

Chairman's Statement

Trading conditions in merchanting, DIY and mortar markets were very challenging in 2008 against the background of a sharp slowdown in the UK and Irish economies. Despite these difficult conditions, a satisfactory level of underlying profit and earnings was achieved compared with the record results in 2007. The major influences on performance were contraction in the UK and Irish economies, a reduction in the availability of credit to households and the depreciation of sterling against the euro.

In the year under review 63 per cent of turnover was generated in the UK and 37 per cent in Ireland.

Financial Overview

- Cash flow optimised in challenging conditions.
- Cash conservation prioritised over development and acquisition spend.
- Working capital reduced by €112 million or 27 per cent.
- Strong cash flow from operations of €253 million.
- Good liquidity retained with cash balances totalling €225 million at year end.
- Net debt reduced by €114.8 million to €435.6 million.
- Strong balance sheet with 50 per cent gearing underpinned by secure funding position and significant property portfolio.
- Turnover declined by 17 per cent to €2.67 billion in euro terms and by 8 per cent in constant currency terms.
- Operating profit before rationalisation and other non-recurring costs fell by 55 per cent to €118.6 million.
- Sterling devalued by 23 per cent during the year significantly impacting the value of UK assets on translation into euro.
- Adjusted earnings per share were down by 62 per cent to 32.2 cent.
- A Ordinary share purchase reduced to 5.0 cent (2007: 12.0 cent).
- Total A Ordinary share purchases of 15.0 cent (2007: 22.0 cent).

Operational Highlights

- Greater branch network efficiencies to respond to declining volumes.
- New initiatives to deliver significant procurement benefits.
- Continued focus on cost reduction, scale-related benefits, closer integration, branch consolidation and brand synergies.
- Cost base reduced by annualised €45 million.
- New investment focused on projects offering exceptional value and strategic positioning for the future.
- UK operations accounted for 63% of turnover and 67% of operating profit:
 - UK turnover of £1.34 billion (2007: £1.35 billion) fell by 1% and by 15% in euro.
 - Demand slowed substantially from mid-year.
 - UK operating profit declined by 52% to €68.0 million (2007: €142.1 million) and by 44% in sterling terms.
- In Ireland, turnover declined by 20% to €986 million (2007: €1.23 billion):
 - First half merchanting turnover fell 16% and 27% in second half.
 - Increased emphasis on RMI and on energy saving materials.
 - Like for like DIY sales down 11%.
 - Closer management integration and significant cost reductions to offset impact of declining turnover.

The UK business had a positive start to the year. Demand eased during the first half and slowed substantially from mid-year. In local currency terms UK turnover declined by 1 per cent to £1.34 billion (2007: £1.35 billion). However on consolidation and conversion into euro, UK turnover was down 15 per cent. Operating profit declined by 52 per cent to €68.0 million (2007: €142.1 million) and by 44 per cent in sterling. The UK is the Group's principal market and accounted for 63 per cent of Group turnover (2007: 62 per cent) and 67 per cent of Group operating profit.

In Ireland, the economy weakened progressively in 2008. Demand in merchandising was affected by a significant deterioration in the housing market. A sharp slowdown in consumer spending was reflected in lower turnover in the DIY business. Irish turnover declined by 20 per cent to €986 million (2007: €1.23 billion). Irish operating profit declined by 73 per cent to €33.5 million from €123.7 million.

The Group ended the year with a strong balance sheet underpinned by a significant property portfolio and a secure funding position. The Group's operations continued to generate strong cash flow. Net debt at year-end fell to €435.6 million, a decline of €114.8 million from €550.4 million in 2007. Good liquidity was retained by holding significant cash balances amounting to €225 million at year end.

Where necessary, individual businesses were restructured to enable them to compete more effectively and emerge from the downturn with stronger market positions. The results include a charge of €17.2 million for rationalisation, restructuring and other non-recurring costs. In 2009 and beyond, the Group will benefit by at least €45 million in annual savings from steps already implemented to reduce its cost base and rationalise operations.

Group markets are expected to remain difficult for the current year. Grafton is however well placed to manage its business through the economic downturn by continuing to tightly control costs, capital expenditure and cash flow.

