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# ScS Upholstery plc

## Report and Financial Statements

30 September 2006

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COMPANIES HOUSE

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**Directors**

M F Browne (Chairman) #  
D Knight (Chief Executive)  
R Turnbull (Finance Director)  
K Royal (Sales Director)  
H A D Beere (Operations Director)  
N G Howes (Senior Independent Non-executive Director)\*#  
D N Jagger (Non-executive Director)\* #

**Secretary**

R Turnbull

**Registered Office**

45-49 Villiers Street  
Sunderland  
Tyne and Wear  
SR1 1HA

**Auditors**

Ernst & Young LLP  
Citygate  
St James' Boulevard  
Newcastle upon Tyne  
NE1 4JD

**Bankers**

Barclays Bank plc  
Tyneside Corporate Group  
PO Box 379  
71 Grey Street  
Newcastle upon Tyne  
NE99 1JA

**Solicitors**

Pinsent Masons  
1 Park Row  
Leeds  
LS1 5AB

**Stockbrokers**

KBC Peel Hunt Ltd  
111 Old Broad Street  
London  
EC2N 1PH

\* Audit Committee and Remuneration Committee

# Nominations Committee

## Chairman's statement

I am delighted to announce another strong performance from the Group with trading profit before tax and property transactions of £16.8 million for the year (2005: £15.1 million).

This result reflects the impact of the significant expansion programme undertaken during the year having opened 21 new stores (including one relocation). Revenue has increased significantly by 23.7% to £195.8 million (2005: £158.3 million). Like for like sales order intake was up by 1% and gross margin of 48.1% (2005: 48.0%) was maintained at expected levels despite a challenging year for the retail sector.

This strong result reflects the Group's proven formula and successful expansion strategy as we continue to strengthen our position as a major specialist sofa retailer.

### Results

Group pre-tax profits were £17.2 million (2005: £17.1 million). The results in 2005 included profits from property transactions of £2.0 million, compared to £0.4 million in 2006. Group pre-tax profits before property transactions were £16.8 million (2005: £15.1 million) an increase of 11.3%. The net margin on this basis is 8.6% (2005: 9.5%). This is very much in line with our expectations and reflects the significant expansion programme undertaken during the year having opened 21 new stores, including one relocation (2005: nine new stores including two relocations, and two store closures).

Earnings per share adjusted to exclude profits from property transactions increased 8.1% to 34.18 pence (2005 adjusted: 31.63 pence).

### Dividend

In line with our strong results and cash position the Board is recommending a final dividend of 12.0 pence per ordinary share. If approved, this would make a total dividend for the year of 19.0 pence per ordinary share (2005: 16.5 pence per ordinary share), an increase of 15.1%.

### Expansion programme

We currently have 88 stores, after opening a new store in Cambridge in October 2006. This store adds to the East Anglia region where we already have stores in Norwich, Colchester and Ipswich, the latter having opened on 29 September 2006. We recently opened a new distribution centre in Thetford with 24,000 square feet of space, to provide distribution capability for the region for the foreseeable future.

Regarding our plans for expansion in the ten months to July 2007, the new financial year end, we expect to open up to ten stores which is more in line with previous years' experience.

### Outlook

Total sales order intake for the first seven weeks of the current financial period is substantially higher than the same period last year. Like for like sales order intake for the first seven weeks of the current financial year is, as expected, down by 7%. This is mainly due to the strong comparatives following the very successful launch of the four new stores opened in October 2005. If the like for like impact of the stores opened in October 2005 is excluded, then like for like sales order intake is down by only 3% which is a very good performance given that existing stores last year traded 14% up for the same period on a like for like basis. We remain confident therefore, that the success of our ongoing expansion strategy and our proven formula will enable us to continue to grow the business profitably.



M F Browne  
Chairman

20 November 2006

## **Business review**

### **Review of operations**

#### **Successful formula**

ScS is a national retailer and specialises in selling lounge room sofas and chairs. We have deliberately positioned ourselves in the middle-market of the upholstery retail sector offering excellent value, choice and service to our customers.

We operate from 88 stores nationwide, 83 of which are in prime out of town retail park locations with a high quality fit out and mezzanine floor. Our branch network has developed through regional clusters supported by 11 distribution centres, which yields cost synergies in distribution and through effective use of national media.

We do not manufacture but source our product from 15-20 principal suppliers with whom we have developed very good working relationships, a critical success factor.

Our excellent people, with a customer service and profit minded culture, have successfully implemented our strategy, consistently producing high margin results.

#### **Market**

Verdict Research recently reported that consumer expenditure on upholstered furniture amounted to £3.7 billion in 2005. It also stated that over the past five years the sales performance of the furniture sector has been less volatile and more consistent with retail as a whole reflecting a more stable economic backdrop. It would appear that our sector continues to benefit from house price inflation through mortgage equity withdrawal with much of the spending being channelled into big ticket items. In addition, media coverage and home improvement programmes have raised awareness of the fashionability and aspirational appeal of sofas, which in turn has shortened replacement cycles.

The last few years have seen leather sofa sales overtake fabric sofa sales and approximately 60% of ScS sales are leather. This popularity is driven by the affordable price of good quality leather sofas, which has decreased to levels similar to fabric products.

The sofa market is very fragmented with the three major specialists, including ScS, accounting for circa 25% of sales. We continue to see our share of the sector increase both as a consequence of our successful formula and as weaker competitors leave the market.

#### **Business risks**

The principal risk to the business is management of the supply chain process. This involves the manufacture of quality product and delivery by suppliers to our distribution centres in the requisite timeframe, the delivery of the product to our customers in a professional manner and at prearranged dates and the provision of an excellent after sales service. Centralised buying, very good working relationships with a wide range of suppliers and our in house distribution capability enable us to manage this risk effectively (see Suppliers and Product Range and Distribution Network).

All risks are monitored on an ongoing basis by the Executive Directors and strategies are developed as appropriate to mitigate against such risks and minimise their impact.

## **Business review**

### **Store format and expansion programme**

The Group's expansion programme remains based upon a format which comprises a prime retail park location with a unique mezzanine floor layout, designed to encourage customers to circulate around the store. Displays are set in attractive, well-lit, open room settings and attention is paid to creating a relaxing homelike environment.

We continue to invest in the enhancement and quality of the visual merchandising of each store and believe that the retail standards in our stores are amongst the highest in the sector. After a store has been open for more than five years we refurbish it to ensure we maintain these high standards of modern display, replacing carpets, signage and fully decorating the store. We have carried out major refurbishments at ten stores during the year.

We have increased our selling space by 38% this year with the opening of a record 21 stores in Durham, Team Valley Retail World near Gateshead, Chesterfield, Dartford, Leicester, Lincoln, Gloucester, Preston, Harlow, Nottingham (a relocation to a better site on the same retail park), Wrexham, Cribbs Causeway Retail Park in Bristol, Mansfield, Silverlink Trading Estate near Newcastle, Colchester, Basildon, Wolverhampton, Wigan, Kilmarnock, Bridgend and Ipswich, the Ipswich store having opened on 29 September 2006. We opened in Cambridge in October 2006, which adds to the Norwich, Colchester and Ipswich stores in that region. The continued expansion within existing regions yields cost synergies through the benefit of shared advertising and distribution.

*The plan for this new financial period is to open up to ten new stores. Two stores are due to open on Boxing Day at Greenock in Scotland and Huddersfield and a further three stores are planned to open in March 2007.*

We will continue our strategy of locating new branches on prime retail parks adjacent to competitors, where returns on investment are greater due to increased footfall of customers shopping for furniture.

### **Suppliers and product range**

The Group does not manufacture any of the products it sells but purchases from a selection of 15-20 principal suppliers, of which approximately 60% are UK based, with the balance of supply from Europe. Centralised buying is critical to our success and we concentrate on developing and maintaining effective, long term working relationships with suppliers. This strategy has enabled the Group to secure attractive purchase terms and support from suppliers and to negotiate exclusivity on all current product lines.

The Group offers its customers a wide range of sofas. Each store typically displays a range of models, of which approximately 40% are fabric and 60% leather. Our average order value remains at circa. £1,500 (2005: circa. £1,500). All prices are determined centrally with no regional variations.

### **Marketing and advertising**

As the business has developed, our advertising strategy has been based upon employing Regional TV (ITV1) with National press (primarily The Sun, supported by The Daily Mail and Daily Express) and local and regional publications for a more local presence, all of which are fronted by the face of ScS, celebrity Martin Kemp.

Our budget for this area is circa 6% of revenue. The budget is spent around key trading periods, such as the Autumn campaign and January sale, with the remaining spend supporting, in the main, all Bank Holiday periods.

## Business review

As the business has grown, with stores added to existing regions and advertising underpinned by regional TV, this has enabled us to make better use of national press, increasing our presence in more upmarket national publications, including colour supplements. We have also expanded our advertising coverage into other TV media, including Satellite and Channel 4. This attracts a new audience to our offer and is helping us build a national brand. Further progress will be made in this area over the coming year as the business continues to expand, but maintaining spend at circa 6% of revenue.

### Distribution network

Delivery to customers is made by the Group's own network of localised distribution centres. Each centre supports several stores in its locality thus providing the Group with benefits from economies of scale. This in-house delivery service enables the Group to retain control of final delivery, which is a very important event for each of our customers. Distribution cost was 4.7% of revenue (2005: 4.8%).

The Group now operates 11 distribution centres throughout the UK mainland having recently opened a 24,000 sq feet warehouse in Thetford to support the three stores currently in East Anglia and anticipated expansion within that region.

### IT systems

Over the past 12 months we have conducted an exhaustive review of our existing systems, as a result of which we have decided to invest £1.3 million in the current financial period to further strengthen our IT capability to support future growth. This will be progressively implemented throughout 2007.

### People

In March of this year The Sunday Times reported the results of their survey into the Top 100 Companies to Work For. The random survey of employees of those companies selected by The Sunday Times in the mid-sized company section resulted in ScS achieving the position of 45th. This is an excellent achievement, and demonstrates that at ScS, our people are at the heart of our business and are key to the success of the Group's strategy of establishing ScS as a major national retailer.

The Group's policy is to involve employees in the business and to ensure that matters of concern to them, including the Group's aims and objectives, are communicated in an open and regular manner. We achieve this principally through the annual sales conference supported by other regular senior management meetings and briefings.

The Board is fully committed to delivering the highest standards of health, safety and welfare for all employees and acknowledges its responsibility for other persons who may be affected by the Group's activities.

The Group prides itself on being able to offer career development opportunities for all of our people through training, coaching and promotion within the Group. We are an equal opportunities employer and have accreditation for the Investors in People standard.

We are committed to employing the right people and to training them well. We have developed a new national training centre at our Sunderland head office, which is complemented by a training centre in the Midlands and by satellite training centres throughout the UK. We have invested in all areas of learning and ensure that our people are given access to local, regional and national training opportunities. We believe that well trained and motivated people are key to our customer-orientated and profit-driven culture and fundamental to the long-term success of the business and we continue to make significant investment in training and developing our people.

## Business review

### Financial review

#### Revenue

Revenue increased by 23.7% on the previous financial year to £195.8 million (2005: £158.3 million) reflecting the impact of the significant expansion programme undertaken during the year, with 21 new stores opened, including one relocation.

The like for like sales order intake, calculated on the basis of all stores open for 12 months or longer, is 1% up for the 52 week period. This is an excellent performance given the strong trading comparables last year and the difficult trading environment which our sector has experienced during the year.

#### Gross profit

Gross profit increased by 23.9% on the previous financial year to £94.2 million (2005: £76.0 million) and gross margin is 48.1% (2005: 48.0%).

#### Group trading profit

Group trading profit is £15.9 million (2005: £14.4 million), an increase of 10.4%.

The trading profit margin of 8.1% (2005: 9.1%) is very much in line with our expectations as it is stated after absorbing the costs of the significant expansion programme during the year. The additional costs associated with staff recruitment, induction and training, together with pre-opening and launch costs for the stores, means that there is an initial negative impact on profitability. Also, given our policy of recognising sales when the goods have been delivered, and with normal lead times from suppliers of six to 12 weeks, new stores have a significant period when costs are incurred but revenue is not earned.

#### Profit before taxation

Profit before taxation is £17.2 million (2005: £17.1 million). Excluding profits from property transactions, profit before taxation was £16.8 million (2005: £15.1 million), an increase of 11.0%. This is an excellent result given the impact of the significant expansion programme.

#### Taxation

The effective rate of tax on profit for the year is 31.5% (2005: 29.8%). This is higher than the standard rate of corporation tax in the UK of 30%, primarily due to the accounting depreciation not eligible for tax purposes (see note 8 to the financial statements).

#### Balance sheet and cash flow

The balance sheet remains very strong with net assets of £37.6 million (2005: £30.2 million) and no borrowings. Additions to fixed assets during the year totalled £14.3 million (2005: £6.6 million). New store leasehold improvements and fixtures and fittings amounted to £12.0 million (2005: £5.3 million). Expenditure on refurbishments amounted to £1.2 million (2005: £0.7 million) during the year. Net book value of leasehold improvements and fixtures and fittings at our stores account for £33.8 million (2005: £23.8 million) of the Group's net asset value as disclosed in the balance sheet.

The continued profitability and strong operating cashflow of the business has resulted in cash balances of £19.7 million at the end of the financial year (2005: £20.2 million). This is after payments on account of corporation tax liabilities of £4.8 million (2005: £5.0 million), dividend payments of £5.8 million (2005: £5.0 million) and total capital expenditure of £14.8 million (2005: £6.6 million).

The strong balance sheet and significant operating cash flow generation of the business optimises our ability to continue the expansion strategy and sustain a sensible growth in dividends, financed from our own resources.

