



Grafton Group plc

Interim Management Report For the six months ended 30 June 2008

The first half of the year brought the most challenging trading conditions encountered by the Group since the early 1990s. The impact of these conditions, together with an average 13 per cent decline in sterling's exchange rate against the euro, resulted in a significant reduction in profitability compared to the record levels achieved in the first half of last year.

Highlights

- Turnover declined by 11 per cent to €1.44 billion and by 2 per cent in constant currency terms.
- Operating profit (before intangible amortisation) was down by 41 per cent to €72.9 million.
- Profit before tax was down by 50 per cent to €53.4 million.
- Adjusted earnings per share were down by 47 per cent to 20.6 cent.
- Despite the more difficult market environment, a significant increase in cashflow was generated from operating activities to a level of €116.9 million.

The instability in the financial markets, which pushed up interest rates and restricted the availability of credit, together with higher energy and commodity prices, while global in nature, led to a decline in residential investment in the UK and intensified the adjustment already underway in the Irish housing market.

The UK business benefited from positive market conditions in the early months of the year but demand eased as the half year progressed due to the impact of interest rate increases and tighter conditions in the credit markets. UK turnover declined by 7.4 per cent to €907.4 million (2007: €979.4 million) but was up by 6.5 per cent in sterling. UK operating profit declined by 24 per cent to €48.6 million (2007: €63.8 million) and by 13 per cent in sterling.

In Ireland, the adjustment in the housing market to more sustainable supply and pricing levels gathered pace leading to sharply reduced volumes in merchandising and manufacturing. Demand in the Irish DIY business was weak due to declining consumer confidence and poor weather compared to the record levels of consumer spending and very favourable weather conditions experienced in the first half of 2007. Irish turnover declined by 16 per cent to €530.5 million (2007: €628.8 million) and operating profit was down 60 per cent to €24.3 million (2007: €60.6 million).

Grafton is well placed to meet the challenges presented by these conditions with a strong balance sheet and strong cash flow during the period. The Group is now focused on emerging from this phase of the economic cycle a stronger and more competitive



organisation. Business units are prioritising competitiveness, optimising efficiencies and capitalising on niche market development opportunities arising in the changed environment. The first half year results include a charge of €7 million associated with rationalisation measures already implemented in Group companies and other costs. The scale and synergies achieved from the substantial growth of recent years are delivering additional benefits to the Group's trading operations.

A Ordinary Share

The Board has agreed to purchase one A ordinary share per Grafton Unit for a cash consideration of 10.0 cent per share on 12 September 2008 (the record date). The cash consideration will be paid on 3 October 2008. The decision to maintain the A ordinary share purchase payment at the same rate as paid in the comparative period is based on the strong financial position and cashflows of the Group.

Development

The Group continued to develop and expand its business through acquisition and organic growth opportunities. Six bolt-on acquisitions were completed improving coverage of the UK merchanting market from a further twelve locations. These businesses had a combined turnover of €40 million at the time of acquisition and offer performance improvement opportunities through purchasing and overhead synergies as part of the wider UK business.

The Group's coverage and positioning within the UK merchanting market also improved with the opening of fourteen branches in locations which offer attractive opportunities for growing market share. Two stores were added to the retail branch network in Ireland.

Against a more challenging trading backdrop, the Group raised the investment criteria in assessing acquisition and development opportunities. Acquisition activity is likely to be at lower levels and only essential capital projects will be undertaken until evidence emerges of an improvement in market conditions in the UK and Ireland. As a strong and competitive player in each of its markets, the Group will be focused on securing profitable market positions and capitalising on market development opportunities that inevitably arise in these conditions.

Operations Review - United Kingdom

Against the background of progressively more challenging macro economic circumstances in the half year, the overall UK business reported an increase in sterling turnover of 6.5 per cent and a decline in sterling operating profit of 13 per cent. However, the weakness in sterling translated into a decline in euro terms. UK turnover declined by 7.4 per cent to €907.4 million (2007: €979.4 million). Operating profit declined by twenty four per cent to €48.6 million (2007: €63.8 million). The operating profit margin was 5.4 per cent (2007: 6.5 per cent).