Share Purchase

The Company purchased 1 'A' Ordinary share per Grafton unit for a cash consideration of 10.0 cent (2007: 10.0 cent) which was paid on 3 October 2008. The Board has evaluated its share purchase policy in the light of current trading conditions and agreed to purchase a further 'A' Ordinary share per Grafton Unit for a cash consideration of 5 cent (2007: 12.0 cent) payable on 8 April 2009. The decision to set the share purchase payment at this reduced level takes into consideration the significant cash resources available, the ongoing cash generative ability of the Group and the Board's desire to adopt a prudent financial approach during a period of significant economic uncertainty. It is the Board's intention to strive to maintain its twice yearly share purchase subject to conditions prevailing at the time.

Operations Review – United Kingdom

Turnover was down in sterling terms by 1 per cent to £1.34 billion (2007: £1.35 billion) and by 15 per cent on conversion to euro. Operating profit declined by 52 per cent to €68.0 million (2007: €142.1 million). The operating profit margin was 4.0 per cent (2007: 7.2 per cent).

Following 16 years of steady growth and low inflation, GDP growth in the UK economy was flat in the second quarter of 2008 and contracted in the third and final quarters. The decline in economic activity was broadly based as credit conditions, including mortgage approvals, tightened and sentiment deteriorated. Consumer spending reduced as unemployment increased quite sharply and households responded by reducing debt and increasing savings. These factors resulted in a sharp fall in house prices and housing transactions. House builders responded to the fall in demand by dramatically reducing housing starts. Completions fell at a lower rate as projects begun in 2007 were completed.

The residential repair, maintenance and improvement (RMI) market contracted progressively but at a considerably lower rate than the new housing market. The uncertain economic outlook also reduced household spending on RMI. Falling mortgage equity withdrawal and increased savings also weighed on demand. Housing RMI is influenced by housing transactions which were sharply lower in 2008.

UK Merchanting

The UK merchanting business faced a challenging year against this economic background. The RMI sector remained firm in the early months of 2008 but weakened over the remainder of the year. Overall sterling turnover was almost flat and down by 6.5 per cent on a like for like basis. The decline in profitability primarily reflected the fall in like for like volumes, increased store opening costs in Selco and expansion of the Plumbworld business, two strategic routes to market that continue to be developed. Profit was also reduced by rationalisation measures, including a reduction of 800 in the workforce.

An evaluation of procurement saving opportunities on indirect goods and services was completed in the second half. This identified significant price reduction benefits through consolidation of volumes, including sourcing services through internet based tendering.

A more streamlined UK merchanting business incorporating the Buildbase, Plumbase and Jacksons brands and specialist merchanting businesses is enabling a deeper integration of the overall business. The new structure will result in significant synergies beyond the rationalisation measures already implemented. These arise particularly in procurement, accounting, other central services and in promoting shared best practice while building on the regional and product group strengths of individual brands.

The reduction in the workforce and procurement initiative should give rise to annual savings of up to €25 million. The rationalisation programme

resulted in the consolidation of 14 branches. Profitable contributions from acquisitions completed in 2008 were more than offset by initial start up trading losses incurred by the 26 greenfield branches that opened during the year.

Buildbase benefited from a positive start to trading but experienced much tougher conditions as the impact of the recession and credit tightening took hold. The business responded to the negative impact on profitability of declining volumes by cutting the workforce and consolidating a number of underperforming branches. Capital expenditure was curtailed and expansion of the branch network was restricted to opportunities that provided the potential for superior returns.

Demand from Buildbase's core RMI customer base declined in the second half as consumer sentiment weakened and investment in housing reduced. Gross margins were maintained despite more intense competition in a market that had some capacity growth in recent years. Exposure to growth segments of the market was increased through securing long-term supply arrangements with Local Authorities and national contractors in health, education and infrastructure projects supported by increased capital spending by Government.

Nine new branch openings and two single branch acquisitions expanded the Buildbase network. These locations have good medium term prospects for growing market share and providing acceptable long term returns on investment. The Coventry and Market Drayton branches were relocated and Hire Centres were opened in eleven branches. Nine branches were consolidated, in most cases releasing freehold property for disposal when credit conditions ease and the property market normalises.