## Business review

### Earnings per share and dividends

Basic earnings per share are 35.12 pence (2005: 36.24 pence), reflecting the reduction year on year in profit on property transactions. Adjusted earnings per share, which excludes profit on property transactions is 34.18 pence (2005: 31.63 pence), an increase of 8.1 %.

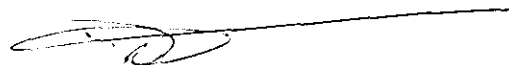
The final dividend proposed of 12.0 pence per ordinary share, if approved, would make a total dividend for the year of 19.0 pence per ordinary share (2005: 16.5 pence per ordinary share), an increase of 15.2% which reflects our strong cash position.

### International Financial Reporting Standards (IFRS)

The consolidated financial statements are prepared under IFRS and the comparatives have been restated accordingly. The main impact on the trading results is to recognise lease incentives in the income statement over the full term of the lease rather than over the period to the first rent review. The effect in the financial year was to carry forward an increased amount of deferred lease incentives within current liabilities and non-current liabilities. This adjustment reduced trading profit (excluding the impact of the disposal of property interests on lease incentives) by £617,000 (2005: £513,000). There is no impact of the move to IFRS on the cash flows or operations of the business.

### Change of financial year end

As reported in the Interim Announcement on 15 May 2006, the Group will be changing its accounting reference date from 30 September to 31 July for the 2006-2007 financial year. The Group will next report unaudited interim results for the six months ending 31 March 2007 and audited results for the ten months ending 31 July 2007.



David Knight  
Chief Executive

20 November 2006

## Directors

### Non-executive directors

*N G Howes LLB, FCA (age 55)*

Nigel Howes was appointed as a non-executive Director in February 2005. Nigel is a Chartered Accountant and was a partner with Arthur Andersen from 1984 to 2002. He joined Deloitte & Touche as a partner in 2002 and retired in November 2004. He has advised a broad range of audit clients from entrepreneurial companies to major plc's and has an in-depth knowledge of financial reporting risk management and corporate governance issues. Through his extensive client base he has developed expertise in many sectors including retail, distribution, manufacturing, leisure and business services. Nigel is also Executive Chairman of Acceleris plc and a non-executive Director of Wraith plc.

*D N Jagger, LLB, Dip.EEC (age 48)*

Denise Jagger was appointed as a non-executive Director in April 2005. A Solicitor, Denise joined Eversheds LLP in 2004 and is a partner working on client service and business development. She was previously Company Secretary and General Counsel of Asda Group Limited which she joined in 1993, where she managed a range of corporate functions including legal, corporate affairs, risk management, share schemes and pensions. Denise is also a non-executive Director of Scarborough Building Society.

### Executive directors

*M F Browne (age 60)*

Mike Browne has spent most of his working life in furniture retailing and joined ScS in 1975. He started with Hardy Furniture & Co in 1963 as a trainee salesman, later working at Times Furnishings and then joined Wades Department Stores in 1970 as a Branch Manager where he subsequently became General Manager. He has played a central part in the growth and strategic development of ScS as Chief Executive and more recently as Executive Chairman.

*D Knight (age 48)*

David Knight joined ScS in 1987 as a General Manager from Wades Department Stores, which he had joined in 1978. He progressed to become the Branch Manager of ScS's flagship store, located at the Metro Centre in Gateshead. He became National Sales Manager in October 1995 and was appointed to the Board in November 1997 as Merchandising Director. In October 1999 he was promoted to the position of Managing Director, then to Chief Executive in January 2002.

*R Turnbull (age 50)*

Ron Turnbull joined ScS in 2004 as Finance Director and Company Secretary from Pubmaster Limited. He was with Pubmaster for 12 years where he held various financial positions, including that of Finance Director from March 1999 until he was appointed Chief Operating Officer in May 2003. Ron's early career comprised 13 years with KPMG where he qualified as a Chartered Accountant and progressed to Audit Manager before joining Price Waterhouse as Senior Audit Manager in 1988.

*K Royal (age 47)*

Kevin Royal joined ScS in 1981 as a trainee Branch Manager, after qualifying as a Marine Engineer within the ship building industry. He has progressed through the business, managing a number of stores, (including the Metro Centre Gateshead flagship store), subsequently being promoted to Regional Manager, before being appointed to the Trading Board in 1999. He was promoted to the main Board as Sales Director in May 2003.

## Directors

### **Executive directors** (continued)

*H A D Beere (Familiar name Sacha) (age 40)*

Sacha Beere joined ScS in 1996 as Financial Controller. He is a Chartered Accountant with extensive practice experience, moving into industry to head the finance function at the Thornton Brothers Group, a major commercial vehicle livery specialist and recovery vehicle manufacturer. Sacha assisted the previous Finance Director closely during the flotation. He was appointed to the Board in March 1999, becoming Finance Director in June 1999. In June 2004 he took up the newly created role of Operations Director to bring more focus to the important areas of customer service, information technology and logistics.

## Corporate governance

### Introduction

The Group is committed to maintaining high standards of corporate governance and supports the revised Combined Code published in July 2003 ("the Combined Code"). This statement describes how the principles of corporate governance are applied by the Group and the extent of the Group's compliance with the Combined Code for the year ended 30 September 2006. The Combined Code, as revised in June 2006 is applicable for accounting periods beginning on or after 1 November 2006.

### Directors' statement on compliance with the Combined Code

The Group has been in full compliance with the provisions set out in Section 1 of the Combined Code throughout the year.

### The Board and its Committees

#### *The Board*

The Board at 20 November 2006 comprised the Executive Chairman, the Chief Executive, the Finance Director, the Sales Director, the Operations Director, the Senior Independent Non-Executive Director and another independent Non-Executive Director. Their biographies are given on pages 8 and 9. A Statement of the Directors' Responsibilities in respect of the Financial Statements is set out on page 24.

Mike Browne is Executive Chairman and his prime responsibility is leadership of the Board and ensuring the effective working of the Board in all aspects of its role and responsibilities.

David Knight is Chief Executive and is responsible for all aspects of the management of the Group and its business, including developing the business strategy for Board approval and securing its timely and effective implementation.

The Board meets regularly to discharge its duties effectively. The table on page 12 identifies the number of Board and Committee meetings held during the past year and the attendance record of individual Directors. The Chairman ensures that the Directors receive accurate, timely and clear information, in particular about the Group's performance, to enable the Board to take sound decisions, monitor effectively and promote the success of the Group. The Board deals formally with matters relating to strategy, performance, investment, divestment and funding, public announcements including trading updates and interim and annual reporting, communication with shareholders, dividend policy and Board appointments.

All Directors are subject to re-election by shareholders following appointment and are subject to re-election at intervals of not more than three years. Kevin Royal retires from the Board at the Annual General Meeting and, being eligible, offers himself for re-election.

Nigel Howes is Senior Independent Non-Executive Director whose prime responsibility is to provide a communication channel between the Board and shareholders and to be available to them if they have concerns, which contact through the normal channels of Chairman, Chief Executive or Finance Director has failed to resolve or for which such contact is inappropriate.

There are two non-executive Directors which, in the view of the Board, is currently appropriate given the scale of the business. With their experience and skills and through their contribution at Board and committee meetings, they bring to the Group independent judgement on issues such as strategy and performance, risk, reporting and people. The Board considers each Non-executive Director to be independent in character and judgement and are satisfied that they comply with the independence criteria as set out in the Combined Code.

## Corporate governance

All Directors are encouraged to develop and update their skills, knowledge and familiarity of the business through their initial induction, ongoing participation in the Board and committee meetings and through meeting people throughout the Group, at head office, store and warehouse locations. The Company Secretary acts as a sounding board to the Chairman and individual Directors on matters of ongoing training, development and Governance and plays a key role in ensuring that Board procedures are complied with and that the Group complies with all relevant rules and regulations. The appointment and removal of the Company Secretary is a matter for the Board as a whole. The non-executive Directors' contracts of employment contain specific instructions stating that they may consult professional advisers at the Group's expense. Executive Directors also have the right to take such action by virtue of their powers of executive authority.

The Board has three standing Committees as follows:

### **Audit Committee**

The Audit Committee comprises the independent non-executive Directors, Nigel Howes (Chairman) and Denise Jagger. The Audit Committee's primary responsibility is to monitor and review the integrity of the financial statements of the Group and formal announcements relating to the Group's financial performance, systems of internal control and risk management, the effectiveness of the internal audit function, the external auditors' independence and objectivity and the effectiveness of the audit process. It is responsible for the appointment and removal of external auditors and approval of the audit plan and their fees, as well as agreeing to the extent, if any, of their involvement in non-audit work. In this regard, the Committee has developed a pre-approval procedure in order to safeguard independence and objectivity taking into consideration relevant UK professional and regulatory requirements. The Audit Committee discharges its responsibility by meeting five times annually to receive and review reports from management and from internal and external auditors and has unrestricted access to the auditors and meets with them without management being present. Both members of the Audit Committee attended every meeting.

### **Nominations Committee**

The Nominations Committee comprises the independent non-executive Directors, Nigel Howes (Chairman) and Denise Jagger, and Mike Browne. The Nominations Committee's primary responsibility is to lead the process for Board appointments and make recommendations to the Board as appropriate. Meetings are held as needed to deal with necessary assignments. There has been no requirement to meet during the financial period.

### **Remuneration Committee**

Information relating to the Remuneration Committee is contained in the Directors' Remuneration Report on pages 15 to 19.

## **Evaluation of performance**

The Board has fully evaluated the effectiveness of its performance and of the Trading Board's performance during the year. The formal process, facilitated by the Chairman, comprised the completion by each Director of an appropriately designed questionnaire, followed by a collective review. It also involved consideration of the collective skills of the Board. The review concluded that the balance of non-executive and executive Directors was appropriate, at present, given the nature, size and complexity of the business, and that the skills mix was also appropriate.

The Board also reviewed the effectiveness of the Audit Committee during the year and concluded that the Committee had operated effectively, measured against its terms of reference and best practice. It is intended to formally review the performance of the other Committees during the current financial period.

## Corporate governance

### Directors' attendance at Board and Committee meetings during the year

<i>No. of meetings in year</i>	<i>Board Meetings</i>	<i>Audit</i>	<i>Committee Meetings</i>	
			<i>Remuneration</i>	<i>Nominations</i>
M F Browne	7	-	-	-
D Knight	7	-	-	-
R Turnbull	7	-	-	-
K Royal	6	-	-	-
H A D Beere	7	-	-	-
N G Howes	7	5	3	-
D N Jagger	7	5	3	-

During the year the Board met 7 times. All members of the Board attended each meeting, with the exception of Kevin Royal who was unable to attend one meeting held during February 2006. The Audit and Remuneration Committees met five times and three times respectively during the year. Both members of the Committees attended each meeting

### Relations with shareholders

Communications with shareholders are given high priority. The Chairman's Statement and Business Review on pages 2 to 7 include a detailed review of the business and its future developments. There is regular dialogue with institutional shareholders including presentations after the Group's preliminary announcement of the year end results and at the half year. The Chairman ensures that the Board is regularly updated on shareholder views following meetings they have with him, the Chief Executive and/or the Finance Director.

The Board uses the Annual General Meeting to communicate with private and institutional investors and welcomes their participation. The entire Board will be available at the Annual General Meeting to answer questions. Details of the resolutions to be proposed at the Annual General Meeting on 19 February 2007 can be found in the notice of meeting.

## Corporate governance

### Internal control

The Board is responsible for the Group's systems of internal control and for reviewing its effectiveness. Internal controls are designed to manage rather than eliminate the risk of failure to achieve business objectives. The implementation of the systems of internal control within an established framework is delegated to management who are accountable to the Board for monitoring the systems and providing assurance that it has done so. Directors place considerable importance on the maintenance of a robust and effective control environment within the Group. However, any system of internal control can only provide reasonable and not absolute assurance against material misstatement or loss.

An ongoing process, in accordance with the guidance of the Turnbull Committee on internal control, now included in the Combined Code, has been established for identifying, evaluating and managing the significant risks faced by the Group. The process has been in place for the full year under review and up to the date of approval of the annual report and financial statements. The Board regularly reviews this process.

The key procedures and processes that are in place with a view to providing effective internal controls are described below:

- There is a formal schedule of matters specifically reserved for decision by the Board including approval of strategic plans and budgets, material capital expenditure, dividend policy, communication with shareholders and Board appointments.
- The Directors have established a Trading Board of Directors in the trading Company to strengthen internal control. This Trading Board, which comprises the Executive Directors and two other Directors of the trading subsidiary responsible for logistics and human resources management respectively, meets formally on a monthly basis and informally as necessary to discuss day-to-day operational matters.
- The Group reports to shareholders twice a year and is committed to best practice in external reporting.
- Segregation of duties has been extensively applied in the structure of the Group's administration procedures to ensure that no one person completes every stage of a transaction.
- Principal business systems operate on secure integrated computer networks giving specified individuals ready access to both detailed transaction data and key management information.
- A formal and comprehensive annual budgeting process ensures that the Board is provided with a timely and detailed plan of action which it approves and which sets out individual performance targets and parameters for cost and profit centres in the Group.
- Actual performance is compared to budget on a monthly basis.
- The forecast for the financial year is monitored in detail on a regular basis.
- There is a system of continuous inventory control whereby stock locations are audited on a risk basis and a detailed report is circulated to senior management and Directors after every visit.