Growth in the UK economy slowed appreciably in the first half due to the combined effects of the credit crunch and rising food and energy prices that pushed inflation to well above the trend rate and limited the near term scope for a further easing of interest rates. Conditions in the residential property market weakened significantly in recent months. Tighter credit conditions led to higher mortgage rates and limited the availability



of credit to borrowers. These factors and weakness in the wider economy reduced housing demand and led to a sharp deterioration in housing activity. Housing transactions and mortgage approvals, key measures of housing market activity, weakened considerably.

The more resilient residential repair, maintenance and improvement market, which is the primary end-use market for the Group's UK merchanting sales, had an encouraging start to the year but weakened in the second quarter due to falling house prices, a lower level of equity withdrawal, declining housing transactions and a deterioration in consumer confidence.

UK Merchanting

Like for like sales in the merchanting business declined by 0.7 per cent. The operating profit margin in the overall merchanting business also declined by 0.7 per cent. This reflected the small decline in like for like sales, an improvement in the trading margin, unchanged like for like overheads in the Buildbase, Jacksons and Plumbase businesses and increased investment in the Selco and Plumbworld businesses. Selco and Plumbworld are two further routes to market which are being successfully developed.

The organisation structure supporting the management and development of the UK merchanting business further evolved during the half year in response to tougher market conditions and in line with the Group's objective of improving the profit stream and returns from the business. An integrated management structure will now have responsibility for Buildbase, Plumbase, Jacksons and the specialist merchanting businesses. The structure should enable the business to function more effectively and over time lead to significant synergies in procurement, accounting, administration and other support office functions while retaining the unique strengths and strong market positions of the individual trading brands.

UK Builders Merchanting

Buildbase benefited in the early months of the year from reasonably favourable trading, broadly continuing the trend established in 2007. However, as indicated above, market conditions weakened in the second quarter.

Regionally, Buildbase branches in the South East performed relatively better and overall turnover in the business increased marginally with the benefit of acquisitions and branch openings. Cost reductions partially mitigate the impact of lower volumes. The branch network was expanded through two single branch acquisitions and the opening of five branches. The Coventry and Market Drayton branches were relocated to new and enlarged facilities and Hire Centres were opened in eight branches.

Buildbase continued to develop its Partnering initiative which provides a structured approach to developing long term supply chain relationships with Local Authorities, Housing Associations and major national contractors including the provision of dedicated procurement management services and managed stores.



Jacksons, the East Midlands regional merchant reported broadly unchanged turnover with the businesses broad end-use market exposure enabling it to more effectively meet the challenges of a weakening market.

Selco, a trade self select warehouse based format, continued to benefit from good levels of activity in the small projects segment of the RMI market. The three stores that opened last year in London grew turnover in line with expectations. Expansion of the format continued with the opening of a store in Sutton, South London and a further four stores are scheduled to open later this year increasing the network to twenty five and providing increased market coverage in London and other large metropolitan areas.

In Northern Ireland, an easing of housing activity and prices from the record levels of recent years was accelerated by the international credit crunch and reduced demand from external investors. The contribution of the public sector to economic activity and employment provided a measure of resilience for the Macnaughton Blair business which achieved strong growth in RMI turnover partially offsetting the impact of a sharp decline in house building. Macnaughton Blair expanded its established position in the architectural ironmongery segment of the merchanting market with the acquisition of two ironmongery related businesses.

UK Plumbers Merchanting

The plumbers merchanting division incorporates the 188 branch Plumbase business and the bathroom products distribution business. The division increased sales substantially and despite generally weaker economic and trading conditions achieved a good level of sales growth in the like for like business. Operating profit increased in line with the scale of the business and the operating profit margin was maintained in line with the first half of 2007.

Plumbase strengthened its market position with the completion of two single branch acquisitions and the opening of seven branches. Sales in plumbworld.co.uk, the internet retailer of bathroom products, continued to grow.

UK Mortar

EuroMix, the leading manufacturer of mortars for use in residential, commercial and public sector construction projects, experienced a significant decline in sales and profitability due to the fall in the volume of residential construction, exacerbated by higher energy and materials costs and competitive pricing trends.