Jacksons, the East Midlands regional merchant, experienced a decline in turnover but produced a satisfactory level of profitability. The gross margin benefited from a change in the customer profile with house builders accounting for a lower proportion of turnover. New branches were opened in Alford, Lincolnshire and York, Yorkshire.

Selco, a trade only self-select warehouse based format, supplies general builders and specialist contractors engaged in small RMI projects on a mainly cash and collect basis. Selco had a very successful year in 2008. The business is positioned in the most resilient segment of the RMI market. The three branches in London that opened in 2007 traded in line with expectations. A further five stores opened during 2008 increasing the network to twenty five including eleven in London. Further opportunities for store openings are being progressed, mainly in London.

In Northern Ireland, like for like turnover declined in Macnaughton Blair. Economic activity slowed sharply in the last quarter, although the impact of the downturn was lessened by the province's large public sector. Volumes in merchandising were lower as house building activity declined, although turnover grew in the RMI and commercial segments of the market. Two acquisitions completed in the first half expanded Macnaughton Blair's position in the architectural ironmongery market.

Plumbase, the UK's fourth largest plumbers merchandising chain, traded from 188 branches at the year end. The business supplies specialist plumbing and heating contractors and general contractors engaged in housing repair, maintenance and refurbishment projects. While competitive pressure reduced like for like sales the business outperformed the market. Plumbase opened nine branches, acquired one branch and consolidated five branches.

UK Mortar

EuroMix manufactures a range of mortars from nine plants in England and Scotland for supply to residential, commercial and public sector construction. While the business remained profitable throughout the year, turnover and operating profit declined significantly due to the dramatic fall in residential construction. Sharply reduced volumes in a competitive market prevented recovery of higher energy and raw materials costs.

Demand from the commercial sector weakened in the second half. Decisive action was taken to reduce the cost base of the business to partially mitigate the effects of the very weak market.

Operations Review – Republic of Ireland

Turnover was down 20 per cent to €985.65 million (2007: €1.23 billion). This reflected a decline of 16 per cent in the first half and a much sharper fall of 24 per cent in the second half. Operating profit was reduced to €33.5 million (2007: €123.7 million). The performance of the business was closely linked to the downturn in the housing sector which is undergoing a substantial fall in activity and prices from the unsustainable levels reached at the peak of the market in 2006. House completions fell by one third to 52,000 units in 2008 from 78,000 units in 2007 and 88,000 units in 2006. Housing starts were also weaker falling by two thirds to 25,000 units. Housing demand was impacted by negative trends in the labour market, tighter mortgage conditions and an expectation that prices have further to fall.

Irish Merchandising

Turnover in the first half in the Heiton Buckley and Chadwicks chains benefited from completion of housing projects commenced in 2007. There was a marked reduction in housing starts in the second half, with the exception of one-off housing which continues to be an important market.

Stable levels of activity were maintained throughout the year in the commercial agricultural and infrastructure end-use markets. The decline in new housing has increased exposure to the RMI market which performed well although down from the record levels in 2007 due to weakness in the last quarter in line with the slowdown in consumer spending.

Despite the sharp fall in volumes, gross margins were supported by changes in the product mix. Significant cost savings were achieved to partially offset the impact of volume declines which have reduced the overall scale of the business. These

included a reduction of 300 in the number of full-time employees, implemented through non-replacement, voluntary redundancies and, in a small minority of cases, compulsory redundancies.

Internal improvements placed increased emphasis on the RMI market including upgrading showrooms to market doors and floors, as well as expanding the range of bathroom products. The business is also successfully developing sales of energy saving building materials and renewables.

Heiton Steel, the leading steel stock holding business in Ireland, maintained profitability on lower turnover against the background of higher steel prices for most of the year. The business benefited from solid demand in the agricultural and commercial sectors.

Developments within the Irish Merchancing business include a fundamental and ongoing reorganisation of the structure supporting the management and development of the business. This is opportune as the harsher market conditions present tougher challenges in 2009. A single management team is now in place for all brands operating from a single head office location. Costs continue to be more aligned with sales volumes available in the current falling market. The management team works closely with the Group Chief Operating Officer in driving cost reduction, branch consolidation and brand synergies while leveraging scale-related benefits.