## Corporate governance

- The Group has an internal audit function which tests branch retail systems and procedures at all stores, selected on a risk basis. Internal audit has been further strengthened during the year with the recruitment of more skilled, experienced personnel. A senior manager heads up this function and has assisted in risk assessment and governance issues generally. A summary report highlighting any key lapses in procedures is circulated to senior management and Directors each month. The Head of Internal Audit attends Audit Committee meetings and updates the Committee on the findings of the work performed and progress regarding the ongoing development of the function. The Audit Committee ensures that recommendations from internal audit are implemented.

The key processes used by the Board to review the effectiveness of the system of internal control comprise the following:

- An annual review of the Group's risk assessment and internal control document, which covers both financial and non-financial areas of the business processes.
- Consideration of the outcome of the Audit Committee meetings and the relevant action determined in respect of any control issues raised by internal or external auditors.
- Monitoring of key performance parameters on a daily, weekly, monthly and quarterly basis.

### Going concern

Having made appropriate enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and for this reason they continue to adopt the going concern basis in preparing the financial statements.

## **Directors' remuneration report**

### ***Information not subject to audit***

This report has been prepared in accordance with the requirements of Schedule 7A to the Companies Act 1985. An ordinary resolution for the approval of this report will be put to the members at the Annual General Meeting.

The law requires the Company's auditors to audit certain of the disclosures provided. Where disclosures have been subject to audit, they are indicated as such under the heading 'Information subject to audit'. The auditors' opinion is included in their report on pages 25 and 26.

### **Remuneration Committee and advisors**

The Group's Remuneration Committee is chaired by Denise Jagger and its other member is Nigel Howes. The Committee met three times during the year and both members of the Committee attended every meeting. The Committee sought the advice of independent consultants (New Bridge Street Consultants) as to how comparative companies of similar size remunerate their executive Directors. This advice was applied in setting executive Directors' remuneration for the year under review. It was not considered necessary to take independent advice in setting remuneration for the current financial period, the Committee having determined this based upon external information available. However, following such comparative analysis the Remuneration Committee decided that the introduction of a long term incentive plan (LTIP) would be in the interests of shareholders in order to motivate the executive Directors and to provide an important retentive element to their remuneration package. Advice in designing this plan has been received from Close Brothers, and further details of this plan (and related proposals concerning executive bonuses) are contained in the circular to shareholders accompanying this report.

### **Remuneration policy**

The Committee's responsibility is to establish and maintain a remuneration policy for the following financial year and for subsequent financial years which is sufficiently competitive to attract, retain and motivate high quality executives. Given the strong and effective sales culture within the business, the Committee believe it is appropriate to link a significant proportion of pay of the executive Directors to the performance of the Group thereby creating a close identity of interest between executives and shareholders. The remuneration package of executive Directors consists of basic salary, performance related bonuses, other benefits in kind and amounts payable to money purchase pension schemes. Share options are granted at the discretion of the Remuneration Committee. The details of individual components of the remuneration package and service contracts are discussed below, with a summary of the Directors' emoluments given on pages 18 and 19.

### **Basic salary and benefits**

The basic annual salary of each of the executive Directors is set annually by the Remuneration Committee. Other benefits comprise a car, fuel and the provision of private healthcare. The remuneration of the non-executive Directors is determined by the executive Directors. The non-executive Directors do not participate in bonuses, share options or long-term incentive plans.

### **Performance related bonuses**

The executive Directors participate in an executive bonus plan, based on the Group's performance. The targets for the plan for the year ended 30 September 2006 were set by the Remuneration Committee by reference to profit before tax for the year and included a maximum limit of 150% of annual salary. In setting the targets, the Remuneration Committee takes into account the business plan profit before tax and a reasonable "stretch" target. Performance related bonuses do not affect the Group pension contributions.

## Directors' remuneration report

### Share options

Share options are granted at the discretion of the Remuneration Committee. The performance target of the executive share option schemes require the average of the percentage increase in the Group's earnings per share over each year in the three year period following the date of grant (8 December 1997, 19 May 1999, 5 December 2001 or 12 September 2002) to be equal to, or greater than, the average of the percentage growth of the Retail Price Index plus three percent in each year over that period. The performance targets have been chosen so that they directly link the remuneration with the performance of the business and shareholder value. The performance targets on the options are measured by reference to the audited financial statements and have been achieved for all of the award dates. No share options have been granted during the year.

### Share award plan

Under the rules of the plan, executive Directors are able to purchase shares with a value of up to 50% of any bonus received by the individual. An award of matching shares is granted with a value equal to the amount of bonus so invested plus an amount equal to the PAYE and NIC suffered on the bonus used to purchase shares. Legal title to the award passes to the individual on the third anniversary of its grant.

### Pensions

Each executive Director has a personal defined contribution pension scheme. Contribution levels are determined by the Remuneration Committee as part of each executive Director's remuneration package. Following independent research commissioned in previous years, the Committee decided that the level of Company contribution would be 20% of basic salary effective from 1 October 1999. This contribution level is periodically reviewed by the Committee. The non-executive Directors do not participate in any of the Company pension schemes.

### Service contracts

The duration of contracts of employment of the executive Directors are not fixed. Payments on termination are restricted to the value of salary for the notice period. The non-executive Directors have letters of appointment for an initial period of 3 years with a provision for termination on not less than 3 months notice. The service contracts and letters of appointment of the Directors include the following terms:

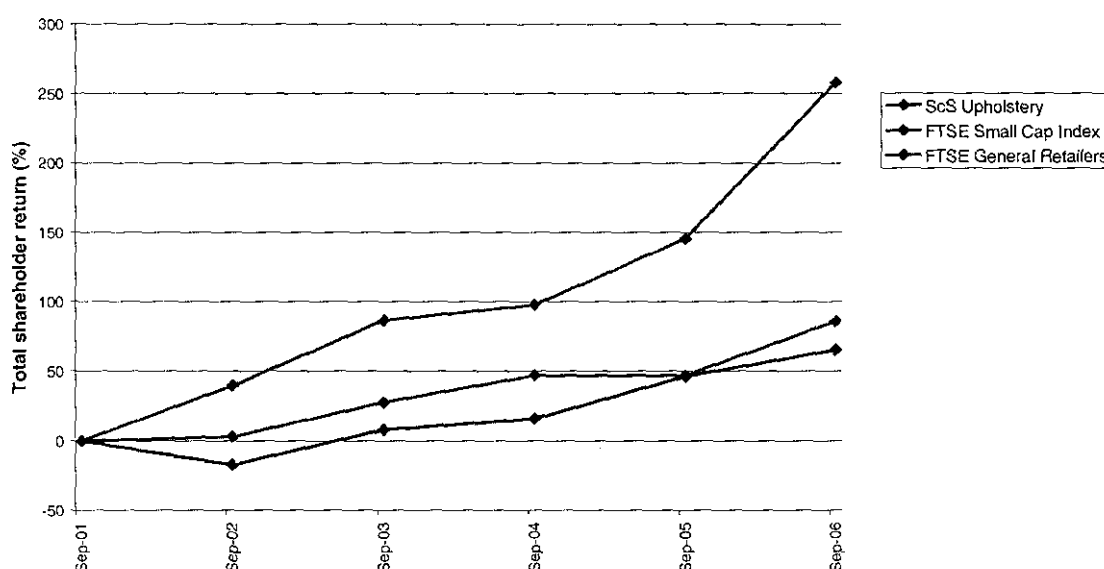
<i>Executive Directors:</i>	<i>Date of contract</i>	<i>Notice period (months)</i>
M F Browne	3 October 1997	12
D Knight	3 October 1997	12
R Turnbull	28 June 2004	12
K Royal	21 April 2004	12
H A D Beere	9 March 1999	12
<i>Non-executive Directors</i>		
N G Howes	8 February 2005	3
D N Jagger	6 April 2005	3

## Directors' remuneration report

### Performance graph

The graph below shows total shareholder return ("TSR"), with dividends reinvested, for each of the last six financial years in a holding of the Company's shares against the corresponding total shareholder return in a hypothetical holding of shares in the Small Cap FTSE share index and the General Retailers FTSE share index.

**Total shareholder return for ScS Upholstery plc vs FTSE Small Cap Index and FTSE General Retailers**



The graph represents the comparative TSR performance of the Group from 30 September 2001 to 30 September 2006. The FTSE Small Cap Index and the General Retailers index are considered appropriate comparators as each is a broad equity market index of which ScS Upholstery plc is a constituent.

In drawing this graph it has been assumed that all dividends paid have been reinvested. The TSR level shown at 30 September each year is the average of the closing daily TSR levels for the 30 day period up to and including that date.

These graphs have been produced in accordance with the requirements of the Directors' Remuneration Report Regulations 2002.

## Directors' remuneration report

### Information subject to audit

#### Directors' emoluments

	<i>Basic salary and fees</i>		<i>Performance related bonus</i>		<i>Other benefits</i>		<i>Total</i>		<i>Pension contributions</i>	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000	2006 £'000	2005 £'000	2006 £'000	2005 £'000	2006 £'000	2005 £'000
<i>Executive Directors</i>										
M F Browne	180	180	-	25	30	29	210	234	36	36
D Knight	225	185	63	130	27	25	315	340	45	37
R Turnbull	160	130	45	70	25	23	230	223	32	26
K Royal	150	110	42	100	22	21	214	231	30	22
HAD Beere	120	90	34	60	22	23	176	173	24	18
<i>Non Executive Directors</i>										
N G Howes*	28	18	-	-	-	-	28	18	-	-
D N Jagger**	28	13	-	-	-	-	28	13	-	-
A J McCann***	-	19	-	-	-	-	-	19	-	-
W K Goldsmith***	-	17	-	-	-	-	-	17	-	-
<b>Total</b>	<b>891</b>	<b>762</b>	<b>184</b>	<b>385</b>	<b>126</b>	<b>121</b>	<b>1,201</b>	<b>1,268</b>	<b>167</b>	<b>139</b>

\* Appointed 7 February 2005, remuneration from date of appointment in 2005

\*\* Appointed 6 April 2005, remuneration from date of appointment in 2005

\*\*\* Resigned 30 June 2005

Other benefits comprise a car, fuel and the provision of private healthcare.

Kevin Royal has been granted share options under the rules of the Company's Executive Share Option Scheme. The details of these grants are as follows:

	<i>1 October 2005</i>	<i>Granted during the year</i>	<i>Exercised during the year</i>	<i>30 September 2006</i>
Kevin Royal	75,000*	-	75,000	-

\* The share options were granted in September 2002 at an exercise price of 230.0 pence and could be exercised in the period September 2005 to September 2009. All 75,000 options have been exercised during the financial year at a market price of 400.0 pence.

## Directors' remuneration report

### Directors' emoluments (continued)

The market price of the Company's ordinary shares at 30 September 2006 was 482.5 pence per share and the range during the year to 30 September 2006 was 324.0 pence to 558.0 pence.

In addition to the Company's executive share option schemes, Directors held matching shares in the share award plan as follows:

	<i>Granted December 2002(a)</i>	<i>Granted December 2004(b)</i>	<i>Exercised during the year</i>	<i>Granted December 2005(c)</i>	<i>30 September 2006</i>
D Knight	42,428	30,882	(42,428)	16,049	46,931
R Turnbull	-	1,618	-	8,642	10,260
K Royal	11,165	21,323	(11,165)	12,346	33,669
H A D Beere	12,282	-	(12,282)	7,407	7,407

The options are exercisable between the following dates:

- (a) Exercised in January 2006 at a share price of 419.0 pence per share
- (b) Exercisable in January 2008.
- (c) Exercisable in January 2009.



D Knight  
Director

20 November 2006

## Directors' report

The Directors present their report and the Group financial statements for the year ended 30 September 2006.

### Results and dividends

The Group profit for the year on ordinary activities before taxation was £17,238,000 (2005: £17,131,000), an increase of 1% on the previous year. This includes profits from property transactions of £445,000 (2005: £2,002,000) (see note 3 to the financial statements).

The Directors recommend a final ordinary dividend of 12.0 pence per share, amounting to £4,047,000, making a total of 19.0 pence per share (2005: 16.5 pence) and £6,326,000 for the year. Dividends are now recognised in the financial statements in the year in which they are paid, or, in the case of the final dividend, when approved by the shareholders, such that the amount recognised in the 2006 financial statements, as described in note 10, is made up of last year's final dividend and this year's interim.

After providing for taxation in the year of £5,430,000 (2005: £5,112,000), £11,808,000 was transferred to reserves (2005: £12,019,000).

Subject to approval at the Annual General Meeting, the final dividend will be paid on 26 February 2007 to those shareholders whose names are on the register on 26 January 2007.

### Principal activity and review of the business

During the year, the Group's sole activity was as a specialist upholstered furniture retailer trading as ScS. The Group does not manufacture. Merchandise is sourced from quality manufacturers based primarily in the UK. The business is conducted by A Share & Sons Limited which is the sole subsidiary of the holding Company, ScS Upholstery plc.

### Business review and future developments

A review of the business and future developments of the Group, together with a statement on business risks and reference to various key performance indicators, is given in the Chairman's Statement on page 2 and the Business Review on pages 3 to 7.

### Financial instruments

A description of the Group's financial and risk management objectives and policies can be found in note 20.

### Political and charitable donations

During the year the Group made charitable donations, which include collections made by staff members, of £20,007 (2005: £22,968). The charitable donations were paid to various local and national charities, including the NSPCC, St Luke's Hospital and Race For Life. No political donations were made (2005: £Nil).

### Environment

The Group is committed to giving high priority to all environmental matters and concerns and co-operates fully with the relevant authorities to ensure that its legal obligations are met.

### Disabled employees

The Group's policy is to give equal consideration to all applicants for employment including disabled people. Career development and training are available to all employees, and those who become disabled are afforded every assistance to enable them to continue in their career, including retraining where necessary.

