

# Chairman's Statement

*"The Group's consistent strategy has enabled development of builders merchanting, DIY and mortar manufacturing businesses in the UK and Ireland with strong regional and national market positions. These businesses and brands have given the Group a solid platform for continued profitable growth and development as well as diversifying its earnings base between the UK and Ireland and across the construction sector and related markets."*

Grafton Group plc is pleased to report that 2004 has been another year of excellent progress and that record sales, profits and earnings have been achieved. This was the Group's thirteenth year of uninterrupted profit growth.

## Highlights

- Sales were up 25 per cent to €1.9 billion (2003: €1.5 billion).
- Operating profit before goodwill increased by 28 per cent to €157.4 million (2003: €123.3 million).
- Profit before tax increased by 29 per cent to €131.9 million (2003: €102.0 million).
- Earnings per share before goodwill and property profit increased by 23 per cent to 55.64 cent (2003: 45.07 cent).
- Cash generated from operations was up 36 per cent to €177 million (2003: €129.8 million).

All of the Group's operations performed strongly in 2004 aided by good market conditions in the UK and Ireland and the benefit of acquisitions completed during 2003. The Group's consistent strategy has enabled development of builders merchanting, DIY and mortar manufacturing businesses in the UK and Ireland with strong regional and national market positions. These businesses and brands have given the Group a solid platform for continued profitable growth and development as well as diversifying its earnings base between the UK and Ireland and across the construction sector and related markets.

It was another year of significant progress for the UK businesses. Favourable economic conditions continued to support strong demand in the repair, maintenance and improvement sector. The completion of a significant acquisition and development programme in 2003 and the related integration and scale opportunities resulted in a substantial increase in sales and operating profit. UK turnover grew by 28 per cent to €1.4 billion (2003: €1.1 billion). UK operating profit increased by 38 per cent to €108.4 million (2003: €78.6 million). As anticipated, the UK operating profit margin increased, for the sixth consecutive year, to 7.6 per cent (2003: 7.1 per cent). The UK accounted for 76 per cent of Group turnover (2003: 74 per cent) and 69 per cent (2003: 64 per cent) of Group operating profit.

The Group was also active on the development front in the UK during 2004 with a continuing successful bolt-on strategy which involved completion of 17 acquisitions. The businesses acquired trade from 22 branches with annual sales of €120 million. These businesses enhance coverage of the UK merchanting market and strengthen our position in the North West region where half of the acquired branches are located. The Group also improved coverage of the UK merchanting market with the greenfield development of 12 branches. EuroMix strengthened its leadership position in the UK dry mortar market with the opening of its seventh plant in Southampton.

In the Republic of Ireland, a gradual economic recovery as the year developed and record levels of activity in the residential construction market provided a favourable background for good growth in turnover and operating profit. Irish turnover increased by 17 per cent to €451.7 million (2003: €384.5 million) and operating profit was up 10 per cent to €49.0 million (2003: €44.8 million). Irish merchandising sales increased by 19 per cent due to the Telfords acquisition and good like for like growth. Incremental sales from Woodie's Cavan and Carlow stores which opened during 2003 and the opening of a further three stores in Clonmel, Naas Road, Dublin and Kilkenny together with like for like sales growth enabled Woodie's to increase turnover by 18 per cent.

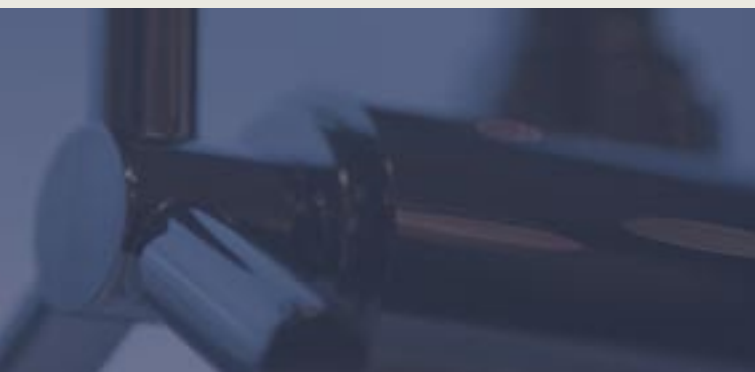
The Group used its strong operating cash flows and balance sheet strength to fund a significant acquisition and development programme during the year. A record cash flow of €177 million from operations in 2004 enabled the Group to continue to implement its development strategy and provide a sound basis for the future profitable growth of the Group.

