

## BUSINESS REVIEW

SIG plc is a leading supplier of specialist products to professionals in the building, construction and related industries, with 753 trading sites throughout the UK and Ireland and Mainland Europe.



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### GLOSSARY OF TERMS

**LIKE FOR LIKE** is defined as the business excluding the impact of acquisitions made since 1 January 2008.

**UNDERLYING** is before the amortisation of acquired intangibles, impairment charges, restructuring costs and gains and losses on derivative financial instruments.

**TRADING CASH CONVERSION** is defined as cash flow from operations before pension movements divided by underlying operating profit.

This Business Review has been prepared by the Board solely for the members of SIG plc. It is intended to provide Shareholders with a summary of the development, performance and financial position of the Group for 2009. It also provides details of the main trends and factors underlying the year's results and which are likely to affect future performance and describes the Group's business and its key objectives, strategies, values and resources, together with the principal risks and uncertainties it faces. A cautionary comment relating to forward looking statements is provided on page 27.

### INTRODUCTION TO SIG

SIG plc is a leading supplier of specialist products to professionals in the building, construction and related industries, with 753 trading sites throughout the UK and Ireland and Mainland Europe and employed 11,800 people as at 31 December 2009.

Founded in 1957 in Sheffield, UK, SIG has grown from a single site insulation distribution business into a multi-national specialist supplier operating in four different market sectors. The Company was listed on the London Stock Exchange in May 1989 and is a constituent member of the FTSE 250 index, listed within the Support Services Sector.

On 17 March 2010, the share price closed at £1.274. At this date there were 590,829,339 shares in issue, giving a market capitalisation at that date of £753m.

### SIG'S ORGANISATIONAL STRUCTURE

SIG's operations are managed on a country-by-country basis. Within each country there is dedicated divisional management focusing on each market sector. This is critical to the success of the business, ensuring that focus is provided to the specific requirements of the customer and the supply chain required to service the customer. Back office functions such as HR, IT, finance, property and fleet management are provided on a country-by-country basis and are shared across business units in each country where it is appropriate and economic to do so.

The Parent Company of the Group, SIG plc, oversees and supports the strategic development of each business via the activities of the Group Board, the Corporate Development Department and the Group Finance Department.

## Focus, Specialisation and Service

### INTRODUCTION TO SIG CONTINUED

#### SIG'S BUSINESS MODEL

SIG is the market leader in most of the specialist markets in which it trades. SIG is positioned as a leading player in the respective specialist market, or seeks to grow its market position through targeted development initiatives.

Specialist markets are characterised by the need to hold a broad and comprehensive range of stock, supported by technical advice and extensive service and delivery capability.

SIG's leading position in specialist markets has enabled the Group's sales growth to outperform the general construction output index in recent years, both on an organic basis and including acquisitions.

Specialist markets provide opportunity for superior growth as they tend to be more fragmented in nature and require technical product and application knowledge which provide entry barriers to the general merchanting community. SIG's strategy in fragmented markets is to build scale and market share whilst generating superior purchasing power and achieving economies of scale in back office activities thereby delivering superior returns.

The supply of specialist products requires a proactive sales approach rather than a passive retail approach together with a more collaborative process of supply chain management.

### SIG'S PRODUCTS

#### Insulation and Building Environments

Thermal insulation

Fire protection

Acoustic insulation

Dry lining

Refrigeration and cold storage

Flooring

Installation of insulation

High temperature insulation

Air tightness testing

Heating and ventilation products

Industrial lining

Pipe insulation

Roofing insulation

Waterproofing

Air handling and treatment

Air conditioning

#### Exteriors

Flat roofing

– Roofing felts – glass, polyester and torch-ons

– Bitumen

– Roof lights and domes

– Solar reflective paints

Slating and tiling

– Concrete tiles

– Clay tiles

– Promenade tiles

– Slates – natural and man-made glass

– Shingles

Sheeting and cladding

– Fire cement sheeting

– Mastic asphalt

– Profiled metal sheeting

– Insulated panels

Rainwater goods

Roofline products

– Soffits

– Facias

– Barge boards

Ventilation

Building Plastics

– UPVC windows and doors

– Plastic cladding

Photovoltaic solar kits/panels

### SIG'S MARKET SECTORS

Over the last two decades, SIG has continuously expanded the range of products it sells to specialist contracting companies and professional trades. SIG now sells different lines of specialist construction products across a number of different countries. The principal countries from which SIG trades are:

	Insulation and Building Environments	Exteriors	Interiors	Specialist Construction Products
United Kingdom	✓	✓	✓	✓
Ireland	✓	✓	✓	✓
Germany and Austria	✓	✓	✓	✓
France	✓	✓	✓	✓
Poland	✓	✓	✓	✓
Benelux	✓		✓	
Czech Republic, Slovakia and Hungary	✓		✓	

In addition to SIG's principal countries of operation as stated above, the Group also has a small trading presence in six other jurisdictions, being Turkey, Romania, Bulgaria, UAE, Spain and Luxembourg. The operations in these six jurisdictions amount in total to less than 1% of Group turnover and have therefore not been included in the table above.

#### Interiors

Suspended ceilings

Partitioning

Doors and doorsets

Category lighting

Dry lining

Fire protection

Insulation

Architectural glass

Toughened and laminated glass

Raised access floors

Office/acoustic screens

Noise control

Fixing products

Temporary protection products

Floor coverings

Washroom systems

#### Specialist Construction Products

Mechanical engineering fixings and accessories

Fixings and fastenings

Groundwork products

– Shoring equipment

– Geotextiles

– Reinforcement products

– Ground stabilisation products

Temporary fencing and scaffolding

Masonry components

Construction chemicals

Safety helmets

Protective clothing

Safety glasses

Safety boots

Ear plugs

Gloves

Dust respirators

Tools (including power tools and accessories)

Concrete accessories

Waterproofing

Render

Precast

Steel support systems

Site set-up equipment

## BUSINESS REVIEW CONTINUED

SIG provides a diverse range of specialist products from manufacturers to support specialist contractors.

### THE CORE SIG BUSINESS OFFERING: SUPPLY SPECIALIST CONTRACTORS WITH SPECIALIST PRODUCTS ACROSS A NUMBER OF DIFFERENT COUNTRIES

- Insulation and Building Environments
- Exteriors
- Interiors
- Specialist Construction Products

#### INTRODUCTION TO SIG CONTINUED SIG'S ACTIVITIES

SIG is primarily a distributor handling and supplying specialist products manufactured by other companies. In markets where the supply chain requires bespoke products to be made and supplied direct to the end user, SIG's route to market is by manufacturing products for its specialist customer contractors to fit. SIG currently manufactures partition systems and doorsets in the UK and fabricates certain custom products across the Group. Fabrication involves adding value by cutting, reshaping or attaching two or more core products together. The largest fabrication activities are the cutting and shaping of industrial insulation, the cutting and processing of glass products and the assembly of roofing panels.

In addition, in the UK SIG also installs loft and cavity wall insulation in residential properties and where customer demands dictate it installs certain interior products.

SIG operates under a wide variety of trading names. Many of these brands are widely recognised throughout their respective market sectors or countries as the leading supplier of specialist products and services to the construction trade.

#### SIG'S ROLE IN THE SUPPLY CHAIN

The products that SIG supplies are specialist in nature and are provided to specialist contracting companies and professional trades, both for new construction and for Repairs, Maintenance and Improvement ("RMI"). Whilst general jobbing builders may purchase some items from SIG, they are more broadly served through the general builders merchant supply chain.

SIG provides a crucial role in the specialist building products supply chain by:

- **PROVIDING ACCESS TO A BROAD AND DIVERSE CUSTOMER BASE**  
SIG provides a diverse range of specialist products from manufacturers to support specialist contractors. Manufacturers deliver products in bulk to SIG's trading sites throughout each country of operation. SIG then focuses upon delivering a packaged range of products in job specific quantities on a time critical basis to a broad and diverse customer base as required by the construction cycle. SIG provides an efficient channel by which manufacturers can access thousands of specialist contractors.
- **PROVIDING "IMMEDIATE" AVAILABILITY OF PRODUCT CLOSE TO SITE LOCATION**  
Through SIG's 753 trading sites, contractors are able to obtain product in rapid timeframes to meet the demands of a fast moving construction site. The majority of construction sites do not have a large area to store product safely and securely and so the ability to source product quickly overcomes the problems caused by such a space constraint.
- **HAVING THE MOST EXTENSIVE DELIVERY FLEET IN THE INDUSTRY**  
SIG delivers over 70% of its goods sold to the construction site. SIG has a wide range of delivery vehicles, including a number of mechanical offload and crane facilities to deliver the product to exactly where it is needed.
- **PROVIDING TECHNICAL ADVICE AND PRODUCT EXPERTISE**  
As Building Regulations, environmental issues and modern methods of construction become ever more complex, SIG's customer base values the comprehensive technical knowledge that SIG's sales staff have of each product's specific application to ensure their suitability for purpose and that legal and safety standards are met in buildings and industry. Where particularly complex queries arise, SIG is able to call upon advice from its supplier base. This is an important value-added element of the service offered by SIG. No other European company has the depth of experience and expertise that SIG has in its product fields.

**INTRODUCTION TO SIG CONTINUED****SIG'S ROLE IN THE SUPPLY CHAIN CONTINUED****■ ENABLING CONTRACTORS TO MAXIMISE EFFICIENT USE OF LABOUR**

It is estimated that there is up to a 40% loss of efficiency whilst skilled labour waits for material delivery. SIG's ability to deliver product at short notice enables contractors to flex their work schedule depending upon the daily needs of the construction site thus minimising this inefficiency. This part of the service offering is highly valued by SIG's customer base and ensures SIG maintains its critical role in the supply chain.

**■ PROVIDING CREDIT TERMS TO CONTRACTORS**

SIG's typical customer is relatively small to medium sized. SIG provides credit to enable a contractor generally to fit goods before they are paid for to ensure continuity of the supply chain. SIG has very well established and rigorous credit control procedures that limits its risk exposure whilst having regard to the needs of the customer base.

These activities have enabled SIG to build businesses that are able to differentiate themselves from mainstream competitors.

**MARKETS SUPPLIED BY SIG**

SIG is well diversified, serving a wide range of industries and markets. The following table provides an indicative estimate, based upon SIG's analysis of market information, of the breakdown of the 2009 Group sales into the different end markets:

	Total % of Group	New build % of sub-Group	RMI % of sub-Group
Non-residential	55%	55%	45%
Residential	35%	43%	57%
Industry (non-construction)	10%	52%	48%

Source: SIG estimates.

The Non-residential market is SIG's largest market. This includes both private and public expenditure on schools, hospitals, prisons, warehouses, leisure complexes, retail developments, sports stadia, airports and offices.

Residential is SIG's second largest market. In this market, SIG is more heavily weighted to the essential repairs and maintenance market which is less sensitive to the economic fluctuations which can impact the new-build sector and provides an underlying market in periods of economic downturn.

The smallest market for SIG is Industry (non-construction). SIG predominantly supplies industrial (technical) insulation to this market which includes, for example, power stations and process industries where heat is an important part of the production process.

**DEMAND FOR SIG'S PRODUCTS**

Demand for the products sold by SIG is influenced by a wide range of factors. Overall economic GDP growth drives construction activity on a long term basis. As the economy grows and contracts, construction activity reflects this trend. New build is driven by the economic cycle whilst RMI activity is more constant in nature and in certain markets can be counter cyclical offering a more constant level of activity.

