

Company No 2128

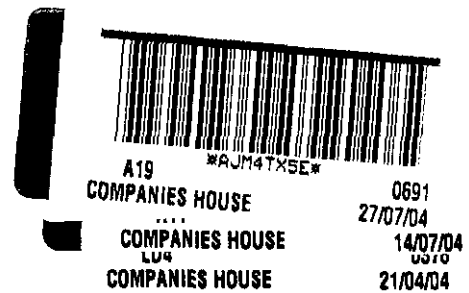
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MFI Annual Report 2003

MFI Furniture Group Plc

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In-store with the Spencers



Highlights

Financial highlights

Sales up 15.1% to £1,481.5m

Pre-tax profit before exceptional items up 28.6% to £103.8m

Pre-exceptional earnings per share up 26.5% to 12.9p

Dividend per share up 22.6% to 3.8p

Financial ratios

	52 weeks to 27 Dec 2003	52 weeks to 28 Dec 2002
Gross margin	50.9%	50.2%
Operating profit margin	7.1%	6.2%
Post tax return on assets employed*	16.0%	14.5%

*excludes profit on disposal of fixed assets

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Dear fellow investor

The size of the average house today is up to 50% smaller than it was 90 years ago. And without modular furniture to manage the space, we wouldn't be able to live the lives that we do. Helping people to live their lives their way is the market we understand – a market where we know that we still have plenty of scope for future organic growth.

Investing in a low-risk way – in our stores and depots, in new products, in IT infrastructure and in international expansion – allows us to develop the business without reliance on the UK economy. What we are trying to do is to build a balanced, strong, customer-aware, and focussed business.

Evidence of our success in understanding the furniture market is reflected in our financial results for last year. Despite a tightening in consumer spending, we grew sales by 15.1% compared to 2002 and profit before tax and exceptional property profits by 28.6% to £103.8 million.

This means that we have grown sales by an annual compound rate of 18% and profits before tax and exceptional items by 43% since 1999.

We remain confident about the future success of the business and are proposing a raised final dividend of 2.0 pence per share (2002 – 1.6 pence), making a total full-year dividend of 3.8 pence per share (2002 – 3.1 pence) – an increase of 22.6%. While maintaining a relatively high level of dividend cover – just over three times – we have increased our dividend over the past four years at an average annual compound growth of 28%.

Our market place

The UK retail furniture market that we address is worth more than £11 billion. It grew by over 4% last year and we estimate that, between 2003 and 2008, it will grow by 20% influenced by four key factors:

- An increased focus on home lifestyle
- A rising and ageing population
- Increased numbers of single person households
- Home working

As Britain becomes more affluent, consumers are spending a larger proportion of what they earn on where they live and a smaller proportion on food and clothing. Buying home furnishings is no longer driven solely by the acquisition of a home. The increased interest in improving the home is evidenced by the many property and interior design TV programmes that are being watched by increasingly fashion conscious consumers who are prepared to replace their furniture in line with fashion and home lifestyle trends.

The UK has an increasing percentage of more affluent, middle-aged customers and a declining number of younger, more price-conscious buyers. While these customers are less likely to move house than younger consumers, they are more likely to spend money on home improvements.

More people are living on their own – arising from increasing numbers of single older people, high levels of single parent families and a younger generation who buy or rent their own properties – and this has led to an increase in demand for furniture.

More people are working from home and this, together with increasing home ownership of computers, is fuelling demand for home office furniture.

We are living in houses that were often not designed to contain the

belongings we now take for granted – playstations, hi-fis, computers, fitness equipment, dishwashers and microwaves. We are acquiring more possessions, but living in smaller spaces.

To take account of these demographic factors we have designed our product to help people enjoy their homes to their full potential. This gives us reason to believe that we are well placed in a market that is set to continue growing for the foreseeable future. And we are the only company offering furniture for every room in the house nationwide.

Our vertical integration gives us the ability to react to customer tastes and requirements by developing and introducing new aspirational products quickly at competitive pricing.

We are very strong in some of our product categories, and our strategy is to develop this strength across the other categories. We see plenty of headroom for growth in the next three years.

We are gradually moving our proposition towards “Done For You” or DFY. The number of installations we handle has nearly doubled in the past three years and is likely to continue growing as we develop and sell more complex, higher-margin products. We completely outsource the installation service to over 2,000 qualified contractors, thus minimising the infrastructure costs for the Group.

This is a further sign of the changing, more service-based relationship with our customers that we are trying to develop. Not only does this enable us to move our own business in a direction our customers like, but it also benefits our self-help policy of moving our cost base from a fixed to a more variable nature. We have a real job to do with customer service and we have a long way to go.

From a standing start two years ago, bathroom sales now have a run-rate of £55 million per annum.