## Share Purchase / Redemptions

The Board redeemed the remaining six redeemable shares per Grafton Unit for a cash consideration of 5 cent payable on 26 March 2004.

Following restructuring of the Group's share capital in June 2004, the Board approved the purchase of one A Ordinary Share per Grafton Unit for 1 cent and payment was made on 1 October 2004.

The Board has decided to purchase a further A Ordinary Share per Grafton Unit for a cash consideration of 7 cent payable on 29 March 2005. Total redemption / share purchase payments to shareholders for 2004 of 13 cent per Grafton Unit represents an increase of 24 per cent on redemptions of 10.5 cent per Grafton Unit for 2003.



## Chairman's Statement continued

### Heiton Group plc

On 7 January 2005, following clearance from the Competition Authority in Ireland, the Group completed the acquisition of Heiton Group plc for a total consideration of approximately €398 million including estimated debt assumed and the cost of the Group's 29 per cent investment in the business held prior to the offer. The consideration payable includes the issue of 21.4 million shares by Grafton to Heiton Group shareholders.

Heiton Group operations, which are located primarily in Ireland, comprises both builders merchandising and DIY activities. The Irish builders merchandising business trades mainly under the Heiton Buckley name and is the largest builders merchandising business in Ireland operating nationally from 25 branches including Cork Builders Providers. The business also incorporates Heiton Steel, the largest steel stockholding business in Ireland, and a 14 branch small plant and tool hire business trading under the Sam Hire brand. The retail operations of Heiton Group trade from 15 branches under the Atlantic Homecare DIY brand and, from 4 stores, under the In-House at the Panelling Centre brand. Heiton Group also operates a small specialist drainage and ground engineering merchandising business from 6 branches in the UK.

Heiton's Irish merchandising and DIY businesses are a good strategic fit with Grafton's existing operations and consolidates the position of Grafton as the leading player in the Irish merchandising and DIY markets.

The acquisition of Heiton Group provides opportunities for scale benefits from two complementary businesses.

### Operations Review - United Kingdom

UK sales increased by 28 per cent to €1.4 billion (2003: €1.1 billion) and operating profit increased by 38 per cent to €108.4 million (2003: €78.6 million). The operating profit margin increased to 7.6 per cent (2003: 7.1 per cent), a rate of improvement consistent with that achieved in each of the previous three years.

In 2004 the UK economy continued a long period of stability and growth. The economy slowed from above trend growth rates as the year progressed in response to a tightening of interest rates aimed at slowing growth and the rate of increase in house prices. It was a very good year for the labour market as the unemployment rate edged down to 4.7 per cent.

The UK repair, maintenance and improvement market, which is the principle end user market for the Group's merchants' sales, put in another solid performance in 2004 with industry estimates indicating volume growth of 3.5 per cent.

The excellent results achieved by the UK businesses reflects strong profit growth in the established merchandising businesses, incremental profit from the businesses acquired during 2003 and contributions from the seventeen businesses acquired during 2004.

Like for like merchandising sales growth of 6.5 per cent, margin improvement as a result of purchasing synergies and trading initiatives and benefits of integrating acquisitions contributed to the substantial operating profit improvement in the like for like businesses.

The Jackson and Plumline acquisitions completed in 2003 joined the Group with very good market positions and performed strongly during 2004.



Development of the UK businesses continued during 2004 with the acquisition of seventeen businesses trading from twenty two branches and thirteen greenfield developments increasing the number of trading locations to 318. Acquisitions made during the year included Keel Supply and Hall and Rogers, two specialist insulation and dry-lining businesses trading from four branches in the North West. These businesses, which traded strongly post acquisition, add critical mass over a narrow product group and offer potential growth opportunities.

Greenfield developments comprised eight plumbers merchanting branches, four builders merchanting and a new mortar plant. Two Scottish builders merchanting branches at East Kilbride and Glasgow successfully relocated to new purpose built facilities.

## UK Builders Merchanting

The UK Builders merchanting division had an excellent year with sales and operating profit substantially ahead of 2003. The strong improvement in profit came from good like for like sales growth in the established branch network, incremental profit from acquisitions made during 2003 and contributions from current year acquisitions.

The results reflect the full year benefit of revised purchasing and sourcing arrangements put in place following the Jacksons acquisition and the continued successful integration of the 61 branches acquired in 2002 and 2003.

## Chairman's Statement continued

Regional coverage was strengthened with further geographic expansion during 2004. Completion of 15 small acquisitions added twenty branches and a further four greenfield branches were opened increasing the UK builders merchanting network to 163 branches at the year end.