## Directors' report

### Employee involvement

The Group's policy is to involve employees in the business and to ensure that matters of concern to them, including the Group's aims and objectives, are communicated in an open and regular manner. We achieve this principally through the annual sales conference supported by other regular senior management meetings and briefings as appropriate.

The Group believes it is in the interests of shareholders and employees for senior staff to have an opportunity to invest in Company shares. Share options were granted in September 2002 to several of the Group's senior employees under the rules of an unapproved share option scheme and an approved share option scheme which are open to both Directors (see Directors' Remuneration Report) and employees. An employee share plan which awards free shares to employees was launched in 2005 and the first awards were made to circa. 100 employees in December 2005.

### Directors and their interests

The current Directors are listed on page 1.

The Directors at the end of the financial year and their interests in the share capital of the Company, other than with respect to options to acquire ordinary shares (which are detailed in the Directors' Remuneration Report), at the end of the financial year (in respect of which there have been no changes up to the date of signing the financial statements) were as follows:

		<i>Ordinary shares</i> <i>30 September 2006</i> <i>No.</i>	<i>Ordinary shares</i> <i>30 September 2005</i> <i>No.</i>
M F Browne	Beneficial 1p each	6,554,700	8,804,700
	Non-beneficial 1p each	595,300	595,300
D Knight	Beneficial 1p each	226,691	192,294
R Turnbull	Beneficial 1p each	37,253	32,154
K Royal	Beneficial 1p each	19,865	19,281
H A D Beere	Beneficial 1p each	40,148	42,496
N G Howes * (Senior Independent Non-executive)	Beneficial 1p each	5,000	5,000
D N Jagger * (Non-executive)	Beneficial 1p each	1,046	-

Details of the Directors' share options are set out on pages 18 to 19 of the Directors' Remuneration Report.

\* Comparatives are stated as at the date of appointment

## Directors' report

### Purchase of shares

The Company acquired 39,846 shares during the year, with an aggregate nominal value of £398 (0.1% of share capital). The consideration paid was £187,475. The shares were acquired to be held by employee benefit trusts for the benefit of the employees, as described in notes 18 and 19.

### Major interests in shares

Apart from the Directors whose shareholdings are detailed under Directors' interests above, the Directors have been notified of the following interests in 3% or more of the Company's ordinary share capital as at 8 November 2006:

	Number of shares held	% of issued share capital
Fidelity Investments	4,904,501	14.4
Standard Life Investments	3,855,473	11.3
Irvin John Bamford	2,056,000	6.0
Threadneedle Asset Management	1,828,000	5.4
Barclays Global Investors	1,646,963	4.8
Independent Investment Trust plc	1,100,000	3.2
J P Morgan Asset Management	1,062,836	3.1
Legal & General Investment Management	1,038,756	3.0

### Supplier payment policy and practice

Payment terms are agreed between the Group and all major suppliers. Payments are made according to these terms, subject to the terms and conditions being met by the supplier.

At 30 September 2006, the Group had an average of 31 days (2005: 31 days) purchases outstanding.

### Special business at the Annual General Meeting

At the Annual General Meeting on 19 February 2007 items 1 to 5 are termed ordinary business, while resolutions 6 to 9 will be special business. The special business is as follows:

- Resolution 6 allows the Directors to allot up to £113,455 nominal value of unissued ordinary share capital representing 33% of issued share capital, which is the maximum permitted under the guidelines laid down by the Institutional Shareholder Committees. This authority lapses at the conclusion of the next following Annual General Meeting.
- Resolution 7 authorises the Directors to allot a limited number of shares without regard to the pre-emption requirements contained in Section 89 of the Companies Act 1989. Such authority is restricted to allotments of shares which cannot be offered under rights issue for legal or practical problems (such as legislation affecting overseas shareholders or problems associated with fractional entitlements) and otherwise to the allotment of not more than five per cent of the Company's issued share capital. This resolution is within the guidelines laid down by the Institutional Shareholders Committees. This authority lapses at the conclusion of the next following Annual General Meeting.

The Directors have no present intention of exercising these authorities and are of the opinion that these proposals are in the best interests of both the Company and its shareholders.

## Directors' report

### Special business at the Annual General Meeting (continued)

- Resolution 8 authorises the Directors to establish a performance related Long Term Incentive Plan, intended to incentivise and reward executive Directors and the subsidiary Trading Board directors. More details concerning the Long Term Incentive Plan will be provided in a letter from the Chairman to be enclosed with the financial statements.
- Resolution 9 authorises the Directors to establish a standard HM Revenue & Customs tax approved Sharesave Plan. More details concerning the Sharesave Plan will be provided in a letter from the Chairman to be enclosed with the financial statements.

The resolutions are set out in the Notice of Annual General Meeting.

### Auditors

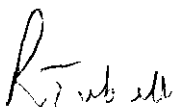
A resolution to re-appoint Ernst & Young LLP as the auditors will be put to the forthcoming Annual General Meeting.

### Directors' statement as to disclosure of information to Auditors

The Directors who were members of the Board at the time of approving the Directors' report are listed on pages 8 and 9. Having made enquiries of fellow Directors and of the Group's auditors, each of the Directors confirms that:

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of this report of which the Group's auditors are unaware; and
- each Director has taken all the steps a Director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditors are aware of that information.

By order of the board



R Turnbull  
Secretary

20 November 2006

## **Statement of directors' responsibilities in relation to the Group financial statements**

The Directors are responsible for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

The Directors are required to prepare Group financial statements for each financial year which present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those Group financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- provide additional disclosures when compliance with specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance.

*The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Group financial statements comply with the Companies Act 1985 and the Group financial statements comply with Article 4 of IAS Regulation. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.*

## **Independent auditor's report**

**to the members of ScS Upholstery plc**

We have audited the Group financial statements of ScS Upholstery plc for the year ended 30 September 2006 which comprise the Consolidated Income Statement, the Consolidated Balance Sheet, the Consolidated Cash Flow Statement, the Consolidated Statement of Change in Equity and the related notes 1 to 25. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent Company financial statements of ScS Upholstery plc for the year ended 30 September 2006 and on the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

The Directors are responsible for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view, the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and whether the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Chairman's Statement and Business Review that is cross referred from the Business review and future developments section of the Directors' Report.

We also report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Director's remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Chairman's Statement, the Business Review, the Directors' information, the Corporate Governance Statement and the unaudited part of the Directors' Remuneration Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

## **Independent auditor's report**

to the members of ScS Upholstery plc (continued)

### **Basis of audit opinion**

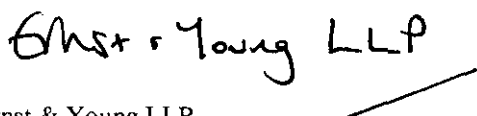
We conducted our audit in accordance with *International Standards on Auditing (UK and Ireland)* issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements.

### **Opinion**

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 30 September 2006 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the Group financial statements.



Ernst & Young LLP  
Registered auditor  
Newcastle upon Tyne

20 November 2006

**Consolidated income statement**

for the year ended 30 September 2006

	<i>Notes</i>	2006 £'000	2005 £'000
<b>Revenue</b>	2	195,828	158,295
Cost of sales		(101,615)	(82,260)
		<hr/>	<hr/>
<b>Gross profit</b>		94,213	76,035
Distribution costs		(9,223)	(7,552)
Administration costs		(69,103)	(54,095)
		<hr/>	<hr/>
		(78,326)	(61,647)
<b>Group trading profit</b>		15,887	14,388
Other income – profit on disposal of property interests	3	445	2,002
		<hr/>	<hr/>
<b>Group operating profit from continuing operations</b>	4	16,332	16,390
Finance revenue	7	906	741
		<hr/>	<hr/>
<b>Profit from continuing operations before taxation</b>		17,238	17,131
Income tax expense	8	(5,430)	(5,112)
		<hr/>	<hr/>
<b>Profit attributable to equity shareholders of the parent</b>		11,808	12,019
		<hr/>	<hr/>
Earnings per share - Basic (pence)	9	35.12	36.24
Earnings per share - Adjusted (pence)	9	34.18	31.63
Earnings per share - Diluted (pence)	9	35.04	36.00
		<hr/>	<hr/>

# Consolidated balance sheet

at 30 September 2006

	Notes	2006 £'000	2005 £'000
<b>Non-current assets</b>			
Property, plant and equipment	11	36,113	25,321
Intangible assets	12	527	314
Other receivables	13	823	-
Deferred tax asset	8	99	326
		<u>37,562</u>	<u>25,961</u>
<b>Current assets</b>			
Trade and other receivables	13	9,652	8,334
Inventories	14	11,546	9,576
Cash and cash equivalents	15	19,671	20,168
		<u>40,869</u>	<u>38,078</u>
<b>Total assets</b>		<u>78,431</u>	<u>64,039</u>
<b>Current liabilities</b>			
Trade and other payables	16	(31,713)	(26,292)
Income tax payable		(1,984)	(1,764)
		<u>(33,697)</u>	<u>(28,056)</u>
<b>Non-current liabilities</b>			
Trade and other payables	16	(7,178)	(5,799)
<b>Total liabilities</b>		<u>(40,875)</u>	<u>(33,855)</u>
<b>Net assets</b>		<u>37,556</u>	<u>30,184</u>
<b>Equity</b>			
Share capital	17	340	336
Share premium account	18	2,971	1,920
Capital redemption reserve	18	195	195
Treasury shares	18	(1,172)	(1,472)
Retained earnings		35,222	29,205
<b>Total equity</b>		<u>37,556</u>	<u>30,184</u>

D Knight  
Director

20 November 2006

**Consolidated cash flow statement**

for the year ended 30 September 2006

	<i>Notes</i>	<i>2006</i>	<i>2005</i>
		<i>£'000</i>	<i>£'000</i>
<b><i>Cash flows from operating activities</i></b>			
Group operating profit		16,332	16,390
Depreciation		3,358	2,563
Depreciation of non current other receivables		39	
Profit on disposal of property, plant and equipment		-	(260)
Amortisation of other intangibles		258	416
Share based payments		271	101
(Increase)/decrease in inventories		(1,970)	275
Increase in trade and other receivables		(2,178)	(2,507)
Increase in trade and other payables		6,843	4,541
Cash generated from operations		22,953	21,519
Income taxes paid		(4,760)	(4,998)
<b><i>Net cash flow from operating activities</i></b>		<b>18,193</b>	<b>16,521</b>
<b><i>Cash flows from investing activities</i></b>			
Interest received		906	741
Payments to acquire intangible fixed assets		(471)	(97)
Purchase of property, plant and equipment		(14,356)	(5,998)
Proceeds on disposal of property, plant and equipment		161	1,726
<b><i>Net cash flows from investing activities</i></b>		<b>(13,760)</b>	<b>(3,628)</b>
<b><i>Cash flows from financing activities</i></b>			
Net proceeds from issue of ordinary shares		1,055	1,185
Payment to acquire own shares		(187)	(971)
Dividends paid to equity shareholders of the parent		(5,798)	(5,011)
<b><i>Net cash flows from financing activities</i></b>		<b>(4,930)</b>	<b>(4,797)</b>
<b><i>(Decrease)/increase in cash and cash equivalents</i></b>		<b>(497)</b>	<b>8,096</b>
Cash and cash equivalents at the beginning of the year		20,168	12,072
<b><i>Cash and cash equivalents at the end of the year</i></b>	<b>15</b>	<b>19,671</b>	<b>20,168</b>

## Consolidated statement of changes in equity

for the year ended 30 September 2006

	<i>Equity share capital £'000</i>	<i>Share premium account £'000</i>	<i>Capital redemption reserve £'000</i>	<i>Treasury shares £'000</i>	<i>Retained earnings £'000</i>	<i>Total equity £'000</i>
At 30 September 2004	326	745	195	(501)	21,879	22,644
Profit for the year	-	-	-	-	12,019	12,019
Equity dividends	-	-	-	-	(5,011)	(5,011)
Items recognised directly in equity:						
Share based payments	-	-	-	-	101	101
Income tax	-	-	-	-	217	217
Acquisition of treasury shares	-	-	-	(971)	-	(971)
Employee share options exercised	10	1,175	-	-	-	1,185
At 30 September 2005	336	1,920	195	(1,472)	29,205	30,184
Profit for the year	-	-	-	-	11,808	11,808
Equity dividends	-	-	-	-	(5,798)	(5,798)
Items recognised directly in equity:						
Share based payments	-	-	-	-	271	271
Income tax	-	-	-	-	223	223
Acquisition of treasury shares	-	-	-	(187)	-	(187)
Employee share options exercised	4	1,051	-	-	-	1,055
Transfer re. treasury shares	-	-	-	487	(487)	-
At 30 September 2006	340	2,971	195	(1,172)	35,222	37,556

## Notes to the financial statements

for the year ended 30 September 2006

### 1. Accounting policies

#### *Statement of compliance*

The consolidated financial statements have been prepared in accordance with IFRS as adopted for use in the European Union as they apply to the financial statements of the Group for the year ended 30 September 2006 and applied in accordance with the provisions of the Companies Act 1985.

The Directors consider the following accounting policies to be relevant in relation to the Group's financial statements.

#### *Basis of preparation*

This is the first year in which the Group has prepared its financial statements under IFRSs and the comparatives have been restated from UK Generally Accepted Accounting Practice (UK GAAP) to comply with IFRSs. The Group's Interim Report incorporated its preliminary IFRS financial statements for 2005 and the reconciliation to IFRSs from the previously published UK GAAP financial statements are summarised in note 25.