Since we acquired Sofa Workshop 15 months ago, we have achieved a run-rate of £75 million of sales per annum.

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Our strategic priorities

We have five strategic priorities:

- continued rollout of Howden Joinery, our trade-only business for small builders
- reformatting the MFI out-of-town stores with introduction of new product categories
- enhancing the performance of our French retail operation – Hygena Cuisines
- developing and learning from selected 'seedcorn' investments
- supply chain initiatives

Each of these can make a positive contribution to our bottom line. The diversification into new products and routes to market makes us less vulnerable to any weakness in the state of the housing market and the wider UK economy.

Howden Joinery

The business was founded only in 1995, but now accounts for two-thirds of the Group's profits. Its annual compound profits growth over the past four years has been 69% and the depots have delivered like for like growth above 25% every year.

Howden Joinery complements our retail operation. It is a highly stable business in a separate sector, which has broadened our customer base by selling joinery and kitchens to builders and small developers – neither of whom previously sourced supplies from MFI. It is a low-cost business, where logistics costs are minimal as most customers collect goods direct from the depot, and it operates from small, low fixed-cost warehouses on industrial estates.

The Howden Joinery business model helps to differentiate us from other trade and builders merchant competitors. The model is one of total

focus on the needs of the small builder who regularly visits the depot – providing access to credit, high quality of service and products that are always in stock, from local depots with the best local prices.

Our sales representatives are trained to develop individual relationships with their customers, and to understand their needs. It is a relationship business based on serving a limited number of customers exceptionally well.

UK Retail

By the end of 2003, 122 of our 191 out-of-town stores had been opened in the new format, including 46 during the year. Full refits, of which 21 were completed in the year, are continuing to show the pattern of 23% sales uplift in year one. We also completed 25 of the new partial refits. These are cheaper to implement and enable smaller stores to be modernised, while producing sales increases of 17% in their first year. Apart from relocations, we have no immediate plans to open a significant number of new out-of-town stores.

These refurbishments are improving the store environment with better use of space and increased sales per square foot. This has enabled us to introduce new product categories, enhancing our offer to cover every room in the house. More than half of the 23% increase in sales, for example, is coming from sales of bathrooms and sofas – neither of which we previously sold.

The £2.8 billion sofa market is competitive. Nonetheless, following our initial eight store trial of the Sofa Workshop range in 2002 – and the subsequent acquisition of Sofa Workshop – we are now selling sofas from 172 stores, accounting for 5% of sales and have taken around 3% of the market in those areas where we operate. We have invested in a new manufacturing facility in Wales to meet the increasing demand of our product.

Store refurbishment has continued apace this year with 46 MFI and 40 Hygena Kitchens stores being opened in the new format.

We continue to develop new products and 2004 will see the introduction of new bed and bedroom ranges.

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Bathrooms were first tested early in 2001 and are now sold in virtually all of our stores. They currently account for approximately 8% of sales and, from a standing start two years ago, we have already taken a 6% market share.

There is a huge middle ground in the UK's £1.1 billion bathroom market between the bottom-end DIY suppliers and the top-end boutiques. We believe we can lead this sector of the market.

There is an opportunity to grow sales on the High Street where we are under-represented. We will be focussing on this in 2004 and plan to open more High Street MFI (currently 22) and Sofa Workshop (currently 29) stores in 2005 when the out-of-town refit programme is completed.

Sales in Hygena at Currys grew significantly over the past 12 months, indicating the opportunity that exists for selling Hygena-branded products outside MFI. We traded from 134 Currys outlets at the year-end.

France Retail

Hygena Cuisines operated from 135 stores at the year-end, supported by distribution depots across the country from which customers can choose to pick up the product themselves or have it delivered to their homes. We have invested significantly in this business during the year. Half our French stores are now in the new format (which is based on the UK model, but tailored to local needs), and our revenue growth target is based on rolling out the refurbishment to all stores, on new store openings, and the introduction of new products.

Trading conditions in the French furniture market have not been easy – the market declined last year as a result of the weakness of the economy. But, with our programme of store conversions producing sales uplifts of around 20% per outlet in the first year, overall sales (in local currency) at Hygena Cuisines grew 10% during the year – clearly a gain in market share.

'Seedcorn' investments

MFI has a good record of growing businesses. Hygena Cuisines and Howden Joinery both developed from the 'pilot, test, invest' approach that we still favour. In two years time our store refurbishment programme in the UK and France will have been completed, and we are already investing for the future through our developing businesses which include Howden Millwork in the US, and our joint venture in Taiwan.

Our approach, as always, is cautious. We experiment without commitment, but stick with it long enough to be sure.

We grew the Howden Millwork pilot from 12 to 15 depots in the year. And during 2004, we hope to move on to the test phase of development with plans to open a further five depots.