In addition, construction activity is also largely dependant on both the level and cost of credit available in order to finance large construction projects. Over the last 18 months, the availability of credit has reduced and the cost of credit has increased significantly, thus having a dampening effect on construction activity.

The current economic downturn is inevitably affecting the short term demand for SIG's products. However, the medium to long term prospects for SIG's market sectors remain strong. The current low levels of residential and private non-residential building activity across certain parts of Europe are not sustainable when set against demographic growth trends. Given that SIG enjoys leading positions in the majority of its markets and geographies and is active in a number of emergent Central European markets, the Group is in a prime position to benefit from any upturn in market demand over the medium term.

## BUSINESS REVIEW CONTINUED

### INTRODUCTION TO SIG CONTINUED

#### DEMAND FOR SIG'S PRODUCTS CONTINUED

Whilst demand is principally influenced by the macroeconomic conditions described on page 9, other factors by product range are detailed below:

#### Business

##### Sector-specific market drivers

#### Insulation and Building Environments

- Demand for products that reduce energy consumption in both new and existing residential and non-residential buildings to reduce the impact of high energy costs and to reduce carbon dioxide ("CO<sub>2</sub>") emissions.
- Demand for insulation products will be driven by regulation in addition to environmental and economic factors.
- Public sector and Private Finance Initiatives ("PFI").

Insulation usage in new construction is affected by the Building Regulations in operation in each country. Over time, it is expected that Governments, businesses and the public will increasingly focus on reducing energy consumption more vigorously than in the past and that as a result, insulation demand will continue to rise.

Government expenditure on infrastructure projects and residential developments, some of which will be funded under Private Finance Initiatives, will help support demand for insulation products in the current economic climate.

#### Exteriors

- A regular and essential RMI requirement for roofs subject to increasingly variable and severe weather conditions.
- Demand for new products to reduce building exterior maintenance costs.
- Growth of specialist distribution as the main supply route.
- Government incentives surrounding solar energy feed-in tariffs providing significant impetus to demand for Solar Photovoltaic Systems.

The age profile of roofs across the UK and Europe gives rise to an ongoing RMI requirement. This provides a core product demand.

Certain products are used extensively for both new build and repair and maintenance in commercial property and demand over time is expected to increase as people look for low-maintenance products and energy efficient options.

Recent reductions in new housing starts, particularly in the UK, will create a shortage of housing in these regions, exacerbated by an increasing population. In the UK and Ireland there is also an oversupply of multiple occupancy buildings, such as city centre flats, and an undersupply of detached single family buildings, which by their nature require more roofing product per person.

#### Interiors

- Rising standards of internal fit out and the growing importance of acoustic and fire safety standards.
- Increased demand for integrated solutions.
- Government expenditure to improve the internal environments of schools and hospitals and other public buildings.

SIG has experienced a trend towards higher quality internal working environments, for example, higher value glass partitions in non-residential buildings and higher quality doors to meet fire and acoustic regulations.

Fire and acoustic regulations are set to become more stringent in the next few years. This will favour the larger suppliers with a depth of technical expertise, such as SIG.

New interiors are often required following a change of use or a change of occupancy within existing non-residential buildings, requiring refitting and removal of partitions, wall storage and ceiling systems.

#### Specialist Construction Products

- Government and utility investment in major infrastructure projects.
- Requirement for value engineered solutions on construction projects.
- "Just-in-time" approach to project management.

Complex major construction projects require specialist application and performance knowledge. This is provided by SIG's specialist businesses in this area.

Over recent years, methods of construction have changed, leading to a requirement for new innovative specialist products which SIG is ideally placed to supply.

#### All Businesses

Convergence of trades and requirement from major contractors for 'bundled' solutions and supply chain management, thus benefiting businesses with significant scale and breadth of product offers such as SIG.

## Focus, Specialisation and Service

### SIG'S STRATEGY

The Group's core strategy is to continue the growth and development of SIG as a leading European specialist supplier to the building and construction industries, in order to create growth in long term shareholder value.

In light of current macroeconomic conditions and the associated reduction in demand for construction related products, SIG has reacted quickly to align the cost base of its businesses to current and anticipated levels of market demand. The Group has also taken a number of actions which drive operational and commercial efficiencies (e.g. the merger of the UK's insulation and interiors distribution businesses as detailed further on page 17). The actions taken to date in both 2008 and 2009 ensure that the Group is in good shape to deal with any further decline in a number of its markets but also to take advantage of the economic recovery when it arrives.

In order to reduce the Group's net debt, cash generation has been a key focus during 2009. This has been driven by a number of initiatives:

- strict management of working capital, through the issue of stringent working capital targets to all business units;
- the deferral of non-essential capital expenditure and the redeployment of certain assets;
- an increased drive for process efficiency through the adoption of best practice principles;
- further cross business unit resource sharing and cost saving initiatives; and
- procurement, logistics and property reviews.

SIG's long term growth plan is focused around five key growth strategies which are as follows:

- **consolidate and exploit existing market leading positions;**
- **market demand growth;**
- **wider product range;**
- **pipeline of development initiatives; and**
- **geographical development into attractive new markets.**

Throughout 2009, despite a backdrop of extremely challenging market conditions and declining markets, SIG worked hard to gain market share in many of its markets. Details of the growth strategies in action during 2009 are set out below:

#### 1. CONSOLIDATE AND EXPLOIT EXISTING MARKET LEADING POSITIONS

SIG's strategy is to develop its distribution footprint in order to achieve further penetration in core markets. SIG continually evaluates its existing trading site network and trading format structure to take advantage of synergistic opportunities within the Group.

Such opportunities include the sharing of trading sites across different trading brands, sharing of transport and inventory across multiple trading sites and combining purchasing capabilities across different business streams throughout the Group.

In light of a reduction in market volumes across SIG's end markets, SIG has reviewed rigorously the appropriate structure of its trading site networks and has quickly resized it to align to the latest forecast of market demand. This has resulted in the closure of 152 trading sites during 2008 and 2009.

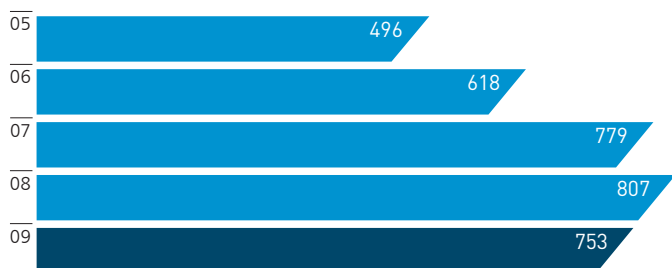
SIG has ensured that it has retained its most profitable and successful trading sites across each of its businesses to ensure that it is well positioned to benefit from any future increases in market demand.

Furthermore, as part of the Group's cost saving and restructuring programme, a number of SIG businesses have been merged to deliver cost savings, but more importantly to deliver operational and commercial efficiencies including the enhancement of the Group's cross selling capabilities. This includes the merger of the UK's insulation and interiors distribution businesses and also the merger of the Group's Polish businesses into one entity.

#### Five year history – trading sites

# 753

trading sites as at 31 December 2009



The change in the number of the Group's trading sites over the last two years is shown below:

	UK and Ireland	Mainland Europe	Total
<b>2007</b>	461	318	779
Closures	(73)	(7)	(80)
Openings	9	34	43
Acquired	36	29	65
<b>2008</b>	433	374	807
Closures	(58)	(14)	(72)
Openings	3	15	18
<b>2009</b>	<b>378</b>	<b>375</b>	<b>753</b>

#### 2. MARKET DEMAND GROWTH

The wider European market into which SIG already supplies is huge. Taking all the Mainland European countries together (except Russia), there is a population of c.600m. The market size for the supply of building and construction products is estimated to be c.€750bn per annum. SIG is well placed to exploit its product and market knowledge to take a larger share of this market place.

SIG believes that the market demand growth for insulation products and sustainable construction products in particular will outstrip the demand for other building products as the world attempts to address the issues caused by climate change and increasing energy costs. SIG is ideally placed to serve this additional demand.

## BUSINESS REVIEW CONTINUED

Following the Group's continued focus on working capital management, working capital reduced by £103.3m in 2009. As a result, despite a reduction in sales, the Group reduced its working capital to sales ratio by 1.7% to 9.0%, representing an excellent performance in the year.

### SIG'S STRATEGY CONTINUED

#### 3. WIDER PRODUCT RANGE

Extending the range of specialist products and services which SIG offers improves customer service and market penetration. Once SIG has identified a new product offering, consideration is then given to widening the supply of this product through the existing trading site network. In order to demonstrate SIG's diverse product offering, it is estimated that on a typical education project (c. £23m in value) in the UK, in excess of 35% of the total material cost can be supplied through SIG. In addition, SIG is at the forefront of product innovation and has developed a number of own brand product ranges.

#### 4. PIPELINE OF DEVELOPMENT INITIATIVES

In support of SIG's long term growth objectives, SIG employs an active business development and portfolio management strategy. This involves identifying attractive growth opportunities for the Group where SIG's key skills and capabilities match with those necessary in developing attractive new market opportunities. This includes a targeted acquisition strategy as well as organic growth initiatives.

In light of the recent challenging market environment the Group ceased its acquisition programme in September 2008. In 2009, the Group has focused on cash generation and cost saving and restructuring initiatives.

Despite the temporary cessation of the Group's acquisition programme, the Group continues to maintain an excellent knowledge of its market place and has ensured that it remains aware of possible future acquisition opportunities across Europe. The Board will be very careful in its considerations regarding the most appropriate time to recommence this part of the Group's strategy.

In the meantime, the Group continues to develop and exploit the synergistic benefits that its historic acquisition programme has provided. These benefits include maximising cross business trading, selling new products to existing Group customers, selling existing products to new Group customers and the sharing of resources to enhance current cash flow and profitability.

#### 5. GEOGRAPHICAL DEVELOPMENT INTO ATTRACTIVE NEW MARKETS

SIG is continually evaluating the construction market prospects of all countries within Europe to assess where the best growth prospects lie. SIG analyses the supply chain structure of each market and evaluates the future potential for SIG to enter the market as a specialist supplier within its chosen four market sectors.

Due to the economic downturn and the cessation of the Group's acquisition programme since September 2008, the Group has not extended its geographic coverage into new countries in 2009. Geographical development, however, remains an integral part of SIG's long term growth plan.

### KEY LONG TERM OBJECTIVES

SIG remains committed to the following key long term objectives:

- create long term growth in shareholder value through a progressive dividend policy and capital growth;
- develop and grow by applying the Group's core principles of Focus, Specialisation and Service;
- expand the Group and its activities as a leading specialist supplier to professional trades in the construction and related industries;
- supplement organic growth with targeted acquisition and development initiatives; and
- be an employer of choice and provide a rewarding and fulfilling environment for its people.

### DEVELOPMENT OF OUR PEOPLE

SIG is committed to ensuring that all employees and management know what is expected of them in their roles and that they receive the necessary training and development to be highly competent in what they do. In the UK, access to e-learning has been extended to include product, technical and management training programmes and the business continues to offer a range of NVQs. As well as acquisition of product knowledge, a great deal of emphasis is placed on on-the-job training and during the year, several coaching skills programmes were run across the Group to further improve the effectiveness of training. New training resource has been added to further strengthen our product and sales expertise.