#### *New standards and interpretations not applied*

During the year, the IASB and IFRIC have issued the following standards and interpretations with an effective date after the date of these financial statements:

	<i>Effective date (periods beginning on or after)</i>
<i>International Accounting Standards (IAS/IFRS's)</i>	
IFRS1 Amendment relating to IFRS6	1 January 2006
IFRS4 Amendment to IAS39 and IFRS4 – Financial Guarantee Contracts	1 January 2006
IFRS6 Exploration for and Evaluation of Mineral Assets	1 January 2006
IFRS7 Financial Instruments: Disclosures	1 January 2007
IAS1 Amendment to IAS1: Presentation of Financial Statements: Capital Disclosures	1 January 2007
IAS21 Amendments to IAS21 The Effects of Changes in Foreign Exchange Rates	1 January 2006
IAS39 Fair value option, cash flow hedge accounting	1 January 2006
<i>International Financial Reporting Interpretation Committee (IFRIC)</i>	
IFRIC4 Determining whether an Arrangement contains a Lease	1 January 2006
IFRIC5 Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	1 January 2006
IFRIC6 Liabilities arising from Participating in a Specific Market-Waste Electrical and Electronic Equipment	1 January 2006
IFRIC7 Applying IAS29 Financial Reporting in Hyperinflationary Economies for the First Time	1 March 2006
IFRIC8 Scope of IFRS2	1 May 2006
IFRIC9 Reassessment of Embedded Derivatives	1 June 2006
IFRIC10 Interim Financial Reporting and Impairment	1 November 2006
IFRIC11 'IFRS2 - Group and Treasury Share Transactions'	1 March 2007

The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements except for additional disclosures when the relevant standards, being IAS1 and IFRS7, come into effect.

## Notes to the financial statements

for the year ended 30 September 2006

### 1. Accounting policies (continued)

#### ***Basis of consolidation***

The Group financial statements consolidate the financial statements of ScS Upholstery plc and its subsidiary undertaking drawn up to 30 September each year. All intercompany transactions and balances have been eliminated in full.

#### ***Goodwill***

Goodwill represents the excess of the cost of acquisition of a business unit over the fair value of the identifiable net assets acquired at the date of acquisition. Consolidated goodwill in respect of acquisitions made prior to 1 January 1998 was written off directly against reserves. Future goodwill will be shown as an intangible asset.

#### ***Property, plant and equipment***

Property, plant and equipment is stated at cost less accumulated depreciation and any recognised impairment loss.

Depreciation is provided on all property, plant and equipment, other than freehold land, at rates calculated to write off the cost, less estimated residual value, of each asset on a straight line basis over its anticipated useful life, at the rates shown below:

Fixtures and fittings	-	5% to 20% straight line per annum
Computer equipment	-	33.33% straight line per annum
Short leasehold property	-	The shorter of the term of the lease or 4% straight line per annum
Long leasehold property	-	Over the term of the lease - minimum 2% straight line
Freehold property	-	2% straight line per annum

#### ***Intangible assets***

Intangible assets are carried at cost less accumulated amortisation, less any recognised impairment loss.

In the opinion of the Directors, computer software has a finite economic life and is charged to administration costs on a straight line basis at a rate of 33.33% per annum.

#### ***Impairment of tangible and intangible assets***

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). The recoverable amount is the higher of fair value less costs to sell and value in use.

In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment charge is recognised in the Income Statement in the year it occurs. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount with the corresponding credit being recognised in the Income Statement. This cannot exceed the carrying amount prior to the impairment charge.

## Notes to the financial statements

for the year ended 30 September 2006

### 1. Accounting policies (continued)

#### *Inventories*

Inventories are stated at the lower of cost and net realisable value. Cost comprises the actual purchase price of goods, less any attributable discounts and rebates plus other directly attributable costs incurred in bringing the product to its present location and condition. Net realisable value is the estimated selling price reduced by marketing, selling and distribution costs. Allowance is made for slow moving and obsolete items.

#### *Trade and other receivables*

Trade receivables are recognised and carried at the lower of their original invoiced value and recoverable amount. The Directors consider that the carrying amount of trade and other receivables approximate to their fair value. Provision is made when there is objective evidence that the Group will not be able to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

#### *Cash and cash equivalents*

Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less (together "cash and cash equivalents").

#### *Leases*

##### *Operating leases*

Leases where the lessor retains substantially all the risks and rewards of ownership of the asset are classified as operating leases in accordance with IAS17. Rentals payable under operating leases are charged in the Income Statement on a straight line basis over the lease term.

##### *Lease incentives*

The aggregate benefit of operating lease incentives is recognised as a reduction of rental expense in the Income Statement. The benefit is allocated on a systematic basis over the lease term. The balance is carried forward as lease incentives in current/non-current liabilities, as appropriate.

##### *Lease premiums*

Premiums paid on entering into a lease are classified as trade and other receivables within current and non-current assets and released over the life of the lease.

#### *Pensions*

Contributions to the defined contribution scheme are recognised in the Income Statement in the period in which they become payable.

#### *Pre-opening and launch costs*

Pre-opening and launch costs are charged to the Income Statement in the year they are incurred.

#### *Supplier contributions*

Contributions receivable from suppliers towards the cost of displaying and promoting their product are recognised in the Income Statement as a reduction in the advertising and marketing costs to which they relate.

#### *Supplier rebates*

Rebates receivable from suppliers are based upon the volume of business with each supplier and are recognised in the Income Statement in cost of sales or credited to inventory as appropriate on an earned basis, by reference to the supplier turnover.

## Notes to the financial statements

for the year ended 30 September 2006

### 1. Accounting policies (continued)

#### **Advertising expenditure**

All routine and general advertising costs are expensed as incurred. Advertising costs paid to media companies are recognised as a prepayment until the advertising is placed in the media and communicated to the public, at which point the expenditure is expensed to the Income Statement.

#### **Treasury shares**

Shares held to meet obligations under the Group's share based payment plan for key employees are held at cost and are shown as a deduction from equity shareholders' funds. On the transfer of shares to employees there is a transfer to the revenue reserve representing the difference between the cost of the shares and the proceeds received from the employees.

#### **Taxation**

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred income tax is recognised on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, except where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that, at the time of the transaction, affects neither accounting nor taxable profit or loss.

Deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred income tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Income tax is charged or credited directly to equity if it relates to items that are credited or charged to equity. Otherwise income tax is recognised in the Income Statement.

#### **Revenue recognition**

Revenue represents amounts invoiced for goods and services, net of discounts and value added tax. Revenue is recognised when the significant risk and rewards of ownership of the goods have passed to the buyer and can be reliably measured. This is deemed to be when the goods have been delivered to the customer.

Finance revenue is accrued on a time basis by reference to the principal balance and at the effective interest rate applicable.

## Notes to the financial statements

for the year ended 30 September 2006

### 1. Accounting policies (continued)

#### Share based payments

The Group issues equity-settled share based payments to certain employees. The cost of equity settled share based payments is measured at fair value at the date of grant. The fair value is expensed in the *Income Statement* on a straight line basis over the vesting period, based on the Group's estimate of the number of shares that will eventually vest. The fair value is determined by an external valuer using the Black Scholes option pricing model, measured at the date of grant. In valuing equity settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of shares of the Company (market conditions).

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and, based on management's best estimate of the achievement or otherwise of non-market conditions, the number of equity instruments that will ultimately vest or, in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date is recognised in the *Income Statement*, with a corresponding entry in retained earnings. Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is negative.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in the income statement for the award is expensed immediately. Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over fair value being treated as an expense in the *Income Statement*.

### 2. Revenue

Revenue disclosed in the income statement is analysed as follows

	2006 £'000	2005 £'000
Sale of goods	195,828	158,295

Revenue, profit before tax and net assets are attributable to the Group's only continuing activity, being that of a specialist upholstered furniture retailer and arose wholly within the United Kingdom, both by origin and destination. There were no discontinued operations during the year under review.

## Notes to the financial statements

for the year ended 30 September 2006

### 3. Other income

	2006	2005
	£'000	£'000
Profit on disposal of property interests	445	2,002

Other income in 2005 represented net income from compensation received on early termination of leases on distribution and retail sites and the profit on the disposal of a freehold property.

Other income in 2006 represents net income on the early termination of a property lease.

### 4. Operating profit

	2006	2005
	£'000	£'000
Group operating profit has been arrived at after charging/(crediting):		
Depreciation of property, plant and equipment - owned	3,358	2,563
Depreciation of non-current other receivables	39	-
Amortisation of computer software	258	416
Release of lease incentives	(458)	(326)
Operating leases - land and buildings	18,097	12,454
Operating leases - plant and machinery	1,252	1,106
Cost of inventories recognised as an expense	104,043	84,899
Including:- write-down of inventories to net realisable value	247	42

### 5. Auditor's remuneration

During the year the Group obtained the following services from the Group's auditors at the costs as detailed below:

	2006	2005
	£'000	£'000
Fees payable to the Group's auditor for the audit of the Group's financial statements	75	54
Fees payable to the Group's auditor for other services:		
- IFRS conversion	51	9
- Taxation services	16	11
- Interim announcement	7	7
- Other	12	1
	86	28

£7,000 of the total fees in the current year relates to the Company (2005: £7,000).

## Notes to the financial statements

for the year ended 30 September 2006

### 6. Staff costs and directors' emoluments

#### (a) Staff costs

	2006 £'000	2005 £'000
Wages and salaries	27,318	21,242
Social security costs	2,593	2,032
Other pension costs	443	256
	<u>30,354</u>	<u>23,429</u>

Included in wages and salaries is a total expense of equity-settled share-based payments of £271,000 (2005: £101,000).

The average monthly number of employees during the year was made up as follows:

	2006 No.	2005 No.
Sales	508	391
Office and managerial	427	371
Services	295	201
Cleaning	78	64
	<u>1,308</u>	<u>1,027</u>

#### (b) Directors' emoluments

	2006 £'000	2005 £'000
Directors' emoluments	1,201	1,268
Company contributions to money purchase schemes	167	139
Aggregate gains made by Directors on the exercise of share options	260	1,923
Number of Directors accruing benefits under money purchase schemes	5	5

Further details of Directors' emoluments are provided in the Directors' remuneration report.

### 7. Finance revenue

	2006 £'000	2005 £'000
Bank interest receivable	906	741

## Notes to the financial statements

for the year ended 30 September 2006

### 8. Taxation

#### (a) Tax on profit on ordinary activities

##### Tax charged in the income statement

	2006 £'000	2005 £'000
<i>Current income tax:</i>		
UK Corporation tax:		
Current income tax charge	5,328	4,842
Amounts under/(over) provided in previous years	4	(105)
Total current income tax	5,332	4,737
<i>Deferred tax:</i>		
Origination and reversal of timing differences	98	375
Total deferred tax	98	375
<b>Tax charge in the income statement</b>	<b>5,430</b>	<b>5,112</b>

##### Tax relating to items charged or credited to equity

<i>Current income tax:</i>		
UK Corporation tax	(352)	(670)
<i>Deferred tax:</i>		
Share based payments	129	453
<b>Tax credit in the statement of changes in equity</b>	<b>(223)</b>	<b>(217)</b>

#### (b) Reconciliation of the total tax charge

The tax expense in the income statement for the year is higher (2005: lower) than the standard rate of corporation tax in the UK of 30% (2005: 30%). The differences are reconciled below:

	2006 £'000	2005 £'000
Accounting profit multiplied by the UK standard rate of income tax of 30% (2005: 30%)	5,171	5,139
Expenses not deductible for tax purposes	45	75
Accounting depreciation not eligible for tax purposes	312	184
Tax benefits from indexation on chargeable assets	(29)	(181)
Adjustments relating to prior year's income tax	(69)	(105)
Total tax expense reported in income statement	5,430	5,112

## Notes to the financial statements

for the year ended 30 September 2006

### 8. Taxation (continued)

#### (c) Deferred tax

The deferred tax included in the balance sheet is as follows:

	2006 £'000	2005 £'000
<b>Deferred tax liability</b>		
Accelerated capital allowances	(797)	(464)
Capital gains held over	(625)	(597)
Property valuations	(92)	(94)
Deferred tax liability	(1,514)	(1,155)
<b>Deferred tax asset</b>		
Share based payment	261	309
Lease incentives	1,326	1,140
Other timing difference	26	32
Deferred tax asset	1,613	1,481
Deferred tax net asset	99	326

Deferred tax assets and liabilities have been offset in arriving at the net balance disclosed in the balance sheet.

The deferred tax included in the Group income statement is as follows:

	2006 £'000	2005 £'000
<b>Deferred tax in the income statement</b>		
Accelerated capital allowances	333	(130)
Capital gains held over	28	597
Property valuations	(2)	(21)
Share based payments	(81)	(30)
Lease incentives	(186)	(16)
Other timing differences	6	(25)
Deferred income tax expense	98	375

## Notes to the financial statements

for the year ended 30 September 2006

### 9. Earnings per ordinary share

Basic earnings per share amounts are calculated by dividing net profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

#### (a) Basic earnings per share

	2006	2005
Net profit attributable to equity holders of the parent (£000)	11,808	12,019
Weighted average number of shares in issue (thousands)	33,624	33,163
Basic earnings per share (pence per share)	35.12	36.24

The weighted average number of shares in issue excludes treasury shares held by the Company, and shares held in trust for the Directors' long term incentive plan.