American houses tend to be larger than those in the UK with larger rooms and owners with higher disposable incomes who spend more on furniture. Nonetheless, the fundamentals of the US market are comparable to the UK – though it is several times the size. There is a huge opportunity for a specialist trade supplier offering range, service and attractive terms.

There are issues to be addressed of course. In the UK, our retail division indicates to Howdens which are the best selling kitchens. In the US we don't have this retail support, and it is taking us longer to learn by experience.

We are also experimenting with the sourcing of product. Initially all kitchens were sourced locally. But during the year, we began selling factory-assembled kitchens exported from the UK. Even with the additional transport costs, these are much cheaper than American-sourced product and are selling well – currently representing around 25% of total sales.

Selling kitchens also gives us the opportunity to sell appliances.
In 2003 we sold over half a million appliances.

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The pilot has shown encouraging early signs, and we are gaining an understanding of sales and margin levels. But we are proceeding with caution, learning by experience at low risk and creating a structure to support rollout. Results, not a timetable, will drive the future development of the business.

The same discipline applies to Taiwan, where we opened our first store in August 2001. There are now 13 – based on the same concept as the UK High Street stores.

Taiwan has a stable economy and a level of home ownership – 87% – that is higher than the UK. The kitchen and bedroom market is highly fragmented and there is a proven consumer demand for western-style products. We entered Taiwan (via a joint venture) as a low-risk way of testing both the potential for rolling out the new formats internationally, and our business model for expansion in the Far East – at the same time allowing us to develop skills and knowledge of working in Asia.

Supply chain initiatives

MFI is a vertically integrated company with a powerful manufacturing capability to which we are absolutely committed. Our rigorous approach to 'make or buy' decisions ensures that the products we do make are made efficiently; and the products that can't be made efficiently are bought in.

We have recently established a joint venture in Hong Kong to source product from China. China is the lowest cost country for sourcing many of our core products and components that are currently procured within Europe. The potential savings are considerable, and the joint venture should begin operation during 2004.

The first phase of our SAP project – the financial systems – went live in July on schedule, and the second phase – supply chain – will be completed in March. Future stages – covering manufacturing, warehouse management systems and the retail stores – will be evaluated on their benefit to the business. To date we have spent £50 million on the SAP system, which is replacing legacy systems that were inadequate for supporting our business growth.

MFI has come a long way since 1999. The changes that we have made have been fundamental and enduringly successful – as evidenced by our performance. We believe we have the right strategy to continue to develop the strength of the brand. Our UK retail business is achieving market share gains in new categories. The outstanding performance of Howden Joinery boosts growth and adds balance and stability to the Group.

We have a strong management team pursuing self-help initiatives that ensure the business is firmly under our control and our future is in our own hands.

We lead a UK furniture market that is big and growing, but a market that is so fragmented that we don't even have a double-digit share of it.

There is still much for us to do, and much for us to go for.

Ian Peacock, Chairman

John Hancock, Chief executive

26 February 2004

Howden Joinery celebrated another year of record results in 2003 and adds balance and stability to the Group.

We have a number of 'seedcorn' investments underway at present. Our approach is to experiment without commitment, but stick with it long enough to be sure.

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Operating and financial review

The results can be summarised as follows:

Turnover	2003 £m	2002 £m	Increase %	Same store increase %
Howden Joinery	448.1	326.9	37.1	27.2
UK Retail	910.9	861.4	5.7	1.8
France Retail	114.2	94.2	21.2	7.3
Howden Millwork	5.1	2.0	n/a	n/a
Other operations	3.2	2.9	n/a	n/a
Total turnover	1,481.5	1,287.4	15.1	8.9

	2003 £m	2002 £m	Increase %
Profit before tax and exceptional items			
Howden Joinery	72.0	44.4	62.2
UK Retail	41.7	37.7	10.6
France Retail	0.3	2.3	n/a
Howden Millwork	(8.4)	(4.5)	n/a
Other operations	–	(0.1)	n/a
Operating profit	105.6	79.8	32.3
Joint venture losses	(2.1)	(2.0)	n/a
Net interest	0.3	2.9	n/a
Profit before tax and exceptionals	103.8	80.7	28.6
Profit on disposal of fixed assets	14.1	0.1	n/a
Profit before tax	117.9	80.8	45.9

Overview

We have continued to make progress on our key strategic priorities – namely the rollout of the new format into our stores both in the UK and in France, the continued expansion of our highly successful Howden Joinery trade operation in the UK, together with the continued piloting of a trade operation in the US and the development of new supply chain initiatives.