The talent management process has been extended across the Group and within operating companies to marry the aspirations of talented people with future business requirements and expectations. This has led to continued investment in the Executive Development Programme run in conjunction with Sheffield Hallam University and the introduction of the SIG Young Manager of the Year Award to recognise the efforts and contribution of new managers within their businesses. The Group also continues to invest in graduate programmes across the Group.

### KEY PERFORMANCE INDICATORS

The Group uses the following key performance indicators to evaluate the success of its business:

#### 1. LIKE FOR LIKE SALES GROWTH

Like for like sales growth is defined as the percentage growth/(decline) in the sales of the Group excluding the impact of current year and prior year acquisitions. Given the significant exchange rate volatility in recent years, the percentage is calculated on a constant currency basis to provide a realistic understanding as to underlying performance.

## Focus, Specialisation and Service

### KEY PERFORMANCE INDICATORS CONTINUED

#### 1. LIKE FOR LIKE SALES GROWTH CONTINUED

The measure reflects the underlying sales growth in the business which typically arises from increased sales volumes to both new and existing customers, product price inflation and selling new products through the existing infrastructure. The growth is supported by investment in new brownfield trading site openings and trading site relocations into larger premises with additional stockholding capability. Maintaining positive like for like growth in every business is a key target by which every business is measured and is a key component of being able to drive profit growth.

Like for like sales growth rates/(rates of decline) on a constant currency basis are set out below:

	2007	2008	2009
UK and Ireland	9.7%	(3.4%)	<b>(22.2%)</b>
Mainland Europe	12.3%	4.2%	<b>(7.6%)</b>
Group	10.5%	(0.8%)	<b>(15.6%)</b>

The like for like sales reduction in the UK and Ireland in 2009 reflects the continued reduction in market demand which was first noted in the second half of 2008, particularly in Ireland, where like for like sales in Euros were down 42.5% in 2009. Management believes that despite this reduction, most businesses have either held or grown their market share.

Despite strong comparator numbers for 2008, the like for like sales decline in Mainland Europe is much lower than that experienced in the UK and Ireland. The economic recession was less severe in the Group's Western European countries of operation (i.e. Germany, France and Benelux which represent c.85% of the Group's Mainland European sales) than in the UK and Ireland.

The geographical spread of the business provides the Group with diversity and an ability to manage risk. As a result of the sales decline in Mainland Europe being less than in the UK and Ireland, coupled with the continued weakness of Sterling against the Euro, sales for the first time in 2009 from the Group's Mainland European businesses represented over 50% of Group sales.

#### 2. UNDERLYING OPERATING PROFIT MARGIN

The underlying operating profit margin is defined as the ratio of underlying operating profit to sales. Underlying operating profit is defined as operating profit before the amortisation of acquired intangibles, impairment charges, restructuring costs and gains and losses on derivative financial instruments.

SIG works to improve its underlying operating profit margin by managing its selling prices in the local markets in which it operates and by controlling the cost base through operational efficiencies. Despite a significant reduction in the Group's cost base in 2009 driven by the Group's cost saving and restructuring programme, SIG has experienced a fall in its underlying operating profit margin in 2009.

The majority of operating costs in the business relate to people, property and transport and in light of the current macroeconomic environment, SIG has taken swift action to align these operating costs with the underlying market demand for its products.

The reduction in operating profit margin in 2009 is a result of the sales volume decline and gross margin pressures suffered in the majority of its markets outpacing the reduction in the Group's operating cost base.

SIG has historically experienced lower underlying operating profit margins in Mainland Europe than in the UK and Ireland. However, due to the greater sales volume and gross margin pressure experienced in the UK and Ireland compared to Mainland Europe and the resultant impact on operating margins, the operating profit margin in Mainland Europe is higher than in the UK and Ireland in 2009.

On an ongoing basis the mix of sales between these two regions will have an influence on the overall Group underlying operating profit margin:

	2007	2008	2009
UK and Ireland	8.0%	6.7%	<b>2.8%</b>
Mainland Europe	4.9%	4.9%	<b>3.5%</b>
Group (after Parent Company costs)	6.5%	5.6%	<b>2.9%</b>

#### 3. WORKING CAPITAL TO SALES

Working capital to sales is defined as the ratio of working capital (including provisions) to annualised sales (i.e. after adjusting for acquisitions and disposals in the current and prior year) on a constant currency basis.

##### Working capital to sales

# 9.0%



The ability of the Group to manage its working capital in relation to the value of sales made by each business is essential to ensure that the Group generates cash from its operations. Cash generation is important to enable the Group to pay its taxes and, particularly in the current environment, to ensure that the Group complies with its debt covenants.

Following the Group's continued focus on working capital management, working capital reduced by £103.3m in 2009. As a result, despite a reduction in sales, the Group reduced its working capital to sales ratio by 1.7% to 9.0%, representing an excellent performance in the year. It is not envisaged that significant further improvement in the Group's working capital to sales ratio will be achieved in 2010.

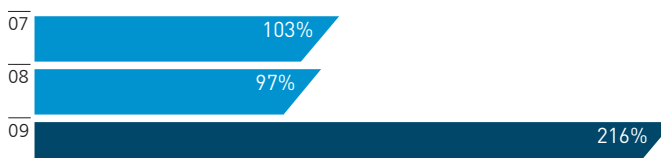
#### CASH CONVERSION

Cash conversion is defined as cash flow from operations before pension movements divided by underlying operating profit. Cash conversion measures the Group's ability to convert its underlying operating profits into cash.

Over the medium term, the Group aims to have a minimum average cash conversion ratio of 100%. However, as the Group begins to benefit from the upturn in construction markets when it arrives, investment in working capital will be required making a cash conversion target of 100% more difficult to achieve.

##### Cash conversion

# 216%



As noted above, due to the significant reduction in working capital achieved in 2009, the cash conversion percentage at 216% is well above the Group's long term average target of 100%. It is not envisaged that the cash conversion percentage of 216% achieved in 2009 will be replicated in 2010, rather a more normalised target of 100% is envisaged.

## BUSINESS REVIEW CONTINUED

In the face of further reductions in demand for its products and services, as well as bearing down on day-to-day running costs and working capital, the Company continued in 2009 to implement a comprehensive range of cost reduction measures aimed at adapting resources to the evolving level of demand in its various market sectors and geographies.

### TRADING PERFORMANCE

Exceptionally challenging trading conditions prevailed in all of SIG's market sectors and countries of operation throughout 2009, with the economic downturn significantly reducing construction activity and hence demand for the products and services which the Company supplies.

The pace and the likely extent of market decline proved especially hard to gauge in the early part of the year, with abnormally harsh winter weather conditions which gripped Mainland Europe throughout Q1 restricting building site activity for all outside trades and severely depressing normal patterns of seasonal demand. Inconsistent trading from week to week across all of SIG's operations was a feature of the early months of 2009 but by mid year underlying trends were beginning to emerge in the Group's different sectors and geographies. It emerged that the heavy fall in demand experienced in the UK and Ireland towards the end of 2008 had gathered speed in the first half of 2009. The much reduced level of activity that the Group experienced from early 2008 onwards in the UK house building market was followed by a rapid slowdown in non-residential construction. By late spring 2009 new housing construction began to show signs of stabilisation, albeit at a historically low level, whilst an increased flow of work coming through from the publicly-funded non-residential sector proved insufficient to offset the decline in commercial new build.

The trading environment in Ireland remained extremely challenging during the year as the full effects of the country's economic difficulties impacted on all sectors of the construction market.

Trading conditions in the Group's Mainland European countries of operation had held up much better than in the UK and Ireland throughout 2008, and whilst none of these countries proved to be impervious to the strengthening macroeconomic headwinds, taken together they were also more resilient in 2009. In general terms, SIG's principal Western European markets of Germany, France and Benelux were less volatile than those of Poland and Central Europe and by early summer they began to emerge from recession. These Western European countries appear to have suffered less economic damage and, as management had anticipated, construction markets there seem to have escaped the depth of decline suffered by the UK and Ireland.

For the first time sales in Mainland Europe in 2009 represented over half of Group turnover. This, along with the exchange gains on the translation of overseas earnings denominated in Euros (following the consistent strength of the Euro) and the relative stability in its European markets, proved beneficial to the Company's results.

The precipitous fall in volumes in many markets from 2008 onwards has exceeded most expectations and, notwithstanding cuts in manufacturing capacity in many product groups and countries, surplus production continued to wash into the market in 2009, exerting downward pressure on factory gate prices and resulting in price deflation averaging a little over 2% for the Group as a whole.

Against this background, total Group turnover in 2009 was £2,744m, a decrease of 10.2% on prior year. Underlying profit before tax was 55.9% lower at £60.6m as a result of the more challenging trading conditions. The Group recorded a loss before tax of £55.3m (2008: profit before tax £33.1m), after accounting for other items amounting to £115.9m (2008: £104.2m).

In the face of further reductions in demand for its products and services, as well as bearing down on day-to-day running costs and working capital, the Company continued in 2009 to implement a comprehensive range of cost reduction measures aimed at adapting resources to the evolving level of demand in its various market sectors and geographies, and which included a significant number of further trading site closures and mergers.

Whilst management's main focus in the year was on optimising revenue and gross margins and delivering cost savings and efficiencies, the Group did selectively continue to allocate some modest additional resources to core operations where opportunities arose to extend market coverage which offered good value.

As a result of these various actions, there was a net reduction of 54 in the total number of the Group's trading locations to 753 at the end of December 2009 (2008: 807), comprising:

- 18 new trading site openings, of which 3 were in the UK, 11 in France, 2 in Benelux and 2 in Central Europe; and
- 72 closures or mergers, of which 58 were in the UK and 14 across Mainland Europe.

### TRADING HIGHLIGHTS

#### UK AND IRELAND (48% OF TOTAL SALES)

- Total sales decreased by £343.2m (20.6%) to £1,326.2m (2008: £1,669.4m).
- Like for like sales decreased by £342.4m (21.7%).
- In the UK only, like for like sales decreased by £296.2m (20.5%).
- Underlying operating profit decreased by £73.5m (66.1%) to £37.7m (2008: £111.2m).
- Underlying operating profit margin was 390 basis points lower at 2.8% (2008: 6.7%).
- In the UK and Ireland the Group recorded an operating loss of £61.6m (2008: profit of £60.4m) after accounting for other items amounting to £99.3m (2008: £50.8m).
- 3 trading sites were added in the year organically, with 58 closures, taking the total at 31 December 2009 to 378 (31 December 2008: 433).

## Focus, Specialisation and Service

### TRADING HIGHLIGHTS CONTINUED UK AND IRELAND (48% OF TOTAL SALES) CONTINUED

As a consequence of the worsening economic situation, construction activity in the UK weakened considerably again in 2009, following an accelerating decline which began in the Spring of 2008 in the house building sector and which subsequently spread to other parts of the market. New housing starts and completions again fell steeply in 2009 to levels not seen for decades, resulting from a powerful combination of negative factors including weak consumer confidence, falling house prices and lack of mortgage finance availability. By the Spring, however, demand in the house building sector began to stabilise, and as the year progressed there were signs of a small but consistent improvement in demand for product from the major national house builders, although smaller regional and local builders were slower to see any signs of recovery.

Discretionary repair, maintenance and improvement ("RMI") demand in the types of higher value residential projects supplied by SIG such as home extensions and re-roofing work, showed a similar negative trend to residential new build construction.