Irish Retailing

Turnover declined by 11 per cent to €303.1 million (2007: €339.8 million) and operating profit was down significantly. Trading in the forty one DIY stores and seven specialist kitchen showrooms was affected by a sharp slowdown in consumer spending arising from falling house prices, rising unemployment and a contracting economy.

Like for like sales in the DIY business were down 11 per cent. The performance for 2008 is benchmarked against exceptional growth in 2007.

First half trading was subdued due to poor weather conditions while demand declined throughout the second half due to pressures on consumer spending and weakening sentiment.

Turnover in the In-House at the Panelling Centre kitchen business was down due to the lower level of transactions in the secondary housing market and slowdown in consumer spending.

Decisive action has been taken to deal with the more difficult retail conditions. The cost base of the business is being tightly managed to partly offset the negative impact on profits of lower turnover.

Development

In view of the extent of the deterioration in market conditions the Group concentrated on optimising cash flow from operations and improving the efficiency of the branch network in response to declining volumes. A total of €79.0 million was invested in acquisitions and capital expenditure already committed. Given the scale of the downturn, both capital and development expenditure has been cut significantly during the second half of 2008.

Six acquisitions, in progress from the end of 2007, were completed in the first half, adding twelve new trading locations turning over €39 million on completion. They brought improved coverage of the UK merchancing market and expertise in niche product areas.

Projects previously approved resulted in development expenditure on the opening of 28 branches. These investments are an important element of the Group's long term strategy of improving its geographic coverage of the UK merchancing market and should provide acceptable returns on investment. In Ireland, the retailing business opened two stores.

In August 2008 the Group established a warehouse in Shanghai to consolidate the supply of goods from existing and new Chinese manufacturers. The new facility delivered initial procurement gains in the second half of the year. It is now fully operational and offers substantial procurement

savings. A strategy to allow Group companies to fully benefit from this investment is now in place. The Group plans to incrementally increase purchasing through the facility over the next three years.

Cash flow will be concentrated only on essential asset replacement projects until evidence starts to emerge of an improving outlook for the UK and Irish economies. Development expenditure will be limited to projects which offer exceptional value and position the Group to take advantage of opportunities for market share growth that are an inevitable consequence of the current cyclical downturn.

The investment in acquisitions in 2008 amounted to €28.1 million (2007: €89.2 million) including deferred acquisition consideration of €8.4 million relating to prior year transactions. Capital expenditure on development projects was €50.9 million (2007: €55.7 million). Total expenditure on acquisitions and projects of a development nature was €79.0 million (2007: €144.9 million).

Management and Staff

A key strength of the Group is the commitment and loyalty of the management and staff throughout the business. On behalf of the Board, we wish to thank the management and staff for the commitment and initiative displayed in response to the very difficult trading environment encountered by the Group's businesses.

Outlook

Trading in January and February 2009 continued to decline, made worse by the heavy snowfall. Plans are in place to deal with any further contraction in business.

The Group's experience of previous recessions has enabled actions to be taken which are proportionate to the challenges faced in its markets. Management continues to reassess its response in the light of changing market conditions and is implementing deeper cuts

to overheads as demand contracts. The Group's focus will remain on cost control, operational efficiencies and cash generation.

In Ireland, the economy is forecast to contract sharply in 2009 resulting in further significant job losses. The adjustment in housing to more sustainable levels of output is now at a very advanced stage and will significantly reduce completions in 2009 leading to a further turnover decline in the Irish merchanting business. These factors and tighter credit are likely to outweigh the potentially positive impact on housing of low interest rates and improved housing affordability.

The Irish DIY business is expected to be affected by the continuing decline in retail sales volumes due to a fall in disposable incomes as a result of increasing unemployment and higher taxation on incomes. Reducing household debt and increasing savings are also expected to weigh on consumer spending.

The UK economy is forecast to contract sharply in the first half of this year before starting to respond to the considerable stimulus measures put in place in recent months. The expectation for 2009 is that demand in the RMI market will continue to weaken as consumer spending contracts further due to lower employment, falling house prices and tight credit conditions.

The UK and Irish economies and Grafton have all been resilient to past economic shocks and will eventually recover from the current downturn. Grafton operates businesses with strong market positions and brands in both economies and expects to emerge from the current market downturn as a more efficient business well placed to take advantage of growth opportunities.

On behalf of the Board

Michael Chadwick
Chairman