Group sales and profitability increased strongly, with the outstanding performance of Howden Joinery adding further balance and stability to the Group. Sales of £1,482m represented a 15.1% increase on the previous year, 8.9% on a same store basis. Profit before tax and exceptional credits rose by 28.6% to £103.8m. An exceptional credit of £14.1m, arising from the disposal of properties, resulted in reported profit before tax of £117.9m. Earnings per share before exceptional items rose by 26.5% to 12.9p.

Overall gross margin has increased from 50.2% to 50.9% reflecting more efficient global sourcing, together with an increased mix of higher margin product in the refurbished MFI stores and improved margins in the Howden Joinery depots.

Total selling and distribution costs have increased by 14.6%. Within this figure is the impact of the acquisition of Sofa Workshop and the additional cost of the new and reformat ted stores and depots; after deducting these, same store costs are up 8%.

Within operating profit there is a £2.7m provision for employer national insurance arising from our various share incentive schemes and a further £0.7m (2002 – £0.1m) amortisation of goodwill arising on the acquisition of Sofa Workshop. Also we have received £4.1m for the surrender of leases which have been credited to operating profit.

Howden Joinery

Howden Joinery has continued to deliver outstanding results with operating profits of £72.0m, up 62.2% on last year's figure of £44.4m. Operating margins have grown from 13.6% to 16.1% over the last 12 months. The returns achieved today are a result of the investment decisions taken in 1999 when we increased our opening programme with the associated revenue costs and impact on profitability at the time.

The continued organic growth from our existing depots, and the rollout of the opening programme, resulted in total sales of £448m – an increase of 37.1% on last year. Same depot sales growth was 27.2%.

By the end of 2003 we had 300 depots trading in the UK, 31 being opened in the year. We aim to open a further 30 depots in 2004 and are ultimately targeting a total of at least 380 depots within the UK.

Operating and financial review continued

UK Retail

Sales were £911m, representing an increase over the previous year of 5.7%, up 1.8% on a same store basis. The operating profit of the UK Retail division has increased from £37.7m to £41.7m, an increase of 10.6%. This has been achieved after incurring £19m of costs and lost revenues associated with the refurbishment programme (2002 – £20m).

A further 46 stores were opened in the new format in 2003 bringing the total to 122 today, two-thirds of the chain. Of these stores 74 are in full refit, 23 have received a partial refit and 25 have received a new partial refit. And by the end of this year 156 will be in the new format, representing just under 90% of our orders. The remaining stores will not be converted.

The first year uplift in orders in our full refit stores was 23%, compared to the 25% level that we saw in 2002. Full refit stores trading in the second year since refit have shown a 10% decline in orders against the first year, impacted by a weak fourth quarter and a reduction in new product development in the year. We are working to improve the performance in the second year using additional promotional support.

At the time of the interims we said we were piloting a new partial refitted store and these stores have achieved a 17% improvement in their first year, compared to the 12% improvement we are seeing in the original partial refits.

Critical mass will be achieved during 2004 which will give us a wider range of opportunities to promote our brands; including the ability to launch national brand advertising across all our products and to develop better long-term relationships with our customers. This, combined with an increased focus on service levels, should drive both customer footfall and frequency of visits.

As we anticipated, the pace of product innovation during 2003 was slowed as we rolled out the store refits. As we complete the refurbishment programme in 2004 the product development will return to former levels of investment with a particular focus on lower-priced kitchens, bedrooms and beds.

France Retail

Notwithstanding a weaker furniture market in France, sales were £114m, up 21.2% on last year (10% in local currency) and with same store growth up by 7.3% in local currency.

We have focussed on the refurbishment programme of our stores during the year, and this will be virtually complete by the end of 2004. We have added 40 new format stores (36 refits and 4 new stores) to the 28 that were open at the beginning of the year – making a total of 68. And we are seeing first year uplifts of around 20% on the refits. We now have 135 stores and plan to open five during 2004.

Operating profits are £0.3m (2002 – £2.3m) after incurring £5m costs of disruption arising from the conversion process (2002 – £4m) and further investment in the infrastructure of the company.

Howden Millwork

The pilot has given us confidence that US tradesmen like the Howdens service proposition and that we can attract and retain good staff. Losses of £8.4m in the year were in line with our expectations and in line with the Howden business model where losses are incurred in the early stages.

We are now moving to the next phase where we will fully evaluate the customers' requirements by testing both pricing and demand for product made to a US specification. This will help validate that the business model can provide acceptable levels of return on any further investment. Plans have been approved to open a further five depots in the Southeast of the US in 2004, expanding the total depot portfolio for the purposes of the test to 20 depots, with an anticipated loss of £10m for the year.