The private sector component of the non-residential construction market contracted sharply in 2009, with the lack of new building projects in the office, retail and leisure segments since mid-2008 causing an acute shortage of work as existing projects under construction came to a finish. The publicly and PFI-funded sectors showed some positive development in programmes such as Building Schools for the Future and NHS infrastructure renewal projects, although this was insufficient to offset the steep drop in the private commercial new build and refurbishment segments.

In Ireland, the severe economic recession and Government austerity measures took a further toll on all areas of the construction market, which suffered an overall decline in 2009 approaching 50%.

Sales of **Insulation** and related products in the UK and Ireland decreased by 16.6% in total, 17.2% like for like, which was better than the overall annual decline in construction markets as a whole in those countries. In the UK, this was again partly due to the higher levels of thermal performance required by the 2006 changes to Building Regulations (Part L) feeding through into increased quantities of insulation being installed in new buildings. There was also some impact from the effects of the Carbon Emissions Reduction Target ("CERT") scheme, a three-year arrangement which came into effect in April 2008 and under which the Government obliges the UK power generation companies to fund CO<sub>2</sub> and therefore energy-saving programmes in existing homes. In Ireland, the sharply reduced level of construction activity resulted in correspondingly lower demand for insulation and all other types of building materials. In the later part of the year however, there was some modest improvement in insulation volumes stemming from Government supported energy saving initiatives.

The Group's Miller Pattison subsidiary, whose main activity is the retrofitting of thermal insulation in the walls and lofts of houses, saw volumes under the CERT scheme grow strongly in the first half of the year, but then fall away from summer onwards. This reflected a reduction in the flow of funding from the utility companies, pending the outcome of Government consultations to increase the value of work to be carried out during the lifetime of the current arrangements and to extend the scheme pro rata for a further year to 2012.

As well as thermal and acoustic insulation for buildings, SIG is the leading UK supplier of specialist insulation materials for a broad range of industrial process applications, ranging from food processing through to power generation, petrochemical and pharmaceutical plant. Demand for insulation for industrial applications was less depressed in 2009 than for construction use, although the severe contraction in non-residential building adversely impacted sales into the Heating and Ventilation ("H&V") sector.

The number of Insulation trading sites decreased by 4 to 79 at the end of December 2009.

The **Exteriors** division through its sales of core roofing and building plastics products is the part of SIG most heavily exposed to the housing market. With both new residential construction and larger discretionary home improvement projects running at low levels, trading conditions remained challenging through the year, and sales in 2009 were down 20.1% on prior year in total and down 21.8% like for like.

The majority of sales in this division are generated from RMI works rather than new construction, and from the summer onwards there was a slight, gradual but consistent increase in market activity partly due to the release of work under the Decent Homes scheme by local authorities in the Midlands and the North of England. Demand for roofing and cladding products into the non-residential building sector remained weak throughout the year.

In 2009 the Exteriors division extended the rationalisation of its trading locations which began in 2008, implementing a significant number of further site closures and merging the hitherto separate Roofing and Building Plastics businesses into a single operating unit. This streamlining has strengthened the commercial and operational efficiency of the Division and provides a solid platform for the future.

The number of Exteriors trading sites decreased by 35 to 218 at the end of December 2009.

The **Interiors** division had a very difficult year, with sales decreasing by 24.4% in total and 25.5% like for like. This division, through its several operating units, supplies a wide range of specialist products for the fit out of the interior space of all types of non-residential building, from offices, shops and hotels to schools, hospitals and other public buildings. The product portfolio encompasses resale items such as suspended ceilings and commercial floor coverings bought and sold through the division's distribution network, and partitioning and door sets made to order in the Company's own manufacturing units. SIG enjoys a leading market position in both distributed and manufactured interior products.

In the UK and Ireland the steep decline in the commercial new build and renovation sector which commenced towards the end of 2008 continued apace in 2009. Whilst there was some growth in the distribution businesses in public works such as schools and hospitals, the fall in the office, retail and leisure sectors resulted in a more significant reduction in sales and profitability in the manufacturing businesses. Gross margins came under pressure from a diluted product mix and from capacity underutilisation in the manufacturing businesses as well as external competition, and major restructuring measures were introduced to improve the commercial and operational efficiency of the division.

The number of Interiors trading sites decreased by 9 to 40 at the end of December 2009.

The **Specialist Construction Products** division supplies a wide range of specialist and niche products to building contractors, including brickwork accessories, access equipment, groundwork preparation products, power tools, fixings, personal protection equipment, cable ducting and other supplies for mechanical and electrical engineering contractors. A large part of the division's sales is into new construction, and with the severe curtailment in the number of new projects getting underway in both housing and non-residential development sales in the year were down 24.4% in total, and down 25.8% like for like. In the face of reducing market demand significant steps were taken in 2009 to further reconfigure the operating structure, increasing the sharing of sites and other resources both within the division and with other SIG businesses.

As a result of these changes, the number of Specialist Construction Products trading sites decreased by 7 to 41 at the end of December 2009.

## BUSINESS REVIEW CONTINUED

Management and staff across the Group are ready to deal with the challenges ahead, to continue to provide excellent service and value to our customers, to strengthen our position in our different markets, to look for opportunities for profitable growth, and to take full advantage of the upturn when it eventually comes.

### TRADING HIGHLIGHTS CONTINUED

#### MAINLAND EUROPE (52% OF TOTAL SALES)

- Total sales in Sterling increased by £33.1m (2.4%) to £1,417.3m (2008: £1,384.2m), aided by a strengthening Euro.
- Like for like sales on a constant currency basis decreased by 7.6%.
- Underlying operating profit decreased by £17.7m (26.1%) to £50.2m (2008: £67.9m).
- Underlying operating profit margin fell 140 basis points to 3.5% (2008: 4.9%).
- Total operating profit reduced by £19.8m (35.4%) to £36.1m (2008: £55.9m) after accounting for other items amounting to £14.1m (2008: £12.0m).

Against a background of strong sales and profit performance in Mainland Europe in 2008, when like for like turnover was up 4% in the year and 5% in H2, 2009's results were overall moderately encouraging. Although sales and profits were well down on 2008, the region as a whole saw construction activity less impaired by the economic downturn than the UK or Ireland, with SIG's main Western European countries of operation going into recession later and emerging from it earlier without the property bubble burst which was experienced in the UK and Ireland.

Broadly speaking, residential new build and RMI was down in Mainland Europe but tended to stabilise as the year unfolded, while non-residential activity declined less than many had expected. In part this was due to the effect of Government stimulus packages, notably in France, although the major support measures put in place in Germany by the federal Government were much slower to take effect. Demand for industrial insulation from non-construction sectors also remained reasonably stable.

In **Germany and Austria** (42% of sales in Mainland Europe) total sales were 3.2% ahead of prior year in Sterling, but down 7.2% in local currency and down 7.6% like for like in local currency. Overall construction activity in the region in the Group's segments is estimated to have been down around 10% on 2008, although the residential sector has been running at a low level for a number of years and experienced only modest further deterioration in 2009. Whilst our German operations outperformed the market again in all segments, the development of the Roofing division was particularly encouraging with like for like sales in Euros held at 2008 levels out of 4 fewer trading locations, and up 6% in H2 on the same basis.

The number of trading sites decreased by 7 to 82 at the end of December 2009.

In **France** (37% of sales in Mainland Europe) total sales in Sterling grew 7.4% versus prior year, but were down 3.5% in local currency both in total and on a like for like basis. Larivière continued to outperform the general French roofing market, with annual sales in Euros versus prior year down by 6.2% in a residential construction market down by more than 10%. Incremental sales from maturing trading sites opened in the previous three years as part of Larivière's strategic development programme, and from a further 4 trading sites opened in 2009, contributed significantly to the positive sales development.

The Group's French Insulation and Interiors operations traded exceptionally well in challenging trading conditions, achieving like for like sales in local currency in line with prior year levels in non-residential construction and process industrial insulation markets estimated together to be down around 10% versus 2008. As in the case of Larivière, these divisions benefited from organic sales growth from trading sites opened in the previous three years as well as from another 7 sites opened in 2009.

The number of trading sites increased by 11 to 175 at the end of December 2009.

In **Poland and Central Europe** (11% of sales in Mainland Europe), total sales in Sterling fell by 27.2% and by 23.8% like for like in local currency. As developing economies, the majority of them recent European Union accession states, the countries in which SIG is present in this region offer the prospect of above average sales and profit growth in the medium term, but are prone to above average volatility.

In Czech Republic, Slovakia and Hungary a variety of local political and exchange rate issues complicated the global macroeconomic pressures on the region, severely reducing construction activity and leading to substantial price deflation. Like for like sales in local currency in this sub-region, which represented 2.4% of Mainland European sales in 2009, were down 42.3% against prior year. The larger core business in Poland, where the Group has been present since 1996 and which accounted for 8.6% of sales in Mainland Europe in the year, traded in an increasingly weak market and suffered a reduction in like for like sales in local currency of 20.5% compared with 2008. Gross margins across the whole region were adversely affected by a combination of significant price deflation and temporary arbitraging across national borders occasioned by exchange rate anomalies as well as by general competitive pressures.

# Focus, Specialisation and Service

## TRADING HIGHLIGHTS CONTINUED MAINLAND EUROPE (52% OF TOTAL SALES) CONTINUED

In light of the unfolding trading environment and forward prospects, significant restructuring measures were implemented in Poland to secure greater operational efficiency and commercial effectiveness. Management continues to have full confidence in the medium term outlook for its businesses in this region.

The number of trading sites decreased by 5 to 92 at the end of December 2009.

Sales in **Benelux** (6% of total sales in Mainland Europe) were up by a substantial 11.8% in total in Sterling, and were held at 2008 level on a like for like basis in local currency. The core business in Benelux is focused on Industrial Insulation and Interiors, and both divisions continued to perform well in 2009 against background market conditions in Benelux which, in SIG's sectors combined, are estimated to have been around 6% lower than prior year.

The number of trading sites increased by 2 to 14 at the end of December 2009.

Sales in **Air Trade Centre**, the European-wide air conditioning and air handling business acquired in April 2008 and which is headquartered in Benelux, amounted to 4% of total sales in Mainland Europe. This business provides SIG with a platform for growth in the field of the energy management of buildings, which is highly complementary to the Group's insulation activities in energy saving and carbon reduction. Like for like sales in Euros in Air Trade Centre in 2009 were 11% lower than in 2008, not all of which period was under SIG ownership.

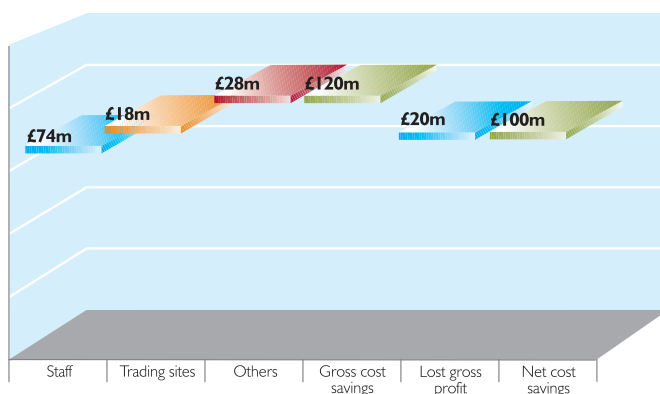
The number of Air Trade Centre trading sites at 31 December 2009 was 12.

