (see accounting policy F).

(F) HEDGING

(i) Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, a firm commitment or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised as a separate component of equity. When the firm commitment or forecast transaction results in the recognition of a non-financial asset or liability, the cumulative gain or loss is removed from equity and included in the initial measurement of the asset or liability. Otherwise the cumulative gain or loss is removed from equity and recognised in the income statement at the same time as the hedged transaction. The ineffective part of any gain or loss is recognised in the income statement immediately.

When a hedging instrument or hedge relationship is terminated but the hedged transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised in the income statement immediately.

(ii) Hedge of net investment in foreign operation

Exchange differences arising from the translation of the net investment in foreign operations, and of related hedges, are taken to the translation reserve. They are released to the income statement upon disposal.

In respect of all foreign operations, any differences that have arisen since 1 December 2004, the date of transition to adopted IFRS, are presented as a separate component of equity in the Group financial statements.

(G) PROPERTY, PLANT AND EQUIPMENT

(i) Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment (see accounting policy L). The cost of self constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads.

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of plant, property and equipment.

(ii) Leased assets

Leases whereby the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and equipment acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation (see below) and impairment losses (see accounting policy L). Lease payments are accounted for as described in accounting policy S. Where land and buildings are held under lease the accounting treatment of the land is considered separately from that of buildings.

(iii) Subsequent expenditure

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred, if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense incurred.

(iv) Depreciation

Depreciation is charged to the income statement on a straight line basis over the estimated useful lives of items of property, plant and equipment, and major components that are accounted for separately. Land is not depreciated. The estimated useful lives are as follows

| | |
|-----------------------|-------------|
| — property | 20–50 years |
| — plant and equipment | 3–15 years |

(H) INTANGIBLE ASSETS**(i) Goodwill**

Goodwill represents amounts arising on acquisition of subsidiaries. In respect of acquisitions that have occurred since 1 December 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets (including intangible assets and contingent liabilities) acquired.

In respect of acquisitions prior to 1 December 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 separable intangibles were not recognised and goodwill was amortised. The classification and accounting treatment of business combinations that occurred prior to 1 December 2004 have not been reconsidered in preparing the Group's opening IFRS balance sheet at 1 December 2004. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Goodwill is stated at deemed cost less any accumulated impairment losses (see accounting policy L).

(ii) Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense is incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense is incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses (see accounting policy L).

(iii) Other intangible assets

Other intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses (see accounting policy L). Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense is incurred.

(iv) 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. Goodwill and intangible assets with an indefinite life are not amortised but are systematically tested for impairment annually and further tested at each balance sheet date if there is any evidence of potential impairment. Other intangible assets are amortised from the date that they are available for use. The estimated useful lives of the identified intangible assets are as follows:

| | |
|--------------------------|------------|
| — technology based | 5–10 years |
| — customer relationships | 4–11 years |
| — marketing related | 10 years |
| — order backlog | 3 months |
| — non compete agreements | 4–5 years |

(I) TRADE AND OTHER RECEIVABLES

Trade and other receivables are stated at their amortised cost less impairment losses (see accounting policy L).

(J) INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

The cost of inventories 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. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

Significant accounting policies continued

(K) CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

(L) IMPAIRMENT

The carrying amounts of the Group's assets, other than inventories (accounting policy J), and deferred tax assets (accounting policy U) are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. For goodwill, assets that have an indefinite useful life and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses recognised in respect of cash generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash generating units (group of units) and then, to reduce the carrying amount of other assets in the unit (group of units) on a pro rata basis. Impairment losses are recognised in the income statement.

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

Goodwill and other intangible assets with indefinite lives were tested for impairment at 1 December 2004, the date of transition to IFRS, even though no indication of impairment existed.

(i) Calculation of recoverable amount

Receivables with a short duration are not discounted.

The recoverable amount of other assets is the greater of their fair value less costs 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 assumptions 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.

(M) SHARE CAPITAL

(i) Preference share capital

Following the adoption of IAS 32, financial instruments issued by the Group are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

- (a) They include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company.
- (b) Where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in these financial statements for called up share capital and share premium account exclude amounts in relation to those shares.

Finance payments associated with financial liabilities are dealt with as part of financial expenses. Finance payments associated with financial instruments that are classified in equity are dividends, and are recorded directly in equity.

(ii) Dividends

Dividends on redeemable preference shares are recognised as a liability on an accrual basis. Dividends on ordinary shares are recognised as a liability in the period in which they are declared. Dividend income is recognised in the income statement on the date that the dividend is declared.

(N) INTEREST BEARING BORROWINGS

Interest bearing borrowings are recognised initially at cost, 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.