HM Customs & Excise claim

As reported at the interims we continue to vigorously contest HM Customs & Excise's challenge to the Company's VAT treatment for structural guarantees. The maximum potential exposure is £50m at the year-end, but this would be expected to be offset by the recovery of approximately £13m of insurance premium tax paid on the sale of extended structural guarantees and by underwriting profit within our captive insurance company. In common with all of our product categories we revise our products from time to time and we will be changing the current insurance product in the first half. We are carrying the tax paid of £46m on our balance sheet as a debtor without any provision and further disclosure is given on page 73.

Taxation

The effective tax rate for the Group before property disposals was 30%, compared to 29% last year. The rate is lower than our peer group, largely because of tax efficient fund raising undertaken back in 1998. We expect this rate of tax to move higher in the future.

Dividends

The Board has proposed a raised final dividend of 2.0p per share to be paid on 11 June 2004 to shareholders on the register at 28 May 2004. The shares will be quoted ex-dividend from 26 May 2004. This brings a total dividend for the year to 3.8p per share, an increase of 22.6% over the previous year.

The Board is reviewing the relative dividend payout ratio between the first and second half. This is primarily due to the second half accounting for a growing proportion of profits, driven by the increasing contribution of Howden Joinery to the Group's results. In future it is likely that the final dividend will increasingly account for a greater proportion of the full-year dividend.

Cash flow

EBITDA amounted to a highly creditable £162.3m compared to the previous year of £128.4m. Working capital has increased as we built stock to ensure that we can meet our customers' requirements and expand the Howden Joinery business – nevertheless we expect to obtain improvements in the use of working capital as a result of the introduction of our new systems.

	2003 £m	2002 £m
Operating profit	105.6	79.8
Depreciation and amortisation	56.7	48.6
EBITDA	162.3	128.4
Working capital	(22.7)	11.2
Cash inflow – operating	139.6	139.6
Cash outflow – operating exceptionals	–	(1.6)
Cash outflow – VAT paid re Structural guarantee	(46.0)	–
Operating cash inflow	93.6	138.0

Operating and financial review continued

A higher level of capital expenditure has been incurred as the business has focussed on its extensive organic growth plans, but this has been partially funded by a property sale and leaseback programme. We have invested £50m over the past two years in integrated IT systems to replace legacy systems that were inadequate for supporting our business growth:

	2003 £m	2002 £m
Howden Joinery	7.4	6.8
UK Retail	48.5	46.2
France Retail	14.0	11.1
Howden Millwork	0.4	1.9
Total routes to market	70.3	66.0
Manufacturing	17.5	11.8
Systems	37.4	12.0
Logistics	2.0	8.5
Gross capital expenditure	127.2	98.3
Disposals	(58.2)	(9.5)
Net capital expenditure	69.0	88.8

The total movement in the net cash position comprises:

	2003 £m	2002 £m
Opening net cash	38.9	51.5
Operating cash inflow	93.6	138.0
Net capital expenditure	(69.0)	(88.8)
Investment in own shares	(14.9)	(25.5)
Investment in joint venture	(1.2)	(3.2)
Acquisition of Sofa Workshop	—	(8.5)
Taxation	(22.2)	(16.2)
Dividends	(19.7)	(16.0)
Net interest receivable	0.3	2.9
Issue of shares and others	4.8	4.7
Closing net cash	10.6	38.9

Included in the cash flow is the financing of the purchase of £14.9m of MFI shares for employee trusts. We believe strongly in share ownership and incentivisation in the business and all staff hold shares in the Company, with over 1,000 of our senior employees having share options. These incentives help to align our employees' interests with those of our shareholders.

Treasury policy

Treasury operations are managed within policies and procedures approved by the Board. Group Treasury reports regularly to a Treasury Committee, which meets four times a year. The major financial risks, to which the Group is exposed, relate to movements in exchange rates and cash management. Where appropriate, the Group uses financial instruments to manage these risks. No speculative use of derivatives, currency or other instruments is permitted. The Treasury function does not operate as a profit centre and transacts only in relation to the underlying business requirements.

Liquidity and funding

At 27 December 2003 the Group had net borrowings of £1.2m (2002 – net cash of £32.2m); this shows a reduction of net cash of £33.4m during the year, but is struck after lodging £46m with HM Customs & Excise for the disputed VAT on our structural guarantee product. In addition the Group held £11.8m (2002 – £6.7m) on short-term deposit, held in escrow for future insurance claims.

During the year the Group negotiated a new £185m revolving credit facility with six of our major relationship banks. This will finance the next stage of our development and has a 5.25 year maturity period to March 2009.

Cash management

Group Treasury policy on investment restricts counterparties to those with a minimum Standard and Poor's/Moody's long term credit rating of AA and a short term credit rating of A1/P1. Investments mainly consist of bank deposits and certificates of deposit. The Group continuously reviews the credit quality of counterparties, the limits placed on individual credit exposures and categories of investments.