## COST SAVING AND RESTRUCTURING

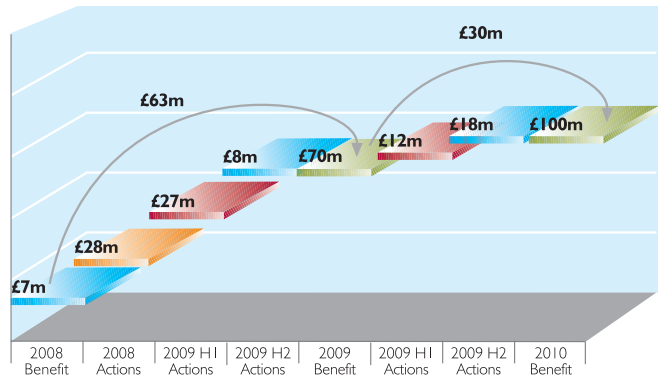
With its individual operating divisions affected differently by the downturn and being at different points in their business cycle, the Group continued a differentiated approach to cost reduction whereby the performance, resources employed and forward prospects of individual trading locations were kept under regular review and pre-planned contingency measures implemented as these

## Annualised net cost savings of £100m implemented

Achieved savings by category



## Incremental net savings benefit by period



became warranted. Consistent with the overarching aims of maintaining customer service and defending market position, as appropriate, staffing and vehicles were cut back and trading locations merged or closed to protect profitability. Such actions were taken in all of the Group's countries and operating divisions, although given the scale of the decline and the density of market coverage, the impact of such changes was heaviest in the UK and Ireland.

In addition to seeking efficiencies in the Group's operations on a standalone basis, a number of further initiatives were implemented to increase commercial and operational efficiencies between some of the UK divisions. These ranged from site sharing between several trading locations in different divisions to the full merger under single management of the insulation and interiors distribution businesses, and likewise of the previously separate roofing and roofline plastics operating units. In Poland, all of the Group's standalone businesses were merged into a single entity with a unified management structure. Furthermore, the Company embarked on the complete reconfiguration of its UK Interiors manufacturing operations, with four previously autonomous businesses being re-formed into a specialist UK Manufacturing Division, rationalising the product range and improving capacity utilisation by reducing the number of production facilities from twelve to six.

The impact of these carefully designed changes will become increasingly apparent in 2010, and will stand the Company in good stead to benefit from eventual market recovery.

## OUTLOOK

2010 is set to be another challenging year, though one in which the rate of decline in most of SIG's different market sectors and countries of operation should gradually level out as the year unfolds. Management and staff across the Group are ready to deal with the challenges ahead, to continue to provide excellent service and value to our customers, to strengthen our position in our different markets, to look for opportunities for profitable growth, and to take full advantage of the upturn when it eventually comes.

## BUSINESS REVIEW CONTINUED

Net borrowing costs benefited from the significant reduction in net debt in the period, reducing from £697.1m at 31 December 2008 to £254.5m at 31 December 2009. The reduction included:

- £325m of equity raised
- £103m reduction in working capital
- £43m reduction in capital expenditure

### FINANCIAL REVIEW

#### REVENUE

Sales fell by 10.2% overall or £310m to £2,744m (2008: £3,054m). On a constant currency basis, like for like sales fell by almost 16%. The deterioration in the macroeconomic backdrop noted in the second half of 2008 continued further in 2009 and affected the demand for SIG's products, with SIG experiencing a like for like constant currency reduction in sales in all countries of operation, with the exception of Benelux.

#### MARGINS

Gross profit margin decreased overall from 26.5% to 25.3%. This reduction was partly due to the change in sales mix (i.e. an increase in the proportion of sales being achieved in Mainland Europe where margins are inherently lower). In the UK and Ireland gross margin fell by 2% to 26.9% (2008: 28.9%) whilst in Mainland Europe the gross margin increased by 0.3% to 23.8% (2008: 23.5%). On a like for like constant currency basis the Group's gross margin fell by 1.2%.

Underlying operating costs as a percentage of sales increased from 20.9% to 22.3% as the sales volume decline outpaced the benefit from the comprehensive range of cost reduction programmes.

A combination of reduced gross margin and increased operating costs as a percentage of sales gave rise to a lower underlying operating margin of 2.9% (2008: 5.6%). As explained in the trading review section, the Group has taken actions in 2008 and 2009 to ensure the cost base is appropriate in the short to medium term.

#### OPERATING PROFIT

Underlying operating profit decreased by 52.4% or £88.9m to £80.9m. Tougher trading conditions throughout 2009 resulted in like for like underlying operating profit falling by 52.2% or £81.8m in 2009 to £74.8m (2008: £156.6m). The Group recorded an operating loss of £32.5m (2008: operating profit of £107.0m) reflecting a number of 'other items' that are described on page 19.

#### FINANCE COSTS

Net finance costs before gains and losses on derivative financial instruments and financing items relating to our defined benefit pension schemes (i.e. net borrowing costs) reduced by £13.6m to £19.0m in 2009. The net borrowing cost as a percentage of average debt in issue during the year reduced from 5.5% to 4.75%.

Net borrowing costs benefited from the significant reduction in net debt in the period, reducing from £697.1m at 31 December 2008 to £254.5m at 31 December 2009. The reduction in net debt of £442.6m in the year included:

- £325m of equity raised via the issuance of 455,047,973 ordinary shares;
- £103m reduction in working capital; and
- £43m reduction in capital expenditure.

Further details are provided in the "Cash Flow and Financial position" section on page 21.

In addition, given that 41% of the Group's borrowings are at variable rates of interest, the significant reduction in interest rates in 2009 (UK and Euro base rates are currently at 0.5% and 1% respectively) also had a beneficial impact on the Group's interest charge in 2009. Further details of SIG's interest rate policies are provided in the interest rate risk section on page 25. Finance costs relating to our defined benefit pension schemes amounted to £1.3m in 2009 (2008: net finance income of £0.1m). Further details are provided in Note 27c to the Accounts on pages 103 to 106.

Finance costs included in the "Other items" column of the Consolidated Income Statement amounted to £3.9m (2008: £41.4m) as outlined below:

Following the Group's equity issuance in H1 2009 and the subsequent reduction in the Group's level of net debt, SIG cancelled certain interest rate derivative contracts at a cash cost of £32m. This termination payment did not increase the Group's overall level of debt as this payment cancelled the mark-to-market liability already included in the Group's Consolidated Balance Sheet. The associated amounts held in reserves are being amortised through the Consolidated Income Statement over the life of the associated debt to 2018 in line with relevant accounting standards. This amortisation is included within the "Other items" column and amounted to £3.9m (2008: £nil).

Finance income included in the "Other items" column of the Consolidated Income Statement amounted to £1.4m (2008: £nil).

**FINANCIAL REVIEW CONTINUED****FINANCE COSTS CONTINUED**

During 2009 the Group continued to hedge its foreign exchange rate loans against the net assets of its overseas subsidiaries, together with the associated tax effects. A £1.4m finance income credit (2008: cost of £41.4m) is included within the "Other items" column of the Consolidated Income Statement to account for hedge ineffectiveness arising from this structure. The Group has taken actions which will reduce the likelihood of being required to account for further hedge ineffectiveness in the Consolidated Income Statement from these arrangements going forward.

**PROFIT BEFORE TAX**

Underlying profit before tax decreased by 55.9% or £76.7m to £60.6m (2008: £137.3m). Profit before tax decreased by £88.4m to a loss before tax of £55.3m (2008: profit before tax of £33.1m).

**OTHER ITEMS**

Amounts included in the "Other items" column of the Consolidated Income Statement which in total amounted to £115.9m (2008: £104.2m) before tax are as follows:

- amortisation of acquired intangibles – £28.6m (2008: £26.4m). The accounting policies section on page 72 and Note 12 to the Accounts on page 90 provide details of what is included within intangible assets and over what periods the assets are amortised;
- impairment charge of £30.0m (2008: £14.2m) – following the continued significant decline of construction activity in Ireland in 2009, in addition to the goodwill impairment charge of £14.2m recognised in 2008, when reviewing the carrying value of goodwill associated with SIG's Irish business, the Group Board has concluded that in light of the anticipated medium term view of profitability in respect of this business unit, that the assets should be further impaired by £30m in 2009;
- restructuring costs of £54.8m (2008: £22.2m) – the Group has taken a number of actions to reduce operating costs in the year as described further on page 17. These one-off actions have resulted in redundancy costs of £16.4m, property closure costs of £23.2m, asset write down costs of £6.8m and other items of £8.4m; and
- net finance costs of £2.5m (2008: £41.4m). The finance costs section opposite explains this item.

**FOREIGN CURRENCY TRANSLATION**

Overseas earnings streams are translated at the average rate of exchange for the year whilst balance sheets are translated using closing rates. The table below sets out the principal exchange rates used:

	Average rate		Closing rate	
	2009	2008	2009	2008
Euro	<b>1.12</b>	1.25	<b>1.12</b>	1.03
Polish Zloty	<b>4.89</b>	4.38	<b>4.62</b>	4.26
Czech Koruna	<b>29.86</b>	31.23	<b>29.72</b>	27.45
Hungarian Forint	<b>316.43</b>	312.66	<b>304.15</b>	275.00

Fluctuations in exchange rates have and will continue to give rise to translation differences on overseas earnings streams when translated into Sterling. Whilst Sterling appreciated against the Euro at 31 December 2009 (€1.12/£) compared to 31 December 2008 (€1.03/£), on average, Sterling was weaker against the Euro during 2009 than in 2008.

As a result, the movement in average exchange rates compared to 2008 had a significant effect on total overseas earnings streams. Total sales increased by £125m and underlying operating profit increased by £5m due to foreign exchange rate movements. Further details of SIG's foreign exchange policies are detailed in the "Foreign currency risk" section on pages 25 and 26.

**TAXATION**

The income tax charge on underlying profits amounts to £18.0m (2008: £40.2m) which represents an underlying effective rate of 29.7% (2008: 29.3%). The Group's underlying effective tax charge increased by 0.4% in 2009, driven principally by the increased proportion of Group profits attributable to the Group's Mainland European countries of operation which on average have higher corporation tax rates than the UK. Cash tax payments amounted to £16.5m, £1.5m below the £18.0m income tax charge on underlying profits primarily as a result of the restructuring costs incurred in the year included within "Other items" reducing UK taxable profits. In 2010, the Group's underlying tax rate will depend on the mix of Group profits from different jurisdictions, although it is anticipated that the Group's underlying tax rate in 2010 could exceed 30%. The Group however does anticipate cash tax payments in 2010 being below the income tax charge as the Group looks to utilise brought forward tax losses arising principally from 2008 foreign exchange rate losses in order to reduce UK taxable profits.

The effective income tax credit on the total loss before tax of £55.3m is 18.4% (2008: charge of 79.5%). These movements are a result of the other items in the year. In both 2009 and 2008 tax relief was not obtained in respect of the goodwill impairment charge and certain restructuring costs.

**EARNINGS PER SHARE ("EPS")\***

Underlying basic EPS amounted to 9.0p (2008: 58.9p), which represents a decrease of 84.7%. Basic EPS amounted to a loss per share of 9.7p (2008: earnings per share of 3.8p), which takes into account amortisation of acquired intangibles, impairment charges, restructuring costs and gains and losses on derivative financial instruments. The weighted average number of shares in issue in the period rose by 305.5m to 469.4m (2008: 163.9m). This increase was primarily due to the placing and open offer and firm placing of 455,047,973 ordinary shares approved by shareholders on 9 April 2009.