Buildbase achieved another year of excellent sales and profit growth. Good like for like sales growth, margin improvement through improved purchasing terms and tight control over overheads delivered profit improvement in the like for like business. This combined with incremental contributions from acquisitions made in 2003 resulted in a significant improvement in operating profit. Buildbase continued with the successful integration of businesses acquired during 2003 and 2004 taking advantage of synergy and product growth opportunities while maintaining the ethos of these small chain and single branch merchants with a long established presence in their local markets.

Buildbase continued to consolidate and expand its strong position in the UK builders merchanting market where the brand is now firmly established.

Jacksons, the UK's largest regional independent merchanting business prior to acquisition in March 2003, achieved an excellent result in its first full year as part of the Group. The strong advance in operating profit on 2003 levels reflected good like for like sales growth, tight overhead control and scale related purchasing synergies.

The Jackson acquisition created a market leadership position for the Group in the East Midlands builders merchanting market and complements the Buildbase branch network which is concentrated in the South East and West Midlands. The strong results for 2004 mean that the financial benefits of the acquisition for the enlarged Group were realised in 2004, the first full year of ownership and well ahead of the 2006 time frame anticipated in the original acquisition announcement.

Buildbase acquired nine businesses trading from twelve branches during 2004 and opened two branches in Stratford E15 and Cirencester. Developments completed by Jacksons during the year included the opening of a greenfield branch in Louth, replacement of the Swinton, South Yorkshire branch with a new purpose built facility and a small bolt-on acquisition which provides a platform for further growth in the Lincolnshire market.

In Northern Ireland, Macnaughton Blair strengthened its leading market position in the province with the acquisition of two builders merchanting businesses trading from branches in Bangor and Coleraine. These acquisitions provide the business with a wider geographic coverage in the province and increase the branch network to 12.

The strong trading performance of Macnaughton Blair in recent years continued into 2004 and the business experienced very good like for like sales and operating profit growth with contributions from the Bangor and Coleraine acquisitions.

## UK Plumbers Merchanting

Plumbase, a plumbing heating and sanitary ware merchanting business, with 147 branches has strong regional market positions in England and Scotland. The business further strengthened its market position during 2004 through the acquisition of two single branch merchants and the opening of eight new branches.

Plumbase achieved growth in sales and operating profit. Purchasing synergies and increased sales enabled a good advance in profit in the like for like Plumbase business.

The results of the division were significantly boosted by a full year contribution from the Plumblin business acquired in September 2003. Plumblin, a leading regional plumbers merchandising chain trading from seventeen branches provided Plumbase with an important initial presence in the Scottish plumbers merchandising market. The business performed ahead of pre-acquisition expectations as sales growth, purchasing benefits and the continued development of a number of branches in the chain which opened in the years prior to acquisition contributed to the increase in profit.



## Chairman's Statement continued

### UK Mortar

The EuroMix mortar business continued to trade well increasing sales and operating profit in a more competitive market. EuroMix, the market leader in the supply of dry mortar, has transformed a traditional market by pioneering the use on-site of dry mortar silo technology to produce a range of quality mortars for the use in block laying and bricklaying.

The EuroMix business operates from a network of seven strategically located plants and provides mortar to key national and regional building and construction companies for use in residential and non-residential construction projects. The distinctive red and white EuroMix silos are now an established feature on construction sites throughout the country.

The plant at Harlow, which commenced production in May 2003, traded strongly and the opening of a plant in Southampton in July provides coverage to house builders, developers and contractors throughout the South of England. Market leadership will be further enhanced with the opening of the eighth dry mortar plant at Severnside, near Bristol. This plant is currently under construction and will provide market coverage in the West Country.

### Operations Review - Republic of Ireland

Irish turnover increased by 17 per cent to €451.7 million (2003: €384.5 million) and operating profit increased by 9.5 per cent to €49.0 million (2003: €44.8 million). The operating profit margin declined to 10.9 per cent from 11.6 per cent. This reflected flat operating profit margins in the established merchandising and DIY businesses, costs associated with Woodie's three new stores, an anticipated lower margin in the acquired merchandising business and a more competitive trading environment with increased competition in the DIY and manufacturing businesses.

The Irish economy delivered an impressive growth performance in 2004 following two years of below trend growth. The economy steadily gathered pace as the year developed and exceeded growth expectations for the year as a whole. The employment market performed strongly with high employment creation and the inflation environment was benign with the slowest annual growth rate for five years.