Currency risk management

Currency movements can affect the Group's reported profit. The Group has a policy of hedging most of its foreign currency denominated transactions by entering into forward foreign exchange purchase contracts. As at 27 December 2003 approximately 75% of the 2004 foreign exchange purchase requirements for euros and US dollars had been protected.

Shareholder funds

Shareholder funds amount to £489.4m, an increase of £71.3m in the year. This is equivalent to 78.9p per share compared to 68.2p per share at the previous year-end.

Accounting standards

The principal accounting policies used by the Group are shown on pages 55 to 56. No new accounting standards came into effect during the year. We have evaluated the impact of International Financial Reporting Standards on our financial performance as part of a high level review and we are currently discussing the detailed impact internally.

Corporate and social responsibility

Introduction

The Group recognises its actual and potential corporate and social responsibilities to society and acts in a strategic way to implement them. Relevant laws and regulations are considered a starting point from which responsible behaviour can build.

Our areas of responsibility are organised and described under four headings:

- Market place
- Environment
- Workplace
- Community

i Market place

Customers

Our aim is to help people live better lives in their own homes by striving to deliver quality merchandise on time and in full, notwithstanding the challenges in delivering the hundreds of individual components required in our products. We are a member of Qualitas, the independent arbitrator, and also participate in an Office of Fair Trading (OFT) payment protection scheme.

Supply chain

It is important for the Group to manage both its own internal supply chain as well as the relationships with our many external suppliers. A global sourcing questionnaire has been developed to assess the corporate and social responsibility performance of external suppliers on the basis of labour standards, human rights and the environment. This has been completed by 82% of our suppliers with no real issues warranting further investigation.

In addition, the Group's purchasing is governed by an Ethical and Social Responsibility Policy when making purchasing decisions. With an expansion into overseas markets, we recognise the need for greater vigilance of social and environmental issues within our supply chain.

Distribution

ii) Environment

We are committed to preserving the natural environment and our key objectives in this regard are to:

- reduce consumption
- re-use or re-cycle wherever possible
- measure progress by setting key performance indicators
- continue working towards achieving the environmental management systems accreditation (ISO 14001) in the manufacturing division
- work closely with our suppliers to ensure that items we purchase come from sustainable renewable resources and are produced in a socially responsible way
- ensure that our policy is communicated to our colleagues and any necessary training provided

Energy

We have been active in measuring and reducing our energy use. Our retail stores in the UK have been awarded the Institute of Energy's prestigious Energy Efficiency Accreditation, having first been accredited in 1996 and again in 1999 and 2002.

We saw a slight increase in energy use in 2003, which was largely the result of an increased property portfolio accompanying the Group's growth. However, when measured against turnover, an increase in efficiency can be seen:

Energy use (k Wh per £1,000 turnover)

Electricity, gas and fuel consumption result in the emission of CO₂, a greenhouse gas that research indicates contributes to climate change. CO₂ emissions in 2003 totalled 140,800 tonnes representing a drop per £1 million turnover rate from 110 to 100 tonnes over the last 12 months. The principal source of emissions is from the use of electricity:

The Group has made considerable efforts to reduce energy consumption over the past ten years, an effort that has been recognised by the Carbon Trust in recent publicity. In addition, 35 stores last year purchased electricity from renewable sources. We will continue to use such sources where available and commercially viable.

Corporate and social responsibility continued

Waste

The Group aims to "reduce, re-use or recycle wherever possible". It is our aim that manufacturing waste and unsold products are disposed of in one of four ways – broken down into chipboard, made into animal bedding, made into compost or used as fuel in the Group's wood combustion boilers. As a last resort waste is disposed of in landfill.

Environmental management

Currently five out of our nine manufacturing and distribution facilities are certified to the environmental standard ISO14001. We aim to certify all manufacturing facilities to the same standard.

iii) Workplace

Currently around 14,000 people work for the Group across areas including retail, logistics and manufacturing – and we expect this number to rise as we continue to grow the Group. We recognise that the level of service we provide to our customers can only be as good as the level of service we provide to each other.

Service excellence

Our colleagues are fundamental to providing customer service. As part of our efforts to achieve this we have launched a programme entitled "Environment of Service" whereby everyone in the Group is valued for their contribution and:

- have a say in the future of MFI
- have the skills and freedom to be effective, efficient and innovative in their work
- receive a share in the financial success of the organisation
- have clarity about their role and how they contribute to the overall plan
- have the trust and respect of their colleagues

Diversity

In 2003 we began a programme called "Respect for All," to gain a better understanding of the make up of our people and how we might better reflect the UK population as a whole and the communities in which we work.

We believe that our colleagues' ability and achievements should solely determine their recruitment, career success and progression. This applies to all colleagues regardless of age, race, gender, disability, sexual orientation, religious belief, lifestyle, class or other method of discrimination.