\* In accordance with paragraph 26 of IAS 33 "Earnings per Share" the Group has treated the discount element to the open offer part of the increase in share capital as if it were a bonus issue. The effect of this is to increase the weighted average number of shares for the reported prior period, with a resulting reduction in the reported basic and diluted earnings per share for the year ended 31 December 2008.

## BUSINESS REVIEW CONTINUED

The Group's cash flow from operating activities amounted to £174.1m (2008: £156.0m). This represents a trading cash conversion ratio of 216% and is a significant improvement on the 97% achieved in 2008.

### FINANCIAL REVIEW CONTINUED

#### DIVIDENDS

The Board continues to review SIG's dividend policy in response to the ongoing challenging trading conditions that the Group continues to face. The Board has decided that it is in the best interests of Shareholders not to pay a dividend in 2009. The Board remains committed to a progressive dividend policy and SIG will resume dividend payments when markets stabilise and it believes it is prudent to do so taking into account the Group's earnings, cash flow and balance sheet position.

#### ACQUISITIONS

Whilst acquisitions remain a key component of SIG's long term growth strategy, as a result of the global financial crisis and difficult trading conditions in the majority of its markets, SIG temporarily ceased its acquisition programme in September 2008. The acquisition programme has remained on hold throughout 2009 and as a result, no acquisitions have been completed this year.

The Board will be very careful in its consideration regarding the most appropriate time to recommence its acquisitions programme.

In respect of prior year acquisitions, £3.9m was paid in 2009 relating to deferred/contingent consideration payments.

#### SHAREHOLDERS' FUNDS

Shareholders' funds increased by £212.6m to £829.6m (2008: £617.0m).

The increase comprised the following elements:

	£m
Loss after tax attributable to equity holders of the Company	(45.6)
Exchange differences on assets and liabilities after tax	(43.3)
Movements attributable to share options	(1.3)
Actuarial loss on pension schemes (net of deferred tax)	(3.4)
Gains and losses on cash flow hedges	(18.8)
New equity share capital issued	325.0
<b>Increase in Shareholders' funds</b>	<b>212.6</b>

### PENSION SCHEMES

In total, the Group operates five defined benefit pension schemes; the largest defined benefit pension scheme is a funded scheme held in the UK. The remaining four defined benefit pension schemes are unfunded book reserve schemes held in the Group's Mainland European businesses. Together the UK defined benefit scheme and the four book reserved schemes are referred to as "defined benefit pension schemes".

In addition to the defined benefit pension schemes, the Group also operates a number of defined contribution pension schemes.

SIG contributed £2.4m (2008: £10.2m) into its five (2008: five) defined benefit pension schemes during the year. The total charge in respect of defined benefit pension schemes to the Consolidated Income Statement was £2.9m (2008: £1.7m); of this total £1.6m (2008: £1.8m) was charged to operating expenses and £1.3m was charged to net finance costs (2008: £0.1m credited to net finance income).

The overall gross defined benefit pension schemes' liability increased during the year by £4.9m to £24.0m. This can be broken down as follows:

	Increase/ (decrease) in pension scheme liability £m
Actual return less expected return on assets	(7.9)
Change in financial assumptions in all schemes*	12.6
Profit and loss charge above cash contributions to the schemes	0.5
Exchange gain	(0.3)
<b>Increase in pension scheme liability</b>	<b>4.9</b>

\* There have been a number of changes in financial assumptions in 2009, the key items being a decrease in the discount rate used to value the pension scheme liabilities from 6.2% to 5.7% and changes in the assumptions relating to the settlement of liabilities.

The Group continues to monitor the life expectancy assumptions used to value its pension scheme liabilities. For the UK defined benefit pension scheme, the life expectancy for a male employee beyond the normal retirement age of 60 is 28.5 years (2008: 28.5 years), which is considered appropriate for a scheme of this nature.

## Focus, Specialisation and Service

### FINANCIAL REVIEW CONTINUED PENSION SCHEMES CONTINUED

The cost of the Group's defined contribution pension schemes decreased by 12% (£0.6m) to £4.3m. Details of the pension schemes operated by SIG are set out in Note 27c to the Accounts on pages 103 to 106.

### CASH FLOW AND FINANCIAL POSITION

The Group has significantly reduced its level of net debt during the year via the raising of £325m of equity proceeds in April 2009 but also through excellent cash generation in the year. The following table explains the movement in SIG's net debt:

	2009 £m	2008 £m
Cash flow from operating activities	<b>174.1</b>	156.0
Interest and tax	<b>(37.9)</b>	(63.4)
Maintenance capital expenditure*	<b>(9.5)</b>	(42.6)
Free cash flow available for investment	<b>126.7</b>	50.0
Acquisition investment (including loan notes issued to vendors)	<b>(3.9)</b>	(123.2)
Investment capital expenditure*	–	(10.3)
Dividends (including minority dividends)	<b>(0.2)</b>	(37.2)
Proceeds from issue of share capital	<b>325.0</b>	1.1
Foreign exchange gains/(losses)	<b>19.5</b>	(154.3)
Other items (including fair value movements)	<b>(24.5)</b>	5.7
Movement in net debt	<b>442.6</b>	(268.2)
Opening net debt	<b>(697.1)</b>	(428.9)
<b>Closing net debt</b>	<b>(254.5)</b>	(697.1)

\* Where capital expenditure is equal to or less than depreciation, all capital expenditure is assumed to be maintenance capital expenditure. To the extent that capital expenditure exceeds depreciation, the balance is considered investment capital expenditure. Capital expenditure shown above includes finance leases drawn down in each year.

### Cash flow from operating activities

# £174.1m



Key points to note are:

- included within "Cash flow from operating activities" is a significant reduction in working capital of £103.3m (2008: increase of £33.4m), which relates to a reduction in trade receivables and stock but also an increase in trade creditors;
- included within "Cash flow from operating activities" is a cash outflow representing the cash costs associated with the Group's cost saving and restructuring programme amounting to £27.1m (2008: £7.2m);

- as trading conditions continue to remain challenging the Group significantly reduced investment in new vehicles and new trading sites in the year. Net capital expenditure amounted to £9.5m in 2009 compared to £52.9m in 2008. For the year as a whole the net capital expenditure to depreciation ratio amounted to 0.24 times (2008: 1.24 times). Where possible the Group has redeployed certain assets from trading sites which have been closed in both 2008 and 2009; and

- as a result of the strengthening of Sterling versus SIG's foreign currencies during 2009, the Group's reported Sterling debt position benefited from an exchange gain of £19.5m during the year. The principal currency to which the Group has exposure is the Euro and this moved from €1.03 at the start of the year to €1.12 at the end of the year. During 2009 the Group converted €95m of Euro denominated debt into Sterling denominated debt at a blended rate of €1.10. However, these foreign exchange rate gains were more than offset by fair value movements associated with the Group's private placement derivative financial instruments of £24.5m, which increased the Group's reported debt position at 31 December 2009.

The Group's cash flow from operating activities amounted to £174.1m (2008: £156.0m). This represents a trading cash conversion ratio of 216% and is a significant improvement on the 97% achieved in 2008. Trading cash conversion is defined as cash flow from operating activities before pension movements divided by underlying operating profit and is a key measure that will continue to be a matter of high focus in 2010.

The key working capital ratios underlying the trading cash conversion are set out below on a like for like constant currency basis:

	2009	2008
Inventory days	<b>40</b>	39
Trade receivable days	<b>44</b>	43
Trade payable days	<b>36</b>	28

During 2009, SIG's working capital targets were successful in reducing inventory and trade receivables and increasing trade payables across the Group.

The Group's bad debt charge (being both bad debts written off and the movement in the allowance for bad debt) amounted to 0.8% of sales (2008: 0.6% of sales). The Group is very mindful of the risk of bad debts increasing as the economies in which it operates continue to remain weak, construction activity remains subdued and that the Group's customer base is at risk of having credit withdrawn by banks. The Group's credit control policies and procedures are regularly reviewed and a number of the Group's businesses have credit insurance to protect them from bad debts rising above prescribed aggregate loss levels.

### DEBT COVENANTS

The Company's debt facilities contain a number of covenants attached to SIG's committed debt facilities. The key covenants are leverage and interest cover and these are tested at 30 June and 31 December each year.

The leverage covenant is a requirement to maintain a ratio of net debt to annualised EBITDA of less than 3.5 times. Annualised EBITDA is defined as operating profit before amortisation of acquired intangibles, impairment charges, depreciation and restructuring costs, plus interest receivable and adjusted if applicable to annualise the EBITDA of acquisitions made during the previous twelve months.

## BUSINESS REVIEW CONTINUED

The commitment, drive and enthusiasm of all SIG's employees are its greatest asset and SIG's ability to meet the demands of its customers, suppliers and Shareholders is dependent upon their efforts.

### FINANCIAL REVIEW CONTINUED DEBT COVENANTS CONTINUED

The interest cover covenant is a requirement to maintain a ratio of the previous twelve months' underlying operating profit to underlying net finance costs (excluding pension scheme finance income and costs) of greater than 3.0 times.

The ratio for each of the debt covenants is set out below:

	Year ended 31 December 2009	Year ended 31 December 2008
Leverage covenant		
Annualised EBITDA	<b>£127.1m</b>	£227.0m
Closing net debt	<b>£254.5m</b>	£697.1m
Leverage ratio	<b>2.0x</b>	3.1x

	Year ended 31 December 2009	Year ended 31 December 2008
Interest cover covenant		
Underlying operating profit	<b>£80.9m</b>	£169.8m
Underlying net finance costs*	<b>£19.0m</b>	£32.6m
Interest cover ratio	<b>4.3x</b>	5.2x

\* Excluding pension scheme finance income and costs.

The Company is in compliance with its financial covenants in all respects and has not requested or gained any waivers thereof.

### CAPITAL STRUCTURE

The Group manages its capital structure to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The capital structure of the Group consists of debt, which includes the borrowings disclosed in Note 17, cash and cash equivalents and equity attributable to equity holders of the Parent Company, comprising issued capital, reserves and retained earnings as detailed in the Consolidated Statement of Changes in Equity on page 70.

The main measure used to assess the appropriateness of the Group's capital structure is its net debt to EBITDA ratio (i.e. leverage), thus ensuring that the Group's capital structure is aligned to the Group's debt covenants. As at 31 December 2008,

the Group's leverage was 3.1x, against a maximum covenant of 3.5x. Given the uncertainty that surrounded the Group's trading environment for 2009, in order to ensure that the Group did not breach its debt covenants SIG raised £325m following the issuance of 455,047,973 new ordinary shares of 75p each through a placing and open offer and firm placing approved by shareholders on 9 April 2009. On a pro-forma basis, this reduced the Group's leverage position from 3.1x at 31 December 2008 to 1.6x at that date. At 31 December 2009, the Group's leverage position is 2.0x.

### OUTLOOK

The Directors' view of the outlook and prospects for the Group are set out in the Chairman's Statement on page 5.