The construction market grew by an estimated 9 per cent in 2004 reflecting very strong activity in the residential sector, strong infrastructure demand and unchanged volumes in the commercial and industrial sectors. House completions for 2004 were a record 77,000 units. Record levels of house completions have been influenced by a prolonged period of low interest rates, strong employment creation, net inward migration, demand for second homes and demand from investors in the buy-to-let market.

### Irish Merchandising

The Irish Merchandising division increased sales by 19 per cent to €286.1 million (2003: €239.8 million) including like for like growth of 6.8 per cent.

Chadwicks builders and plumbers merchandising business had a busy year due to record demand in the residential construction market and good levels of activity in the repair, maintenance and improvement market. While the merchandising market enjoyed good volume growth, there was strong competition in the sector from both the national chains and independent operators.



Chadwicks Wexford branch, which relocated to a modern out of town purpose built facility at the end of 2003, traded successfully in 2004 and the two Chadwicks Plumb Centre branches in Galway and North Dublin which opened last year made good progress growing market share.

Telfords, the three branch builders merchandising business acquired in October 2003, traded ahead of pre-acquisition expectations benefiting from strong sales growth and purchasing synergies. This long established merchant provides the Group with an important presence in the Midlands market.

## Irish Retailing

Woodie's, the leading player in the Irish DIY market, achieved another year of sales and profit growth. Sales increased by 18 per cent to €129.8 million (2003: €110.3 million). Like for like sales growth of 2 per cent for the year reflected good first half demand, influenced by strong sales of seasonal products, and the softening of demand in the DIY Superstore sector generally in the second half of the year in an increasingly competitive market.

## Chairman's Statement continued

The Cavan and Carlow stores which opened in 2003 traded ahead of expectations in 2004. Woodie's continued to consolidate its market leadership position with the opening of stores in Clonmel and Naas Road, Dublin in the first half of 2004 and in Kilkenny in the second half bringing the total network to nineteen.

Development plans for 2005 will involve relocating the Cork and Bray stores and opening new stores in Naas and Carrickmines. Further store openings in Drogheda and Navan are planned for 2006.

## Irish Manufacturing

CPI's EuroMix business strengthened its position in the dry mortar market in the greater Dublin area, but its block and readymix divisions suffered from intense competition. MFP, the plastics manufacturing business, experienced difficult market conditions due to increased raw materials prices and intense competition in the sector.

## Board

Mr. Leo Martin, Chief Executive of Heiton Group plc, was appointed to the Board of Grafton on completion of the acquisition. As previously announced, the Board is in the process of appointing two additional non-executive directors whose appointment will reflect the scale and geographical spread of the Group's interests.

Mr. Norman Kilroy retired as Managing Director on 30 April 2004 and will retire from the Board on 31 August 2005.

## Management and Staff

On behalf of the Board and our shareholders, we are pleased to acknowledge the very important contribution of the management and staff in the UK and Irish businesses to another set of record results for the Group. We also warmly welcome our new colleagues from Heiton Group plc who joined us on the 7 January 2005.

## Outlook

The Group's cash generative businesses combined with a strong balance sheet following completion of the Heiton acquisition and high interest cover leave it well placed to continue to pursue its successful strategy.

Growth in the UK economy is expected to ease back to its long term sustainable rate in response to a tightening of monetary policy during 2004 and should continue to be supportive of growth in the repair, maintenance and improvement sector, our principle end user market. The Group will focus on realising integration benefits from acquisitions made during 2004 and also in the wider UK merchanting business. We expect to further strengthen our position in the UK merchanting market by completing further acquisitions and through new developments. The UK mortar business is expected to build on its market leadership position with the opening of its eighth plant later this year.

The Irish economy has consistently outperformed the European economy over the past decade and growth forecasts for 2005 are also very good. Low inflation, a strong employment market and reasonable growth in incomes are expected to lead to stronger consumer spending which should be supportive of RMI growth in the Heiton Buckley and Chadwicks merchandising businesses. We expect the number of house completions in Ireland to gradually moderate to long term sustainable levels which will be more heavily influenced by population and household formations as demand for second homes and rented properties reduce. The Woodie's and Atlantic Homecare DIY businesses are both well placed to benefit from increased retail spending and should also benefit in 2005 from contributions from the five stores opened during 2004.

We look forward to further progress in 2005 confident in the success of our strategy and proven track record of profitable growth in the enlarged Group.

On behalf of the Board

**Michael Chadwick**  
Chairman