(O) EMPLOYEE BENEFITS

The Group operates defined benefit pension plans and defined contribution pension plans. The Company also offers share based compensation benefits to certain employees.

(i) Defined contribution plans

A defined contribution pension plan is one under which fixed contributions are paid to a third party. The Group has no further payment obligations once these contributions have been paid. Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

(ii) Defined benefit plans

A defined benefit pension plan is one that specifies the amount of pension benefit that an employee will receive on retirement. The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine the present value, and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on AA credit rated 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.

Where the calculation results in a benefit to the Group, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

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

All actuarial gains and losses as at 1 December 2004, the date of transition to IFRS, were recognised. In respect of actuarial gains and losses that arise subsequent to 1 December 2004 these are recognised immediately in the Statement of Recognised Income and Expense.

(iii) Equity and equity-related compensation benefits

The Company and Group have applied the requirements of IFRS 2. In accordance with the exemption available within the transitional provisions of IFRS 1, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2005.

The Company operates various equity settled and cash settled share option schemes. Equity settled share based payments are measured at fair value at the date of the grant, and the fair value determined at the grant date of these payments is expensed on a straight line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. The fair value of cash settled payments are remeasured at each balance sheet date and the cost of these payments is recognised over the vesting period, taking into account the remeasurement of fair value at each balance sheet date.

The Low & Bonar 1995 Employees' Share Ownership Plan Trust (the "ESOP") purchases shares in the Company in order to satisfy awards made under the Company's Long Term Incentive Plan. Shares held by the ESOP are treated as Treasury Shares and a deduction is computed in the Company's issued share capital for the purposes of calculating earnings per share.

Fair value is measured by use of the Monte Carlo Simulation model.

(P) PROVISIONS

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions for restructuring costs are recognised when the Group has a detailed formal plan for the restructuring that has been communicated to affected parties.

(Q) TRADE AND OTHER PAYABLES

Trade and other payables are stated at their amortised cost. They are not interest bearing.

(R) REVENUE — GOODS SOLD AND SERVICES RENDERED

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Sales of goods are recognised when the Group has transferred the significant risks and rewards of ownership of the goods to the buyer, the amount of revenue can be measured reliably and it is probable that the economic benefits of the transaction will flow to the Group.

(S) EXPENSES**(i) Operating lease payments**

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

(ii) Finance lease payments

Payments made under finance leases are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

(iii) Net financing costs

Net financing costs comprise interest payable on borrowings calculated using the effective interest rate method, dividends on redeemable preference shares, return on scheme assets and interest costs on scheme liabilities in respect of defined benefit pension schemes, interest receivable on funds invested, dividend income, foreign exchange gains and losses, and gains and losses on hedging instruments that are recognised in the income statement (see accounting policy F). Interest income is recognised in the income statement as it accrues, taking into account the effective yield on the asset.

Significant accounting policies continued

(T) NON-RECURRING ITEMS

Items which are both material and non-recurring are presented within their relevant consolidated income statement category. The separate reporting of non-recurring items helps provide a better indication of the Group's underlying business performance.

(U) TAXATION

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

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

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit; goodwill in respect of acquisitions prior to 1 December 2004; and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the future. The amount of deferred tax provided is based on the expected manner or realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(V) SEGMENT REPORTING

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment). The Group identifies business segments as its primary segments. The business segments identified are Floors and Technical Textiles.

(W) DISCONTINUED OPERATIONS

A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale, that has been disposed of, has been abandoned, or that meets the criteria to be classified as held for sale.

Discontinued operations are presented on the income statement in a single line including the post tax profit or loss of the discontinued operation and the post-tax gain or loss recognised on the remeasurement to fair value less costs to sell or on disposal of the assets or disposal groups that constitute the discontinued operations.

(X) BORROWINGS

Borrowings are carried at their issue proceeds net of finance costs, less amounts repaid. Finance costs are allocated over the term of the borrowings.

(Y) SIGNIFICANT JUDGEMENTS AND ESTIMATES

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these 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.

In relation to the Group's property, plant and equipment (note 13), useful economic lives and residual values of assets have been established using historical experience and an assessment of the nature of the assets involved. Impairment tests have been undertaken with respect to intangible assets (note 12) using commercial judgement and a number of assumptions and estimates have been made to support their carrying amounts.

(Z) FINANCIAL GUARANTEE CONTRACTS

With respect to the financial guarantee contracts, where the Group enters into such contracts to guarantee the indebtedness of other companies within the Group, the Group considers these to be insurance arrangements, and accounts for them as such. In this respect the Group treats the guarantee contract as a contingent liability until such time as it becomes probable that the Group will be required to make a payment under the guarantee.