### RESOURCES EMPLOYEES

The commitment, drive and enthusiasm of all SIG's employees are its greatest asset and SIG's ability to meet the demands of its customers, suppliers and Shareholders is dependent upon their efforts. Throughout SIG, regardless of country or sector, we believe our people are recognised as the best in their particular field. SIG's policy and strategy towards its employees is detailed further in the Corporate Responsibility Report on page 43. Training, coaching and the opportunity for personal career advancement within the Company are important features of how SIG seeks to recruit, retain and develop skilled staff.

### BRAND STRENGTH

SIG operates under a wide range of trading names in the respective markets and countries in which it has trading sites.

Many of these brands, including the original company name, Sheffield Insulations, are widely recognised throughout their respective market sectors or countries as the leading supplier, offering very focused products and services to customers.

SIG believes that the strength and market awareness of its brands are important assets.

### COMPETITIVE POSITION

SIG aims to occupy leading positions as a specialist supplier in each of its main markets of insulation and building environments, exteriors, interiors and specialist construction products. A position of market leadership has been achieved in a number of specific markets. Operations in the other countries and market sectors are continuing to develop their position.

## Focus, Specialisation and Service

### RESOURCES CONTINUED INVENTORY

Immediate availability of a wide range of specialist materials is vital to the customers served by SIG.

Materials are often required within hours on an emergency basis. For example, when a roof leaks and immediate repairs are necessary to prevent damage to the building and its contents, or in a chemical processing plant where a pipeline becomes dangerously overheated due to a breakdown of the insulation. In both of these examples, customers have an unplanned, emergency need for specific and specialist products in order to prevent substantial damage and costs.

A fundamental feature of SIG's position in the supply chain is having these products, in depth, in strategically located trading sites to ensure customer requirements can be met.

### TRADING SITES

SIG has an extensive network of trading sites as demonstrated in the chart on page 11. These are an important resource and an important feature of the SIG business model in each country of operation, as they enable the local market surrounding each trading site to be serviced on an immediate availability basis. As part of the Group's cost saving and restructuring programme, 72 sites have been closed in 2009 (152 since mid 2008). As part of the consultation process, when identifying trading sites for closure, particular attention has been focused on ensuring that the closure of these trading sites has not affected the Group's service offering to its customers.

For customers conducting work on a regional or national basis in each country, SIG can provide a full national service using locally held inventory, thus avoiding the time and cost penalties of shipping products over large distances.

### FLEET DELIVERY CAPABILITY

SIG uses a mix of own delivery vehicles and external hire to deliver goods to customers. This enables availability and service to customers to be maximised whilst ensuring that the cost base is flexible to cope with periods of higher or lower daily demand.

The direct ownership of a large proportion of the fleet and the management of this resource on a local basis is an important feature of the speed, flexibility and responsiveness that SIG offers to customers.

### PRINCIPAL RISKS AND UNCERTAINTIES

There are a number of potential risks and uncertainties which could have a material impact on SIG's long term performance. SIG has a comprehensive system of risk management installed in all parts of its business. The processes are described in detail on page 54 of the Corporate Governance Report.

### LEVELS OF MARKET DEMAND IN THE BUILDING AND CONSTRUCTION MARKETS IN WHICH SIG OPERATES

Approximately 90% of SIG's sales are made to the building, construction and civil engineering industries.

These industries are driven by private and Government expenditure and include major new construction projects (e.g. airports, hospitals, schools and sports complexes), new residential housing developments and a wide range of renovation, upgrading and repair work on existing buildings.

SIG is exposed to changes in the level of activity and therefore demand from these industries. Government policy and expenditure plans, private investor decisions, the general economic climate and both business and (to a lesser extent) consumer confidence are all factors which can influence the level of building activity and therefore the demand for many of SIG's products.

Approximately 10% of SIG's sales are made into specific industrial applications, especially where there are temperature critical processes and the use of highly specialist insulation is an important part of the process plant itself. These industries include power generation, oil and gas processing, chemical, pharmaceutical and cold storage facilities.

SIG is exposed to activity levels and therefore demand for some of its products within these diverse industries. These industries would, in turn, be affected by the general economic climate, energy demand and energy costs and business investment decisions in major industries such as power generation and petrochemicals.

### COMPETITORS

SIG has a mix of both direct specialist competition and some overlap with more general suppliers (such as general builders merchants) in all its markets and countries of operation. As a distributor handling and supplying products manufactured by other companies, SIG is itself dependent upon other companies for in excess of 90% of the products that it sells. Some of SIG's competitors may be funded in such a way that they are willing to accept lower financial returns than SIG or have a greater breadth of resources than SIG in particular market sectors. Competition with these companies could adversely affect SIG's profitability and/or, financial condition.

However, the majority of products that are sold by SIG are relatively bulky and inexpensive in relation to their mass and the cost of transport. This means that the risk faced by SIG of price disruption and possible cross border or international trading having a detrimental impact on prices in any particular country is low. Similarly, the risk posed by internet-based trading dependent upon parcel-carrier service is mitigated by the bulky nature of most of the products sold by SIG and the fact that specialist handling and delivery services are an important feature of the service provided by SIG to many customers.

### INFORMATION TECHNOLOGY ("IT")

SIG uses a range of computer systems to provide order processing, inventory control and financial management within each country. Outages and interruptions could affect SIG's ability to conduct day-to-day operations. Any lengthy failure or disruption to the IT system in any business unit or country would result in loss of sales and delays to cash flow. Interruption to SIG's IT systems could be caused by a number of factors, including as a result of human error or malfeasance, malfunction, damage, fire or power loss. There can be no certainty that recovery plans and contingency plans will be effective in the event that they need to be activated. SIG's IT systems are not interdependent and there are dedicated support staff directly employed, together with external support service providers, to monitor the IT systems.

### COMMERCIAL RELATIONSHIPS

SIG is exposed to changes in relationships with both customers and suppliers. Failure to negotiate competitive terms of business with its suppliers or failure to satisfy the needs of its customers could harm the Group's business. It is a key task for the operational management in each country and business unit to maintain and develop their relationships with customers and suppliers.

## BUSINESS REVIEW CONTINUED

### PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

#### CREDIT RISK

SIG, by the nature of its position in the supply chain, buys products from highly reputable suppliers in bulk and sells the products to a wide variety of professional contractors on credit terms. There is a risk that customers do not pay as the typical customer does not have many assets. SIG has therefore developed well proven credit control guidelines and procedures that are designed to minimise its credit risk whilst trying to maximise sales potential. For the year ended 31 December 2009 bad debt expense increased to 0.8% of sales (2008: 0.6% of sales) reflecting the more challenging economic conditions faced by many of the Group's customers.

#### CREDIT INSURERS

A number of the Group's suppliers insure their credit exposure to SIG with a small number of credit insurers. Likewise SIG also insures its credit exposure in relation to a number of its customers. These credit insurers could withdraw their cover on SIG or its customers which would affect the trading relationship between SIG, its suppliers or its customers and potentially the profitability of SIG.

#### RESTRUCTURING OF SIG

Since 1 July 2008 the Group has actively taken steps to align its cost base in those markets where short to medium term demand is expected to remain subdued and also to drive operational and commercial efficiencies within the Group. There is a risk that the restructuring plans may not achieve their goals and may cost more than anticipated.

#### GOVERNMENT LEGISLATION

SIG operates in a number of countries across Europe, each with its own laws and regulations, encompassing environmental, legal, health and safety, employment and tax matters. Changes in these laws and regulations could impact on SIG's ability to conduct its business, or make such conduct of business more costly.

SIG is committed to complying with all local legal requirements and the clear devolution of responsibility to local operating management, together with the employment of competent advisers. Changes to legislation are monitored locally and appropriate actions taken to ensure they are incorporated into the Company's business policies and procedures.

#### TRANSPORT AND FUEL PRICES

In excess of 70% of SIG's sales are delivered to customers. Prolonged disruption to road transport systems or the availability of vehicle fuel would result in reduced sales in any country in which this may occur. In addition, a significant increase in fuel prices can affect profitability.

#### PRODUCT AVAILABILITY AND PRODUCT PRICES

The availability and market prices of products that the Group supplies can change. These changes can adversely affect the Group's sales and operating profits.

If product demand outstrips supply, be it due to demand rising or supply falling, there could be a negative impact on the Group's ability to service its customers' needs. The factories that produce fibrous insulation products take a number of years to build and so if demand exceeds the production capacity, product shortages could result. The Group keeps in regular contact with its suppliers to ensure that it protects its position regarding product availability and product pricing. The Group also sources its products from a number of manufacturers in order to reduce its reliance upon any one manufacturer.

The Group negotiates purchase prices with its suppliers. The ability of SIG to secure satisfactory terms of trade in these negotiations is key to its ability to supply the products to its customers at competitive prices. Rising product prices are advantageous for SIG as the Group's standard gross margin is achieved on a higher selling price resulting in improved overhead recovery, thus providing a higher underlying operating profit margin. Rising prices may also provide SIG with the opportunity to benefit from inventory gains whereby inventory is bought at the lower price and sold on at the higher price.

Conversely, falling product prices are disadvantageous for SIG. In recent years, product price inflation across the basket of SIG products has been positive rather than negative, although in 2009, the Group has experienced price deflation of 2.3%.

There is an additional risk that disruption in the supply chain, for example due to the insolvency of a supplier, industrial action or adverse weather conditions, could affect SIG's business. This could lead to SIG being unable to fulfil certain commitments and this could lead to a material adverse effect on SIG's reputation, business, results of operations and overall financial condition.

#### IDENTIFICATION AND INTEGRATION OF ACQUISITIONS

The Group's long term growth strategy is partly dependent upon the identification of appropriate acquisition opportunities at appropriate prices and the successful integration of acquisitions into the Group. Failure to identify, acquire and integrate new acquisitions could adversely affect the growth of the Group's business in the long term.

SIG commits dedicated resources to the research of new markets, the origination of appropriate acquisition targets and the execution of appropriate due diligence and the contract negotiation process. Post acquisition, SIG constantly evaluates the management structures of its businesses to ensure that appropriate management time can be dedicated to new businesses.

#### LOSS OF KEY MANAGEMENT OR PERSONNEL

The Group's businesses are highly reliant on the continued services of its Senior Management, including its Executive Directors and other key personnel. These individuals possess sales and marketing, technical, manufacturing, financial and administrative skills that are important to the continued successful operation of the Group's business. SIG is also reliant on the ability to recruit and retain skilled and experienced labour available within the industry at an operational level.

Failure to retain such individuals, or the failure to attract and retain strong management and technical staff in the future, could have an adverse effect upon the Group's business, results of its operations and financial condition.

#### PRODUCT DEFECT CLAIMS

High product quality is an important reason why customers buy products from SIG. The inadvertent supply of defective or inferior products by SIG to its customers could have an adverse impact on the Company's reputation and standing, thereby harming the Company's business and financial results. The Group takes care to source products selectively to ensure any possible risk associated with product quality issues is minimised.

## Focus, Specialisation and Service

### TREASURY RISK MANAGEMENT

#### TREASURY RISK

SIG enters into derivative financial instruments (principally foreign currency and interest rate swaps) to hedge certain currency risks arising from SIG's operations and to hedge interest expenses arising from SIG's sources of finance. SIG's financial instruments, other than derivatives, comprise borrowings, cash and liquid resources and various items such as trade receivables and trade payables that arise directly from its operations.

SIG's Finance and Treasury Policies set out the Company's approach to managing treasury risk. These policies are approved by the Board on a regular basis. It is Company policy that no trading in financial instruments or speculative transactions be undertaken. To minimise the credit risk associated with derivative financial instruments, SIG only enters derivative financial instruments with its principal UK banks.