#### (b) Adjusted earnings per share

Adjusted earnings per share excludes the impact on the Group of profits on property transactions and is calculated as follows:

	2006	2005
Net profit attributable to equity holders of the parent (£000)	11,808	12,019
Profit on disposal of property interests	(445)	(2,002)
Tax on profit on disposal of property interests	131	474
Adjusted net profit attributable to equity holders of the parent (£000)	11,494	10,491
Weighted average number of shares in issue (thousands)	33,624	33,163
Adjusted earnings per share	34.18	31.63

## Notes to the financial statements

for the year ended 30 September 2006

### 9. Earnings per ordinary share (continued)

#### (c) Diluted earnings per share

Diluted earnings per share amounts are calculated by dividing the net profit attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

	2006	2005
Net profit attributable to equity holders of the parent (£000)	11,808	12,019
Weighted average number of shares in issue (thousands)	33,624	33,163
Effect of dilution:		
Dilutive potential ordinary shares under share option schemes (thousands)	73	224
Adjusted weighted average number of shares (thousands)	33,697	33,387
Diluted earnings per share (pence per share)	35.04	36.00

### 10. Dividends paid and proposed

	2006 £'000	2005 £'000
<i>Declared and paid during the year:</i>		
Equity dividends on ordinary shares:		
Final dividend for 2005: 10.5 pence (2004: 9.0 pence)	3,519	3,006
Interim for 2006: 7.0 pence (2005: 6.0 pence)	2,279	2,005
Dividends paid	5,798	5,011
<i>Proposed for approval by shareholders at the AGM:</i>		
Final dividend for 2006: 12.0 pence (2005: 10.5 pence)	4,047	3,511

## Notes to the financial statements

for the year ended 30 September 2006

### 11. Property, plant and equipment

	<i>Freehold property £'000</i>	<i>Leasehold property £'000</i>	<i>Computer equipment £'000</i>	<i>Fixtures and fittings £'000</i>	<i>Total £'000</i>
Cost:					
At 1 October 2004	675	18,928	3,872	10,923	34,398
Additions	-	4,087	249	2,223	6,559
Disposals	(364)	(1,110)	-	(684)	(2,158)
At 30 September 2005	311	21,905	4,121	12,462	38,799
Additions	-	9,769	334	4,208	14,311
Disposals	-	(209)	-	(147)	(356)
At 30 September 2006	311	31,465	4,455	16,523	52,754
Depreciation and impairment:					
At 1 October 2004	98	2,971	3,521	5,009	11,599
Provided during the year	12	988	234	1,329	2,563
Disposals	(35)	(235)	-	(414)	(684)
At 30 September 2005	75	3,724	3,755	5,924	13,478
Provided during the year	6	1,302	262	1,788	3,358
Disposals	-	(61)	-	(134)	(195)
At 30 September 2006	81	4,965	4,017	7,578	16,641
Net book value at 30 September 2006	230	26,500	438	8,945	36,113
Net book value at 30 September 2005	236	18,181	366	6,538	25,321
Net book value at 30 September 2004	577	15,957	351	5,914	22,799

## Notes to the financial statements

for the year ended 30 September 2006

### 12. Intangible assets

	<i>Computer software £'000</i>
Cost:	
At 1 October 2004	1,571
Additions - internal development	97
	<hr/> 1,668
At 30 September 2005	1,668
Additions - internal development	471
	<hr/> 2,139
	<hr/>
Depreciation and impairment:	
At 1 October 2004	938
Amortisation during the year	416
	<hr/> 1,354
At 30 September 2005	1,354
Amortisation during the year	258
	<hr/> 1,612
	<hr/>
At 30 September 2006	1,612
	<hr/>
Net book value at 30 September 2006	527
	<hr/>
Net book value at 30 September 2005	314
	<hr/>
Net book value at 30 September 2004	633
	<hr/>

### 13. Trade and other receivables

	<i>2006 £'000</i>	<i>2005 £'000</i>
<b>Current</b>		
Trade receivables	1,132	965
Prepayments and accrued income	5,151	4,669
Other receivables	3,369	2,700
	<hr/> 9,652	<hr/> 8,334
	<hr/>	<hr/>
<b>Non current</b>		
Other receivables	823	-
	<hr/>	<hr/>

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value.

All amounts are non-interest bearing.

## Notes to the financial statements

for the year ended 30 September 2006

### 14. Inventories

	2006 £'000	2005 £'000
Finished goods at cost	11,546	9,576

### 15. Cash and cash equivalents

	2006 £'000	2005 £'000
Cash at bank and in hand	19,671	20,168

Bank balances and cash comprise cash held by the Group and the carrying value of these assets approximates to their fair value. Cash at bank earns interest at floating rates based on daily bank deposit rates.

At 30 September 2006, the Group had available £3m (2005: £3m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met. The review date of this bank overdraft facility is 15 May 2007.

### 16. Trade and other payables

	2006 £'000	2005 £'000
<b>Current</b>		
Trade payables	15,213	13,582
Other taxation and social security	3,473	2,924
Accruals	7,552	5,383
Lease incentives	497	371
Customer deposits	4,978	4,032
	31,713	26,292

Trade payables and accruals principally comprise amounts outstanding for trade purchases and ongoing costs.

Trade payables are non-interest bearing. The Directors consider that the carrying amount of trade payables approximates to their fair value.

	2006 £'000	2005 £'000
<b>Non Current</b>		
Lease incentives	7,178	5,799

## Notes to the financial statements

for the year ended 30 September 2006

### 17. Authorised and issued share capital

#### *Authorised*

	2006 £'000	2005 £'000
Ordinary shares of 1p each	600	600

#### *Allotted, called up and fully paid*

	2006 No	2005 No	2006 £'000	2005 £'000
Balance at beginning of year	33,571,950	32,595,100	336	326
Exercised under share option schemes	468,207	976,850	4	10
Balance at end of year	34,040,157	33,571,950	340	336

Further details of employee and executive share schemes are given in note 19.

#### **Substantial shareholdings**

Details of substantial interests in the Company's issued ordinary share capital received by the Company at 30 September 2006 under the provisions of the Companies Act 1985 have been disclosed in the substantial shareholders section of the Report of the Directors.

## Notes to the financial statements

for the year ended 30 September 2006

### 18. Note to the consolidated statement of changes in equity

#### Share premium account

This balance represents the difference between the total net proceeds and the nominal value of the equity share capital on issue of the Group's equity share capital.

#### Capital redemption reserve

This balance represents the accumulation of profits allocated to the reserve in respect of the redemption or buyback of shares in the Group.

#### Treasury shares

Treasury shares represent the cost of shares in ScS Upholstery plc purchased in the market and held by employee benefit trusts ("the Trusts") for the benefit of the employees. Shares are held in trust until such time as they may be transferred to employees in accordance with the terms of the relevant employee share scheme, with the principal requirement being that the employee is still in employment with the Company after a three year period. Surplus shares may be held to satisfy future awards.

The Trusts hold 338,066 shares with an aggregate nominal value of £3,380, acquired at an average cost of 347.0 pence per share. The market value of the shares at the year end was 482.5 pence per share (2005: 348.75 pence per share). Of these shares 1,032 have not been conditionally awarded at the year end.

All rights to dividends on these shares have been waived. All expenses incurred by the Trusts are settled directly by the Company and charged in the financial statements as incurred.

The Company acquired 39,846 shares during the year, with an aggregate nominal value of £398. The consideration paid was £187,475. The shares were acquired to be held by employee benefit trusts for the benefit of the employees, as described in note 19.

#### Profit and loss account

The cumulative amount of goodwill written off to reserves at 30 September 2006 is £141,000 (2005: £141,000).

## Notes to the financial statements

for the year ended 30 September 2006

### 19. Share based payments

An expense is recognised for share based payments based on the fair value of the share awards at the date of grant. The charge for share based payments under IFRS 2 is £271,000 (2005: £101,000) across the following schemes:

- (a) Share award plan
- (b) Employee share plan
- (c) Executive share option schemes

Details of the share schemes are provided below:

#### (a) Share award plan

This is an equity settled plan that is open to Trading Board and Executive Directors who are able to purchase shares with a value of up to 50% of any performance related bonus awarded to the individuals. An award of matching shares is made with a value equal to the amount of the performance related bonus invested by the individual, grossed up for the PAYE and NIC suffered on the performance related bonus so invested.

The shares are purchased by the Group in the market and are held in employee benefits trusts ("the Trusts"). The shares remain in the Trust for three years, at which point they vest to the Director. If the Director ceases to hold office within the three years, they will receive the initial shares (the shares bought with their bonus), but will only receive the matching shares (the free shares) if they have left for reasons of ill health, disability, injury, redundancy, retirement or because the part of the business they work in has been disposed of by the Group. If the Directors are given notice, then the matching shares lapse. The Directors can withdraw their initial shares from the plan within the 3 years, but will then forfeit the matching shares. The Directors have 30 days from the third anniversary of putting the shares into the Trust to exercise their right to receive the award.

The following table illustrates the number of, and movement in, the matching share awards during the year.

	2006 No.	2005 No.
Outstanding as at 1 October	120,695	174,706
Awarded during the year <sup>a</sup>	48,148	57,026
Forfeited during the year	-	(5,744)
Exercised during the year <sup>b</sup>	(65,875)	(105,293)
Outstanding as at 30 September	102,968	120,695

<sup>a</sup>The weighted average fair value of the award granted during the year was £3.56 (2005: £3.06).

<sup>b</sup>The weighted average share price at the date of exercise for the awards exercised was £4.19 (2005: £3.52).

All of the awards granted have an exercise price of £1.

For the share awards outstanding at 30 September 2006, the weighted average remaining contractual life is 20 months.

## Notes to the financial statements

for the year ended 30 September 2006

### 19. Share based payments (continued)

The fair value of equity-settled share awards granted is estimated as at the date of grant using the Black-Scholes model, taking into account the terms and conditions upon which the matching shares were granted. The inputs to the model used for the years ended 30 September 2006 and 30 September 2005 are provided in the table below.

#### (b) Employee share plan

On 6 December 2005, ScS established an equity-settled plan within which it is possible to grant awards of ordinary shares in the Company to certain employees of the Group.

The shares that are awarded are fully paid ordinary shares in the capital of ScS Upholstery plc and the awards are conditional rights to existing issued shares subject to and in accordance with the plan rules. The vesting period is three years beginning with the award date.

The shares are held in Trust for employees until such time that they may be transferred to the employees in accordance with the plan rules, with the principal requirement being that the employee is still in employment with the Group after a three year period. Surplus shares may be held by the Trust to satisfy future awards.

The following table illustrates the number of, and movement in, the shares held in Trust during the year:

	2006 No.	2005 No.
Outstanding as at 1 October	-	-
Awarded during the year	234,066	-
Exercised during the year	-	-
Outstanding as at 30 September	234,066	-

The shares were awarded subject to the plan rules on 12 December 2005 at a mid market price of 414.5 pence. They will be exercisable under the rules of the plan in December 2008. The weighted average fair value of awards granted during the year was £3.57. The fair value of equity-settled share awards granted is estimated as at the date of grant using the Black-Scholes model, taking into account the terms and conditions upon which the shares were granted.

The inputs to the model used for the years ended 30 September 2006 and 30 September 2005 for both the share award plan and the employee share plan are provided in the table below.

	Share award plan	Employee share plan plan
Dividend yield (%)	5	5
Expected share price volatility	25	25
Risk free interest rate	4.5	4.5
Expected life of award (years)	3	3
Weighted average share price (£)	3.82	4.14
Annual leaver rate (%)	-	25

## Notes to the financial statements

for the year ended 30 September 2006

### 19. Share based payments (continued)

The expected life of the awards is based on the fact that the shares become exercisable after three years. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, and may not necessarily be the actual outcome.

#### (c) Executive share option schemes

The Group has approved and unapproved share option schemes under which options to subscribe for the Company's shares have been granted to certain employees. Share options are granted at the discretion of the Remuneration Committee. The performance target of the share option schemes require the average of the percentage increase in the Group's earnings per share over each year in the three year period following the date of grant (8 December 1997, 19 May 1999, 5 December 2001 or 12 September 2002) to be equal to, or greater than, the average of the percentage growth of the Retail Price Index plus three per cent in each year over that period. The performance target has been chosen so that it directly links the remuneration with the performance of the business and shareholder value. The performance targets on the options is measured by reference to the audited financial statements and has been achieved for all of the award dates. No share options have been granted during the year.

The following table illustrates the number (No.) and weighted average exercise prices (WAEP) of share options during the year:

	2006 No.	2006 WAEP	2005 No.	2005 WAEP
Outstanding as at 1 October	623,450	2.26	1,635,300	1.64
Awarded during the year	-	-	-	-
Exercised during the year	468,207	4.21	976,850	3.42
Forfeited during the year	10,043	2.30	35,000	2.30
Outstanding as at 30 September	145,200	2.24	623,450	2.26

The reduction in the number of share options in the year relates to leavers and to the exercise of options. Those options exercised during the year were as follows:

	No	Nominal Value £	Consideration £'000
Employee share option scheme issued on floatation at 113.5 pence	7,400	74	8
Employee share option scheme issued in May 1999 at 76.5 pence	2,000	20	1
Employee share option scheme issued in December 2001 at 206.0 pence	15,100	151	31
Employee share option scheme issued in September 2002 at 230.0 pence	443,707	4,437	1,015
			1,055

## Notes to the financial statements

for the year ended 30 September 2006

### 19. Share based payments (continued)

At 30 September 2006 options under this scheme were outstanding as follows:

- 7,300 (2005: 14,700) options at 113.5 pence each, being exercisable between December 2000 and December 2007;
- Nil (2005: 2,000) options at 76.5 pence each, being exercisable between May 2002 and May 2009;
- 2,150 (2005: 17,250) options at 206.0 pence each, exercisable between December 2004 and December 2011;
- 135,750 (2005: 589,500) options at 230.0 pence each, 73,327 being exercisable between September 2005 and September 2009 and 62,423 being exercisable between September 2005 and September 2012.