Operations Review – Republic of Ireland

Irish turnover declined by 16 per cent to €530.5 million (2007: €628.8 million) and operating profit declined by 60 per cent to €24.3 million (2007: €60.6 million). The operating profit margin was 4.6 per cent (2007: 9.6 per cent).

Growth in the Irish economy slowed sharply as the decline in residential construction which started in 2007 accelerated considerably. The housing market had an important role in the development of the economy in recent years and the adjustment in activity that is now well underway has contributed to the slowdown in the pace of economic activity generally. The Irish economy has also been affected by developments in



international financial markets which have limited the availability and increased the cost of finance for home buyers. Higher oil and food prices and adverse exchange rate movements also had a negative affect on economic growth.

Irish Merchanting

Turnover declined by 16 per cent to €354.7 million (2007: €424.2 million) and profitability was significantly lower. This performance was influenced by the decline in housing output in response to a sharp fall in demand, the weaker pricing environment and a high level of unsold properties. Housing starts progressively weakened during 2007 and forecast current year completions of approximately 45,000 units represents a decline of 42 per cent on the level of supply in 2007 and half the level of completions at the peak of the market in 2006. Housing starts weakened further indicating that supply will moderate further. There was a small reduction in capacity in the merchanting sector and this trend is expected to continue with the closure of uneconomic competitor operations.

The Heiton Buckley and Chadwicks business performed relatively well in the half year by limiting the impact of the dramatic fall in housing volumes through market share gains and an increased focus on the one-off housing market and the more resilient RMI market which continued to register volume growth. A number of branches benefited from an established exposure to the civils and commercial sectors where activity levels were good. The South Dublin City branch which opened last year and the relocated Tullamore branch performed strongly.

Heiton Steel, the market leading steel stock-holding business, increased sales and profits. Stronger demand from the commercial and agricultural sectors largely offset lower volumes in the housing market and all products achieved better pricing due to the increase in steel prices.

Management has responded to the significant challenges posed by the contraction in the housing market with tighter control of costs to partially offset the impact on profit of volume declines. Work continued on achieving closer integration of business units in order to fully realise scale related benefits and procurement gains derived from the substantial growth of recent years.

Irish Retailing

Turnover declined by 8 per cent to €154.6 million (2007: €168.2 million) and profitability was significantly lower. Trading in the forty two DIY and seven In-House at the Panelling Centre stores was influenced by a weakening trend in consumer spending and retail sales volumes following five years of strong growth.

The performance of the Group's retailing business in the half year is benchmarked against exceptional growth in the first half of 2007 which benefited from higher spending linked to the maturing SSIA savings accounts and favourable weather which boosted seasonal demand for gardening products. In contrast, poor weather conditions led to more subdued demand during this year's gardening season. A new store in Carrick-on-Shannon which opened in March traded to expectations.



The In-House at the Panelling Centre kitchen business is mainly exposed to the replacement market where demand held up well. Turnover was lower due to a more competitive environment as a number of participants commenced supplying the replacement segment of the kitchens market following the downturn in the new housing market.

Irish Manufacturing

Turnover and profitability in the windows, concrete and plastics businesses declined significantly due to the fall in residential construction activity. Management actions have been taken to better match capacity with demand.

Finance

The strong cash generative nature of the Group's businesses resulted in a cashflow from operating activities of €116.9 million (2007: €80.9 million) in the half year. This cashflow together with a favourable translation adjustment due to sterling weakness led to a decrease of €40.0 million in net debt despite spending €87.4 million on acquisitions and capital expenditure.

Control of working capital was a key priority in our operations and resulted in a reduction in investment of €45.5 million which in part reflected the decline in turnover.

The Group ended the half year in a strong financial position with shareholders funds of €1.04 billion after accounting for a negative translation movement of €46.7 million that arose, due to sterling weakness, on conversion of the net investment in the UK business. Shareholders' funds at 30 June 2008 were equivalent to net assets per share of €4.52. This figure does not reflect the potential uplift to fair value of the Group's large portfolio of freehold and long leasehold properties in the UK and Ireland including a number of properties which may become surplus to the Group's trading requirements.

Net debt at 30 June 2008 was €510.4 million (30 June 2007: €586.5 million) equivalent to gearing of 49 per cent (30 June 2007: 53 per cent). Group debt repayable in the period to the end of 2010 is covered by cash resources and committed facilities.