SIG finances its operations through a mixture of retained profits, Shareholders' equity, bank, private placement and other borrowings. SIG uses derivative financial instruments to change the Group's currency and interest rate profile, so managing SIG's exposure to exchange rate and interest rate fluctuations. A small proportion of SIG's assets are funded using fixed rate finance lease contracts. At 31 December 2009 outstanding liabilities in respect of such contracts amounted to £9.4m (2008: £12.6m).

The Group's financial liabilities (including derivative financial assets) at 31 December 2009 of £473.9m (2008: £768.8m) can be analysed as follows:

- £141.3m (2008: £151.3m) has a maturity profile of greater than five years; £217.0m (2008: £393.7m) is denominated in foreign currencies, held to partially hedge the assets of our overseas businesses;
- £151.2m (2008: £443.1m) carries a fixed rate of interest; and
- £460.2m (2008: £749.2m) is borrowed on an unsecured basis.

Details of derivative financial instruments are shown in Note 17 to the Accounts on pages 93 to 95.

#### INTEREST RATES

The Company's interest costs in respect of its borrowings will increase in the event of rising interest rates. To reduce this risk the Company has a policy of fixing between 60% and 85% of its net debt by entering into appropriate derivative financial instruments. However, due to the unprecedented low interest rate environment which has prevailed throughout 2009, in order to reduce the Group's interest charge in 2009, the Group has held a greater proportion of its debt at variable rates of interest. At 31 December 2009, 59% (31 December 2008: 64%) of the Group's net debt is at fixed rates of interest.

#### LIQUIDITY RISK AND FINANCIAL FACILITIES

Liquidity risk is the risk that SIG is unable to meet its financial obligations as they fall due. In the longer term, a substantial reduction in operating performance and cash generation may result in the Group being unable to service its debt, which would have a material adverse effect on the Group's business.

In order to mitigate the risk of not being able to meet its financial obligations, SIG seeks a balance between certainty of funding and a flexible, cost-effective borrowing structure, using a mixture of sources of funding in order to reduce the risk of being over reliant upon any one provider. The key sources of finance are private placement note providers, being mainly US-based pension funds and principal bankers, The Royal Bank of Scotland plc, Barclays Bank plc and Lloyds TSB Bank plc. The last private placement transaction completed on 1 November 2006 increased the certainty of the Group's debt funding, providing a committed 7, 10 and 12 year facility.

There is a risk that funding will not be made available to the Group or that the cost of accessing and servicing the funding may be prohibitive. The significant reduction in net debt in 2009 driven largely by the raising of £325m via a placing and open offer and firm placing increases the Group's ability to raise and service appropriate debt funding.

As at 31 December 2009, SIG had undrawn UK committed borrowing facilities from its debt providers of £210.0m (2008: £79.6m). In addition, at 31 December 2009, the Group held positive cash on deposit of £219.4m (2008: £71.7m) which it can call upon to meet any future financial obligations.

The Group has £145m of bank borrowings due for repayment in 2010. In order to meet this repayment requirement, the Group has undrawn UK committed facilities expiring in 2011 and 2013 of £175m and also £219m cash held on deposit at 31 December 2009, creating a funding surplus of £249m. The Group therefore does not envisage refinancing its debt facilities which mature in 2010.

The year end maturity profile and value of undrawn committed borrowing facilities are set out in Note 18 to the Accounts on pages 96 to 97.

#### FOREIGN CURRENCY RISK

SIG has a number of overseas businesses whose revenues and costs are denominated in the currencies in which the operations are located. 55% of SIG's 2009 revenues were in foreign currencies, being primarily Euros, Polish Zloty, Czech Koruna and Hungarian Forint. The vast majority of SIG's sales and purchases are not cross-border. When cross-border transactions occur it is SIG's policy to eliminate currency exposure at that time through forward currency contracts, if the exposure is considered to be material.

SIG faces a translation risk in respect of the local currencies of its primary foreign operations, being Euro, Polish Zloty, Czech Koruna and Hungarian Forint profits. SIG also faces a translation risk from the US Dollar in respect of its private placement borrowings.

The Consolidated Balance Sheet of the Group is inherently at risk from movements in the Sterling value of its net investments in foreign businesses and the Sterling value of its foreign currency net debt.

## BUSINESS REVIEW CONTINUED

Gearing decreased during the year from 112.6% to 30.6%. The reduction in gearing was largely due to the increase in capital employed and subsequent reduction in Group debt arising from the Group raising £325m of equity proceeds.

### TREASURY RISK MANAGEMENT CONTINUED FOREIGN CURRENCY RISK CONTINUED

For currencies where the Group has significant translational risk, SIG seeks to mitigate this risk by combining financial liabilities and derivatives in currencies that partially hedge the net investment values. The Group's policy is that for currencies where a material translational exposure exists, the Group will hold financial liabilities in that particular currency in proportion to the overall ratio of net debt to capital employed.

At 31 December 2009, SIG had net foreign currency borrowings (including cash and cash equivalents) amounting to €179.4m and HUF111.2m. The Group also had cash and cash equivalents amounting to PLN47.6m and CZK98.1m at that date.

Net Euro borrowings at 31 December 2009 therefore represent 63% of Group net debt.

Gearing, being net debt divided by net assets, decreased during the year from 112.6% to 30.6%. The reduction in gearing was largely due to the increase in capital employed and subsequent reduction in Group debt arising from the Group raising £325m of equity proceeds from the issuance of 455,047,973 shares via a placing and open offer and firm placing.

The net after tax effect on the Consolidated Balance Sheet of currency transaction and translation differences relating to our overseas subsidiaries in 2009 was a reduction in net assets of £40.6m (2008: increase of £37.9m). This reduction in net assets arose principally as a result of the 8.7% year on year appreciation of Sterling versus the Euro (€/£1.12 at 31 December 2009 versus €/£1.03 at 31 December 2008), thus decreasing the carrying value of SIG's net investments in its Euro denominated businesses.

### DEBT COVENANTS

SIG's debt facilities provided by its private placement note holders and its three relationship banks in the UK contain certain covenants. The key covenants are leverage and interest cover and are tested at 30 June and 31 December each year. The leverage covenant is a requirement to maintain a ratio of net debt

to Annualised EBITDA of less than 3.5x. The interest cover covenant is a requirement to maintain a ratio of previous twelve-month underlying operating profit to underlying net finance costs (excluding pension scheme finance income and costs) of greater than 3.0x. At 31 December 2009, the Group's leverage was 2.0x (2008: 3.1x) and interest cover was 4.3x (2008: 5.2x).

SIG must manage its business and its capital structure so that it meets its debt covenants, thus ensuring it can meet its liabilities as they fall due.

### GAINS AND LOSSES ON DERIVATIVE FINANCIAL INSTRUMENTS

The Group has a number of treasury hedging arrangements that attempt to eliminate foreign exchange, interest rate and associated tax risks under the terms of SIG's Treasury Policy. Where these hedges are deemed imperfect or where exceptional gains and losses arise, then these are included within "Other items" in the middle column of the Consolidated Income Statement. Further details are set out on in the "Finance costs" section on pages 18 and 19.

### OTHER MATTERS SHAREHOLDER RETURN

SIG has delivered a 5.3% return on capital employed in 2009 (2008: 10.9%). The reduction in the return on capital employed compared to the prior year primarily reflects the reduced operating profits in the Group in light of the challenging trading environment and also the increased level of capital employed following the Group's raising of £325m additional equity through the placing and open offer and firm placing in April 2009.

SIG is mindful of this reduction in return and is confident that the restructuring actions it has taken and its ongoing actions will enable it to increase return on capital employed when building and construction activity upturns.

As at 17 March 2010, SIG's share price closed at £1.274 per share, representing a market capitalisation of £753m at that date. SIG monitors relative Total Shareholder Return ("TSR") for assessing relative financial performance. The Group's TSR performance has been detailed in the Directors' Remuneration Report on page 60.

## Focus, Specialisation and Service

### OTHER MATTERS CONTINUED GOING CONCERN BASIS

In determining whether the Group's 2009 Accounts can be prepared on a going concern basis, the Directors considered all factors likely to affect its future development, performance and its financial position, including cash flows, liquidity position and borrowing facilities and the risks and uncertainties relating to its business activities. These are set out in the Chairman's Statement and Business Review on pages 4 to 27 and in the Notes to the Group Accounts.

The key factors considered by the Directors were as follows:

- the implications of the challenging economic environment and continuing weak levels of market demand in the building and construction markets on the Group's revenues and profits. The Group prepares forecasts and projections of revenues, profits and cash flows on a regular basis. Whilst this is essential for targeting performance and identifying areas of focus for management to improve performance and mitigate the possible adverse impact of a deteriorating economic outlook, these also provide projections of working capital requirements;
- the impact of the competitive environment within which the Group's businesses operate;
- the availability and market prices of the goods that the Group sells;
- the credit risk associated with the Group's trade receivable balances;
- the potential actions that could be taken in the event that revenues are worse than expected, to ensure that operating profit and cash flows are protected; and
- the committed finance facilities available to the Group. The Group has access to a variety of bi-lateral banking facilities to meet day-to-day working capital requirements. At 31 December 2009, the Group had undrawn facilities of £210m. The Group also had cash held on deposit at 31 December 2009 amounting to £219.4m.

Having considered all the factors above impacting the Group's businesses, including downside sensitivities, the Directors are satisfied that the Group will be able to operate within the terms and conditions of the Group financing facilities for the foreseeable future.

The Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Group's 2009 Accounts.

### CAUTIONARY STATEMENT

This Business Review has been prepared to provide the Company's Shareholders with a fair review of the business of the Group and a description of the principal risks and uncertainties facing it. It may not be relied upon by anyone, including the Company's Shareholders, for any other purpose.

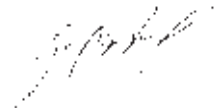
This Business Review and other sections of this Report contain forward looking statements that are subject to risk factors including the economic and business circumstances occurring from time to time in countries and markets in which the Group operates and risk factors associated with the building and construction sectors. By their nature, forward looking statements involve a number of risks, uncertainties and assumptions because they relate to events and/or depend on circumstances that may or may not occur in the future and could cause actual results and outcomes to differ materially from those expressed in or implied by the forward looking statements. No assurance can be given that the forward looking statements in this Business Review will be realised. Statements about the Directors' expectations, beliefs, hopes, plans, intentions and strategies are inherently subject to change and they are based on expectations and assumptions as to future events, circumstances and other factors which are in some cases outside the Company's control. Actual results could differ materially from the Company's current expectations.

It is believed that the expectations set out in these forward looking statements are reasonable but they may be affected by a wide range of variables which could cause actual results or trends to differ materially, including but not limited to, changes in risks associated with the level of market demand, fluctuations in product pricing and changes in exchange and interest rates.

The forward looking statements should be read in particular in the context of the specific risk factors for the Company identified on pages 23 to 26 of this Business Review. The Company's Shareholders are cautioned not to place undue reliance on the forward looking statements. This Business Review has not been audited or otherwise independently verified. The information contained in this Business Review has been prepared on the basis of the knowledge and information available to Directors at the date of its preparation and the Company does not undertake any obligation to update or revise this Business Review during the financial year ahead.



**CHRIS DAVIES**  
CHIEF EXECUTIVE



**GARETH DAVIES**  
FINANCE DIRECTOR