All options awarded under the Executive share option scheme were granted prior to 7 November 2002 and they have not been accounted for under IFRS 2, in accordance with the transitional provisions of that standard.

### 20. Financial instruments

The Group's principal financial instruments may comprise cash, short term deposits and a bank overdraft if required. At the year end there were no short term deposits or overdrafts. The main purpose of these financial instruments is to provide funds for the Group's operations. The Group's borrowings would be subject to floating rates of interest. The Group has various other financial instruments such as trade receivables and trade payables that arise directly from its operations. The only financial assets and liabilities held by the Group are current receivables and payables which have been excluded from the disclosure below.

It is, and has been throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken. The Group has not entered into derivative transactions during the year. The Group does not undertake any speculative transactions and continues to pursue prudent treasury policies by investing surplus funds only with reputable financial institutions.

There are no differences between fair values and book values for any financial assets and liabilities.

#### **Credit risk**

The finance for all the Group's credit sales is provided from external financing companies without risk to the Group.

#### **Liquidity risk**

The Group's exposure to liquidity risk is low considering the cash balance of £19.7 million (2005: £20.2 million). However, short term flexibility is available from an overdraft facility should it be required. The undrawn overdraft facility amounted to £3.0 million at 30 September 2006 (2005: £3.0 million), is renewed annually and is subject to floating rates of interest.

#### **Foreign currency risk**

There is no foreign currency risk as all sales are made within the UK and all overseas suppliers invoice in sterling.

## Notes to the financial statements

for the year ended 30 September 2006

### 20. Financial instruments (continued)

#### Interest rate risk

The Group's policy is for deposits to mature when it is anticipated that the funds will be used within the business, subject to certain limitations to maximise continuing liquidity. Interest rate return exposure on financial assets is managed through deposits being placed for the full period to anticipated use, interest being applied at floating rates at the best available rate on the day, subject to the aforementioned limits. Floating rates are based on LIBOR. The Group did not enter into any interest rate derivatives during the year.

### 21. Obligations under leases

As at 30 September 2006 the Group has minimum future lease payments under non-cancellable operating leases as set out below:

	<i>Land and buildings</i>		<i>Plant and machinery</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Operating leases which expire:				
Within one year	155	-	128	65
After one year but not more than five years	1,993	1,100	2,289	2,478
After five years	307,140	231,217	158	183
	<u>309,288</u>	<u>232,317</u>	<u>2,575</u>	<u>2,726</u>

Operating lease payments represent rentals payable by the Group for its branches. Leases are negotiated for various terms and rentals are fixed for an average of 5 years.

### 22. Pension commitments

The Group operates several defined contribution pension schemes for the benefit of its staff. The assets of the schemes are held separately from those of the Group in independently administered funds. The pension charges represent contributions payable by the Group to these funds.

Pension contributions accrued at 30 September 2006 amounted to £79,000 (2005: £8,000).

### 23. Capital commitments

	<i>2006</i>	<i>2005</i>
	<i>£'000</i>	<i>£'000</i>
Contracted for but not provided	<u>2,422</u>	<u>4,938</u>

# Notes to the financial statements

for the year ended 30 September 2006

## 24. Related parties

Transactions between the Company and its subsidiary, which is a related party, have been eliminated on consolidation and are not disclosed in this note.

### **Compensation of key management personnel of the Group**

The key management are considered to be the Executive Directors of the Group.

	2006 £000	2005 £000
As disclosed in Directors' remuneration report	1,145	1,201
Pension contributions	167	139
Share-based payments	260	1,923
	<u>1,572</u>	<u>3,263</u>

## 25. Transition to IFRS

### **First time adoption and key financial impacts**

This note sets out details of the changes in accounting policies arising from the adoption of IFRS, together with the restated opening balance sheet at 30 September 2004 and restated financial information for the year ended 30 September 2005.

#### **IFRS 1 - First time adoption**

The date of transition to IFRS for the Group is 30 September 2004, being the opening balance sheet for the comparative information in the September 2006 IFRS financial statements of the Group.

In implementing the transition to IFRS, the Group has followed the requirements of IFRS 1 which, in general, requires that IFRS accounting standards effective as at 30 September 2006 are applied with full retrospective effect in deriving the opening balance sheet at the date of transition. In accordance with IFRS 1 - "First-time Adoption of International Financial Reporting Standards" the Group is entitled to a number of voluntary and mandatory exemptions from full restatement. The relevant transitional provisions are set out where applicable below.

#### **IFRS 2 - Share based payments**

The charge recognised in the income statement for share-based payments is based on the fair value of the option or award at date of grant, which is expensed over the vesting period of the option or award. Fair value is measured by use of the Black Scholes valuation model. The Group has applied transitional rules to share options granted before 7 November 2002. The effect of this standard has resulted in an increase in operating profit of £25,000 for the year to 30 September 2005. Operating profit has increased as the charge under IFRS 2 was lower than the equivalent charge under UK GAAP.

#### **IAS 10 - Events after the balance sheet date**

Under UK GAAP dividends have been recognised in the period to which they relate. IAS 10 requires that dividends declared after the balance sheet date should not be recognised as a liability at the balance sheet date. Therefore, the "other payable" relating to the final dividend for 2003/2004 (£2,933,000) and 2004/2005 (£3,511,000) have been removed in the respective balance sheets.

#### **IAS 12 - Income taxes**

There is a difference between the basis of providing deferred tax on timing differences under UK GAAP compared to IFRS, which requires the provision of deferred tax on temporary differences which are defined as the difference between the carrying amount in the balance sheet and the tax base.

## Notes to the financial statements

for the year ended 30 September 2006

### 25. Transition to IFRS (continued)

#### First time adoption and key financial impacts (continued)

##### *Deferred tax on share based payments*

Under IFRS 2 the Group is required to account for share based payment charges in the income statement. Such accounting charges are not deductible for UK corporation tax purposes, however corporation tax deductions can be claimed when individuals exercise their share options. This represents a temporary difference under IAS 12. As a result, deferred tax is required to be accounted for, based on the anticipated future tax deduction, which will be claimed at the time when the share options are eventually exercised by employees.

The deferred tax is calculated on all share based payments which have not vested at each balance sheet date. A deferred tax asset of £732,000 and £309,000 has been recognised at 30 September 2004 and 30 September 2005 respectively, with the corresponding charge or credit being taken to the Income Statement or Statement of Changes in Equity, as appropriate.

##### *Deferred tax on other IFRS adjustments*

Deferred tax is required to be provided on other adjustments made on adoption of IFRS relating to the temporary differences that arise including, for example, the impact of IAS 17 on "other payables". Deferred tax assets of £1,009,000 and £1,046,000 have been recognised at 30 September 2004 and 30 September 2005 respectively.

##### *IAS 16 – Property, plant and equipment*

The Group has elected to retain previous UK GAAP carrying values of property, plant and equipment at the date of transition.

##### *IAS 17 - Lease incentives*

Under UK GAAP, the policy on recognition of operating lease incentives in respect of rent free periods and inducements received is to spread the incentive by releases to the income statement over the period to the first rent review, usually 5 years. In accordance with SIC 15 - "Operating Lease - Incentives", all lease incentives must now be recognised in the income statement over the full term of the lease. The effect of this standard has resulted in an adjustment to carry forward an increased amount in the value of rent free periods and inducements, in deferred lease incentives within current liabilities and non current liabilities, totalling £3,747,000 at 30 September 2004 and £3,800,000 at 30 September 2005. This adjustment has reduced operating profit by £54,000 for the year ended 30 September 2005.

##### *IAS 38 - Intangible assets*

Under UK GAAP, software and software development is included within tangible assets. Under IAS 38 'Intangible assets' software has been reclassified from tangible assets and recorded in intangible assets. The balance sheet reclassification amounts to £633,000 at 30 September 2004 and £314,000 at 30 September 2005. There is no overall impact on the Income Statement.

## Notes to the financial statements

for the year ended 30 September 2006

### 25. Transition to IFRS (continued)

#### First time adoption and key financial impacts (continued)

##### Summarised consolidated income statement for the 52 weeks to 30 September 2005

	UK GAAP £000	Share based payments IFRS 2 £000	Lease Incentives IAS 17 £000	Deferred Tax IAS 12 £000	Effect of Transition to IFRS £000	Restated under IFRS £000
Revenue	158,295	-	-	-	-	158,295
<b>Trading profit before exceptional items</b>	14,876	25	(513)	-	(488)	14,388
Other operating income – exceptional	1,283	-	459	-	(1,742)	-
Exceptional profit on disposal of properties	260	-	-	-	(260)	-
Other income – profit on disposal of property interests	-	-	-	-	2,002	2,002
<b>Group operating profit from continuing operations</b>	16,419	25	(54)	-	(29)	16,390
Finance revenue	741	-	-	-	-	741
<b>Profit from continuing operations before taxation</b>	17,160	25	(54)	-	(29)	17,131
Tax expense	(4,509)	-	-	(603)	(603)	(5,112)
<b>Profit attributable to equity shareholders of the parent</b>	12,651	25	(54)	(603)	(632)	12,019
Earnings per share – Basic – (pence)	38.15					36.24
Earnings per share – Adjusted – (pence)	34.51					31.63
Earnings per share – Diluted – (pence)	37.89					36.00

## Notes to the financial statements

for the year ended 30 September 2006

### 25. Transition to IFRS (continued)

First time adoption and key financial impacts (continued)

**Consolidated balance sheet  
as at 30 September 2005**

	<i>UK GAAP</i> £000	<i>Intangible Assets IAS 38</i> £000	<i>Lease Incentives IAS 17</i> £000	<i>Dividends IAS 10</i> £'000	<i>Deferred Tax IAS 12</i> £000	<i>Effect of transition to IFRS</i> £000	<i>Restated under IFRS</i> £000
<b>Non-current assets</b>							
Property, plant and equipment	25,635	(314)	-	-	-	(314)	25,321
Intangible assets	-	314	-	-	-	314	314
Deferred tax asset	-	-	-	-	326	326	326
	25,635	-	-	-	326	326	25,961
<b>Current assets</b>							
Trade and other receivables	8,334	-	-	-	-	-	8,334
Inventories	9,576	-	-	-	-	-	9,576
Cash and cash equivalents	20,168	-	-	-	-	-	20,168
	38,078	-	-	-	-	-	38,078
<b>Total assets</b>	63,713	-	-	-	326	326	64,039
<b>Current liabilities</b>							
Trade and other payables	(30,254)	-	451	3,511	-	3,962	(26,292)
Tax liabilities	(1,764)	-	-	-	-	-	(1,764)
	(32,018)	-	451	3,511	-	3,962	(28,056)
<b>Non-current liabilities</b>							
Trade and other payables	(1,548)	-	(4,251)	-	-	(4,251)	(5,799)
Tax liabilities	(1,029)	-	-	-	1,029	1,029	-
	(2,577)	-	(4,251)	-	1,029	(3,222)	(5,799)
<b>Total liabilities</b>	(34,595)	-	(3,800)	3,511	1,029	740	(33,855)
<b>Net assets</b>	29,118	-	(3,800)	3,511	1,355	1,066	30,184
<b>Equity</b>							
Share capital	336	-	-	-	-	-	336
Share premium account	1,920	-	-	-	-	-	1,920
Capital redemption reserve	195	-	-	-	-	-	195
Treasury shares	(1,472)	-	-	-	-	-	(1,472)
Retained earnings	28,139	-	(3,800)	3,511	1,355	1,066	29,205
<b>Total equity</b>	29,118	-	(3,800)	3,511	1,355	1,066	30,184

# Notes to the financial statements

for the year ended 30 September 2006

## 25. Transition to IFRS (continued)

### First time adoption and key financial impacts (continued)

#### Consolidated balance sheet as at 30 September 2004

	UK GAAP £000	Intangible Assets IAS 38 £000	Lease Incentives IAS 17 £000	Dividends IAS 10 £'000	Deferred Tax IAS 12 £000	Effect of transition to IFRS £000	Restated under IFRS £000
<b>Non-current assets</b>							
Property, plant and equipment	23,432	(633)	-	-	-	(633)	22,799
Intangible assets	-	633	-	-	-	633	633
Deferred tax asset	-	-	-	-	1,154	1,154	1,154
	23,432	-	-	-	1,154	1,154	24,586
<b>Current assets</b>							
Trade and other receivables	5,827	-	-	-	-	-	5,827
Inventories	9,851	-	-	-	-	-	9,851
Cash and cash equivalents	12,072	-	-	-	-	-	12,072
	27,750	-	-	-	-	-	27,750
<b>Total assets</b>	51,182	-	-	-	1,154	1,154	52,336
<b>Current liabilities</b>							
Trade and other payables	(24,850)	-	412	2,933	-	3,345	(21,505)
Tax liabilities	(2,695)	-	-	-	-	-	(2,695)
	(27,545)	-	412	2,933	-	3,345	(24,200)
<b>Non-current liabilities</b>							
Trade and other receivables	(1,333)	-	(4,159)	-	-	(4,159)	(5,492)
Tax liabilities	(587)	-	-	-	587	587	-
	(1,920)	-	(4,159)	-	587	(3,572)	(5,492)
<b>Total liabilities</b>	(29,465)	-	(3,747)	2,933	587	(227)	(29,692)
<b>Net assets</b>	21,717	-	(3,747)	2,933	1,741	927	22,644
<b>Equity</b>							
Share capital	326	-	-	-	-	-	326
Share premium account	745	-	-	-	-	-	745
Capital redemption reserve	195	-	-	-	-	-	195
Treasury shares	(501)	-	-	-	-	-	(501)
Retained earnings	20,952	-	(3,747)	2,933	1,741	927	21,879
<b>Total equity</b>	21,717	-	(3,747)	2,933	1,741	927	22,644

#### Explanation of material adjustments to the cash flow statement for the year ended 30 September 2005 (date of last UK financial statements)

The adoption of IFRS does not affect the Group's cash flows. However, the IFRS presentation of cash flows differs from that required under UK GAAP. IFRS requires that the cash flows of the Group be split between 3 categories – operating activities, investing activities and financing activities.