The Group's development over the past two decades has been largely funded by internal cashflows and a prudent level of borrowings. A strong balance sheet with high tangible net asset backing, cash generative businesses with leading market positions and the Group's good standing through its long term bilateral banking relationships has routinely enabled existing facilities to be refinanced and new facilities put in place over the past year against the background of much tighter conditions in the credit markets. The refinanced and new facilities are competitively priced at spreads which have not materially increased.

Risks and Uncertainties

The transparency (Directive 2004/109/EC) Regulations 2007 requires disclosure of the principal risks and uncertainties which could have a material impact on the Group's performance over the remainder of the financial year and cause actual results to differ materially from expected and historical results.



Trading in the Group's business is affected by economic conditions in the UK and Ireland where the Group's earnings are generated.

Demand in the UK and Irish builders merchandising markets and in the Irish DIY and UK mortar markets are sensitive to economic conditions generally including consumer confidence, interest rates, employment trends, inflation, demographic factors and housing market conditions. More difficult market conditions may reduce demand in the Group's markets resulting in lower volumes and profitability.

A further deterioration in the financial and credit markets may also have an impact on the wider economy and housing market in both the UK and Ireland and potentially lead to lower demand in the Group's merchandising, DIY and mortar businesses.

Sterling weakness could lead to lower reported Group earnings on translation of the results of the UK business into euro at the average rate of exchange for the second half of the year.

Cautionary Statement

This interim report contains forward-looking statements. These statements have been made by the directors in good faith based on the information available to them up to the time of their approval of this report. Due to the inherent uncertainties, including both economic and business risk factors underlying such forward-looking information, actual results may differ materially from those expressed or implied by these forward-looking statements. The directors undertake no obligation to update any forward-looking statements contained in this report, whether as a result of new information, future events, or otherwise.

Outlook

Trading conditions in July and August remained challenging and there are no immediate signs of an improvement in our markets. In Ireland, turnover continued to decline at a similar rate to the first half and UK like for like sales showed a mid single digit decline in July.

The Irish economy is forecast to contract modestly in 2008 due to the decline in new housing investment. The ongoing adjustment to the housing market together with a general tightening in mortgage lending and higher interest rates is expected to lead to a continuation of the difficult trading environment in the Irish merchandising market over the remainder of the year. The weaker trend in consumer spending due to ongoing cost of living increases and weaker labour market conditions should continue to be reflected in moderating demand in the DIY sector.

The near term outlook for the UK economy remains subdued with a further softening in activity forecast over the remainder of the year. The impact of the slowing economy, lower house prices and a sharp decline in housing market activity has weakened prospects for the RMI market which we expect to remain challenging.

Grafton's long term experience of dealing with adverse economic conditions as well as growth phases has facilitated the implementation of systems and measures to both



protect and maximise the Group's position during this downturn. Prudent management of resources during the extended growth period of recent years has produced high levels of cash flow and a strong balance sheet, leaving the Group well positioned to face the challenges of a downturn and to benefit from any related opportunities in its market.

The Group will benefit in the second half from closer integration of the UK and Irish merchandising operations and a reduced cost base. The recently established warehouse facility in Shanghai will consolidate the supply of goods from existing and new Chinese suppliers into a single base and improve procurement returns.

Despite the slowdown in Ireland and the UK, both economies are fundamentally sound and should return to more sustainable levels of growth when the restraining effects of higher inflation and tighter credit conditions ease. Grafton's current focus on cash generation, cost control, efficiency improvements and market development should leave the Group strongly positioned for profitable growth when the Irish and UK economies recover and trading conditions improve.

Conference Call

Grafton will host an Analysts' conference call today at 8.30am (Irish Time) to discuss this announcement. The dial-in numbers are:

Ireland:	+ 353	1 436 4265
UK:	+ 44	208 817 9301
US:	+1 718	354 1226
Other:	+353	1 436 4265

A replay of the conference call will be available from 11.30am (Irish Time). To access the recording, the dial-in numbers are:

Ireland:	+353	1 436 4267
UK:	+44	207 7696425
US:	+1	630 6523111
Other:	+353	1 436 4267

The digital replay security code is: 1375232#