Learning and development

Learning and development is a critical part of creating an environment of service inside our Company. We believe in investing in our people, so that they have the skills and freedom to be effective, efficient and innovative in their work. We spend over £5 million annually on colleague training and development. This includes £1.5 million on operational health & safety training and mechanical training.

Health & safety

Our principal objective is to develop the safety culture of the business such that each individual understands their responsibilities regarding health & safety. This year has seen major developments in the Occupational Health & Safety system within manufacturing and this has resulted in reduced risk of injury to our colleagues.

Three of the manufacturing sites have achieved the Occupational Health & Safety Standard (OHSAS 18001) and it is our aim to extend this to all the remaining sites. We took part in the "European Week of Safety" again this year and were awarded a prize by the Health & Safety Commission in recognition of our contribution.

In terms of our performance this year we have had 250 reportable incidents, we have had no improvement notices, no prohibition notices and no prosecutions by the Health & Safety Executive.

A summary of the top six types of accidents is given in the pie chart below:

iv) Community

It is our aim to contribute to the well-being of the communities within which we trade and where our colleagues live. Our policy is to support local charitable causes, colleagues who pursue good works within their local communities and, generally, education and the Arts.

In 2003, we continued our sponsorship of the London Chamber Orchestra's 'A Chance to Play' scheme which enables school children to start learning to play musical instruments. We are also sponsoring the English National Opera's 'The Ring Cycle', which will be performed during 2004 and 2005.

In 2003 the Group made cash and product donations to over 200 individual community organisations and charities totalling £329,000, up from £149,000 in 2002.

Board of directors

Ian Peacock (age 56) – *Non-executive Chairman*

Ian joined the Board in January 2000, having previously held senior management positions at BZW and Kleinwort Benson. He is also a non-executive director of Norwich and Peterborough Building Society and Lombard Risk Management and non-executive Chairman of Mothercare. For the period 1998 to 2000, Ian was a Special Adviser to the Bank of England.

John Hancock (age 54) – *Chief Executive*

John became Chief Executive in March 1999, having served as a non-executive director since December 1998. John was previously an executive director of WH Smith and his career includes senior posts with Associated British Foods and Ted Bates Advertising. John is also non-executive director of Manchester Airport, a board director of the National Retail Federation in the USA and Vice President of the British American Business Council.

Martin Clifford-King (age 40) – *Finance Director*

Martin, a chartered accountant, joined the Board in December 2000. Prior to that Martin was Group Finance Director of Harvey's Furnishing. Before that, Martin had been Chief Financial Controller of Debenhams, Finance Director of Evans and had worked within Burton/Debenhams for nine years. Martin started his career with Deloitte, Haskins & Sells.

Mark Horgan (age 37) – *Executive Director MFI Retail*

Mark joined MFI in September 1999 from Mars Confectionery Europe where he was effectively responsible for the global marketing of the Mars bar. In 1996 he took up the position of Joint Marketing Director of McVities UK responsible for corporate communications, marketing and product development.

Matthew Ingle (age 49) – *Managing Director Howdens*

Matthew, previously Managing Director of the Magnet Trade operation, joined MFI in 1995 to set up the successful Howden Joinery business. He was elected to the Board of MFI in 1998 and is responsible for the growth of the Howdens business.

Gordon MacDonald (age 46) – *Chief Operating Officer*

Gordon worked as a consultant with MFI prior to becoming Chief Operating Officer in 1999. Prior to this, he held a number of positions at Safeway between 1989 and 1998. Before joining Safeway, Gordon worked for a number of leading consumer goods and retail companies, including Grand Metropolitan, Associated British Foods, Levi Strauss (UK) and Cadbury Schweppes.

Bob Wilson (age 50) – *Manufacturing and Purchasing Director*

Bob has been with Hygena since 1977, a member of its Board since 1982 and became Managing Director in 1993. He was appointed to the Board in 1998, and has been largely responsible for directing the investment program that has confirmed MFI as one of the most efficient furniture manufacturers in the world.

Tony De Nunzio (age 43) – *Non-executive Director*

Tony joined the Board in September 2000 and also serves as Chairman of its Audit Committee. Tony is currently President and Chief Executive Officer of Asda Stores Limited. Leading up to the takeover by Wal-Mart, Tony was Group Finance Director of Asda Group, his career with the company beginning in 1994 after a spell as Finance Director of Allied Maples. Prior to this he was Planning Director for Central Europe at PepsiCo in the early 1990s after having been Group Financial Controller for L'Oreal (UK). Tony started his career with Unilever.