## **Statement of directors' responsibilities in relation to the Company financial statements**

The Directors are responsible for preparing the Company financial statements in accordance with applicable United Kingdom law and United Kingdom generally accepted accounting practice.

Company law requires the Directors to prepare Company financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the Company financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

 **ERNST & YOUNG**  
**Independent auditor's report**  
to the members of ScS Upholstery plc

We have audited the parent Company financial statements of ScS Upholstery plc for the year ended 30 September 2006 which comprise the Company Balance Sheet and the related notes 1 to 10. These parent Company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the Group financial statements of ScS Upholstery plc for the year ended 30 September 2006.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the parent Company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent Company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent Company financial statements give a true and fair view, the parent Company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and whether the information given in the Directors' Report is consistent with the financial statements.

The information given in the Directors' Report includes that specific information presented in the *Chairman's Statement and Business Review* that is cross referred from the *Business review and future developments* section of the Directors' Report.

We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent Company financial statements. The other information comprises only the Chairman's Statement, the Business Review, the Corporate Governance Statement and the unaudited part of the Directors' Remuneration Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent Company financial statements. Our responsibilities do not extend to any other information.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent Company financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the parent Company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

**ERNST & YOUNG**  
**Independent auditor's report**  
to the members of ScS Upholstery plc (continued)

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent Company financial statements and the part of the Directors' Remuneration Report to be audited.

**Opinion**

In our opinion:

- the parent Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 30 September 2006;
- the parent Company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the parent Company financial statements.

*Ernst & Young LLP*

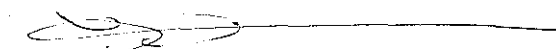
Ernst & Young LLP  
Registered auditor  
Newcastle upon Tyne

20 November 2006

## Company balance sheet

at 30 September 2006

	Notes	2006 £'000	Restated 2005 £'000
<b>Fixed assets</b>			
Investments	4	1,966	1,966
<b>Current assets</b>			
Debtors	5	1,981	64
<b>Creditors: amounts falling due within one year</b>	6	(163)	(1,301)
<b>Net current assets/(liabilities)</b>		1,818	(1,237)
<b>Net assets</b>		3,784	729
<b>Capital and reserves</b>			
Called up share capital	7	340	336
Share premium account	8	2,971	1,920
Capital redemption reserve	8	195	195
Treasury shares	8	(1,172)	(1,472)
Profit and loss account	8	1,450	(250)
<b>Equity shareholders' funds</b>	8	3,784	729



D Knight  
Director

20 November 2006

## Notes to the financial statements

for the year ended 30 September 2006

### 1. Parent Company accounting policies

#### ***Basis of preparation***

The separate financial statements of the Company are presented as required by the Companies Act 1985. They have been prepared in accordance with applicable United Kingdom generally accepted accounting practice. The Company prepares its financial statements on the historic cost basis of accounting.

No profit and loss account is presented by the Company as permitted by Section 230 of the Companies Act 1985 and the Company has taken the exemptions under FRS 1 to not present a cash flow statement.

The Company has taken advantage of the exemption for disclosure available to parent companies under FRS 25 "Financial Instruments" and FRS 13 "Derivatives and other Financial Instruments" for 2006 and 2005 respectively.

#### ***Prior year adjustment***

##### ***FRS 21 'Events after the balance sheet date'***

The Company has adopted FRS 21 'Events after the Balance Sheet Date' in these financial statements. Dividends are now recorded where an obligation exists at the balance sheet date. Consequently, dividends which the Group approves in a general meeting after the balance sheet date are no longer accrued, but are required to be disclosed in the notes to the financial statements (see note 2). The prior year comparative figures have been restated to reflect the dividends paid in that year, in accordance with the first year adoption requirements of FRS 21. As a result, the "other creditor" relating to the final dividend for 2003/2004 (£2,933,000) and 2004/2005 (£3,511,000) have been removed in the respective balance sheets.

##### ***FRS 20 'Employee benefits'***

The Company has adopted FRS 20 'Employee Benefits' in these financial statements. Under FRS 20 the charge recognised in the profit and loss account for share-based payments is based on the fair value of the option or award at date of grant, which is expensed over the vesting period of the option or award. Fair value is measured by use of the Black Scholes valuation model. The Company has applied transitional rules to share options granted before 7 November 2002 that were unvested as of 1 October 2005. The effect of this standard has resulted in an increase in operating profit of £26,000 for the year to 30 September 2005. Operating profit has increased as the charge under FRS 20 is reflected in the financial statements of the subsidiary company to which services have been supplied, in accordance with paragraph 3 of FRS 20.

#### ***Investments***

The fixed asset investment in the subsidiary undertaking is shown at cost less provision for impairment.

#### ***Taxation***

The charge for the year is based on the profit for the year.

#### ***Treasury shares***

Shares held to meet obligations under the Group's long term incentive plan for key employees are held at cost and are shown as a deduction from equity shareholders' funds.

## Notes to the financial statements

for the year ended 30 September 2006

### 2. Dividends

	2006	Restated (note 1) 2005
	£'000	£'000
Equity dividends on ordinary shares paid	5,798	5,011
Final dividends on ordinary shares proposed	4,047	3,511

### 3. Profit attributable to members of the parent Company

The profit dealt with in the financial statements of the parent Company was £7,985,000 (2005 restated: £4,347,000).

### 4. Investments

	Subsidiary undertaking £'000
Cost:	
At 1 October 2005 and 30 September 2006	1,966

The investment represents a holding of 100% of the equity share capital of A Share & Sons Limited, a Company incorporated in England and Wales.

The subsidiary is engaged in the trade of specialist upholstered furniture retailing.

### 5. Debtors

	2006	Restated 2005
	£'000	£'000
Prepayments and accrued income	10	6
Amounts due from subsidiary undertaking	1,971	-
Corporation tax debtor	-	58
	1,981	64

## Notes to the financial statements

for the year ended 30 September 2006

### 6. Creditors: amounts falling due within one year

	2006 £'000	Restated 2005 £'000
Accruals	163	100
Amounts due to subsidiary undertaking	-	1,201
	<u>163</u>	<u>1,301</u>

### 7. Share capital

#### Authorised

	2006 £'000	2005 £'000
Ordinary shares of 1p each	600	600

#### Allotted, called up and fully paid

	2006 No	2005 No	2006 £'000	2005 £'000
Balance at beginning of year	33,571,950	32,595,100	336	326
Exercised under share option schemes	468,207	976,850	4	10
Balance at end of year	<u>34,040,157</u>	<u>33,571,950</u>	<u>340</u>	<u>336</u>

The information required by Schedule 6(1) of the Companies Act 1985 is provided in the Directors' Remuneration Report on pages 15 to 19.

The audit fee payable in respect of the Company was £7,000 (2005: £7,000)

## Notes to the financial statements

for the year ended 30 September 2006

### 8. Reconciliation of movements in shareholders funds

	Share capital £'000	Share premium account £'000	Capital redemption reserve £'000	Treasury shares £'000	Profit and loss account £'000	Total £'000
At 30 September 2004 as previously stated	326	745	195	(501)	2,047	2,812
Prior year adjustment – FRS 21	-	-	-	-	(1,633)	(1,633)
At 30 September 2004 as restated	326	745	195	(501)	414	1,179
Profit for the year (restated)	-	-	-	-	4,347	4,347
Dividends (restated)	-	-	-	-	(5,011)	(5,011)
Acquisition of Treasury shares	-	-	-	(971)	-	(971)
Employee share options exercised	10	1,175	-	-	-	1,185
At 30 September 2005 (restated)	336	1,920	195	(1,472)	(250)	729
Profit for the year	-	-	-	-	7,985	7,985
Dividends	-	-	-	-	(5,798)	(5,798)
Acquisition of Treasury shares	-	-	-	(187)	-	(187)
Employee share options exercised	4	1,051	-	-	-	1,055
Transfer re. treasury shares	-	-	-	487	(487)	-
At 30 September 2006	340	2,971	195	(1,172)	1,450	3,784

Treasury shares represents the cost of shares in ScS Upholstery plc purchased in the market and held by employee benefit trusts ("the Trusts") for the benefit of the employees. Shares are held in trust until such time as they may be transferred to employees in accordance with the terms of the relevant employee share scheme, with the principal requirement being that the employee is still in employment with the Company after a three year period. Surplus shares may be held to satisfy future awards.

The Trusts hold 338,066 shares with an aggregate nominal value of £3,380 acquired at an average cost of 347.0 pence per share. The market value of the shares at the year end was 482.5 pence per share (2005: 348.75 pence per share). Of these shares 1,032 have not been conditionally awarded at the year end.

All rights to dividends on these shares have been waived. All expenses incurred by the trust are settled directly by the Company and charged in the financial statements as incurred.

The Company acquired 39,846 shares during the year, with an aggregate nominal value of £398 (0.1% of share capital). The consideration paid was £187,475. The shares were acquired to be held by employee benefit trusts for the benefit of the employees, as described in note 7.

## **Notes to the financial statements**

**for the year ended 30 September 2006**

### **9. Contingent liabilities**

Other than the cross guarantee between the parent undertaking and subsidiary undertaking for banking facilities, there were no contingent liabilities at 30 September 2006 and 30 September 2005. No loss is expected to arise in respect of this arrangement.

### **10. Related party transactions**

The Company has taken advantage of the exemption conferred under paragraph 3 of FRS 8 "Related Party Transactions" not to disclose transactions with other Group companies.

## Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of ScS Upholstery plc will be held at the Marriott Gosforth Park Hotel, High Gosforth Park, Newcastle upon Tyne, NE3 5HN on 19 February 2007 at 12 noon for the following purposes:

1. To receive the report of the Directors and audited accounts for the year ended 30 September 2006.
2. To approve the Directors' remuneration report.
3. To declare a final dividend of 12.0 pence per share on the ordinary shares.
4. To re-appoint K Royal who retires by rotation, as a Director
5. To re-appoint Ernst & Young LLP as auditors and authorise the Directors to fix their remuneration.

To consider, and if thought fit, pass the following Resolutions of which Resolutions 6, 8 and 9 will be proposed as Ordinary Resolutions and Resolution 7 will be proposed as a Special Resolution.

6. That the Board be authorised in accordance with Article 7.1 of the Company's Articles of Association to allot relevant securities during the period ending at the conclusion of the next Annual General Meeting having an aggregate nominal value of not more than £113,455 (being 33% of the issued ordinary share capital).
7. That the Board be authorised in accordance with Article 7.2 of the Company's Articles of Association to allot equity securities for cash during the period ending at the conclusion of the next Annual General Meeting and, for the purposes of paragraph 7.2.2 of the Article having an aggregate nominal value of not more than £17,020 (being 5% of the issued ordinary share capital).
8. That the Board be authorised to establish the ScS Long Term Incentive Plan 2007, a copy of the draft rules of which has been produced to the meeting and initialled by the Chairman (for the purposes of identification only), a summary of the main provisions of which will be set out in a letter from the Chairman to be enclosed with the financial statements.
9. That the Board be authorised to establish the ScS Sharesave Plan 2007 (the "Sharesave Plan"), a copy of the draft rules of which has been produced to the meeting and initialled by the Chairman (for the purposes of identification only), a summary of the main provisions of which will be set out in a letter from the Chairman to be enclosed with the financial statements, and to do all such acts and things as may be necessary or expedient to give effect to the Sharesave Plan, including *amending the rules of the Sharesave Plan in such a manner as may be necessary to ensure that the Sharesave Plan is approved by HM Revenue & Customs.*

By order of the Board

R Turnbull  
Company Secretary

20 November 2006

Notes:

A shareholder entitled to attend and vote at the meeting may appoint one or more proxies to attend and, on a poll, vote instead of him/her. The proxy need not be a shareholder of the Company and the appointment of such proxies does not preclude shareholders from subsequently attending. A form of proxy for use of shareholders is enclosed, and, to be effective, must be completed, signed and lodged with the Company's Registrars: Capita Registrars, Proxy Department, Bourne House, 34 Beckenham Road, Beckenham, Kent, BR3 4TU, not less than 48 hours before the time appointed for the meeting.

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## Notice of Annual General Meeting (continued)

Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the time by which a person must be entered on the register of members in order to have the right to attend and vote at the Annual General Meeting is 12 noon on 17 February 2006 (being not more than 48 hours prior to the time fixed for the Meeting) or, if the Meeting is adjourned, such time being not more than 48 hours prior to the time fixed for the adjourned meeting. Changes to entries on the register of members after that time will be disregarded in determining the right of any person to attend or vote at the Meeting.

The following documents will be available for inspection during business hours at the Registered Office until the date of the meeting:

- the register of Directors' interests in the Company shares.
- copies of the Directors' service contracts.

The following documents are available for inspection at the offices of Pinsent Masons, CityPoint, One Ropemaker Street, London EC2Y 9AH during normal business hours (Saturdays, Sundays and Bank Holidays excepted) from the date of this Notice until the close of the meeting and will also be available for inspection at the place of the meeting for at least 15 minutes before and during the meeting:

- The draft rules of the ScS Long Term Incentive Plan 2007; and
- The draft rules of the ScS Sharesave Plan 2007.

If the proposed dividend is approved, the final dividend will be paid on 26 February 2007 to those shareholders on the register of members at the close of business on 26 January 2007.