Lesley Knox (age 50) – *Non-executive Director*

Lesley was appointed non-executive director in May 2001 and also serves as Chairman of the Remuneration Committee. Lesley was a founder director of British Linen Advisers, a specialist corporate finance adviser focusing on growth companies. She was previously Head of Institutional Asset Management and then Group Director at Kleinwort Benson. She joined the Corporate Finance Division of Kleinwort Benson in 1981 and has advised many domestic and international clients on strategic issues. She is also a non-executive director of the Alliance Trusts, HMV Group and Hays.

Ian Smith (age 50) – *Non-executive Director*

Ian is Chief Executive for Exel Europe, Middle East and Africa (one of the world's largest logistics and freight forwarding businesses) and a member of the Board. He was previously Group Commercial Director of Ocean Group before its merger with NFC to form Exel and, prior to that, Managing Director of Monitor Company Europe, a strategy consulting firm. Ian began his business career with Royal Dutch/Shell Group of companies, working with Shell UK Oil in various commercial/sales roles and then moving to the Middle East; first as Marketing Director of Shell Oman and then setting up and managing the Shell joint venture in Jordan. Ian received an MA from Oxford University and received an MBA with high distinction from Harvard Business School. Ian was appointed non-executive director in September 2001.

Peter Wallis (age 56) – *Non-executive Director*

Peter is Senior Partner and founder of the respected SRU strategy and market research consultancy. His specialty is advice to CEOs on strategic direction. Peter was appointed a non-executive director in January 2001.

Directors' report

The directors have pleasure in submitting their report and the audited financial statements for the 52 week period ended 27 December 2003. Comparative figures relate to the 52 weeks ended 28 December 2002.

Principal activities, business review and results

The principal activities of MFI Furniture Group Plc and its subsidiaries are the manufacture, distribution and sale of kitchen cabinetry and household furniture.

A detailed review of the development and activities of the Group's business is contained in the Company Statement and the Operating and Financial Review on pages 1 to 25.

The full results for the period are shown in the Financial Statements on pages 50 to 74.

Share capital

The total number of ordinary shares of 10 pence each in issue at the period end stood at 620,052,840. Details of the Company's share capital are given on page 66. Details of share options granted and exercised during the period are also given on pages 67 to 68.

Dividends

The Board recommends a final dividend of 2.0 pence per share (2002 – 1.6 pence) payable on 11 June 2004 to shareholders on the register on 28 May 2004. The shares will be quoted ex-dividend on 26 May 2004. An interim dividend of 1.8 pence per share (2002 – 1.5 pence per share) was paid on 24 October 2003. The total dividend for the period will therefore be 3.8 pence per share (2002 – 3.1 pence per share).

Substantial shareholdings

As at 1 March 2004 the following substantial interests (3% or more) in the Company's share capital had been notified to the Company:

Shareholder	Ordinary shares	% holding
Computershare Trustees (CI)	47,337,642	7.63
Legal & General	24,985,558	4.03
Aviva	19,384,446	3.13

Donations

In addition to furniture products and services donated to various charities, the Company made charitable donations during the period amounting to £329,000 (2002 – £149,000). The Group made no political donations during the current and previous period.

Suppliers' payment terms

The Group's policy, in relation to all its suppliers, is to settle its terms of payment when agreeing the terms of the transaction and to abide by those terms provided that it is satisfied that the supplier has provided the goods or services in accordance with the agreed terms and conditions.

The number of days' purchases outstanding for payment by the Group at the period end was 53 (2002 – 54) and nil (2002 – nil) for the Company.

Employees

The average number of employees and their remuneration are shown on page 58.

The Group has approximately 14,000 employees throughout the United Kingdom and overseas and strives to engage its employees wherever possible in its business goals. Indeed, apart from conferences, intranet technology, staff briefings and bulletins and the publication and circulation of the quarterly staff magazine, several discussion groups comprising management and staff were held during the year to ensure that the aims of the Group were clearly communicated to the business as a whole, to obtain feedback from staff and management alike on a variety of issues and to work at creating an environment of service within the Group.

The Board remains committed to linking reward to business goals and thereby giving employees the opportunity to share in the financial success of the Group. The Board recognises employees for their contribution in this regard and includes employee incentive plans and share plans within remuneration overall. In May 2003, the Company awarded up to £200 worth of free shares to all employees who were employed as at 28 December 2002 in recognition of their contribution to the Company's performance that year. This is the second successive year that an award of up to £200 has been made to all employees under the FreeShare Plan. The Company also made an offer to employees under its Sharesave Plan, whereby employees may save to purchase shares in the Company in five years' time at an option price of 184 pence.

The Group promotes the importance of diversity and adopts an Equal Opportunities Policy under which training and career development opportunities are available to all employees, regardless of gender, religion or race. The Group is committed to meeting the code of practice on the employment of disabled people and full and fair consideration is given to disabled applicants for employment. It aims to do all that is practicable

Directors' report continued

to meet its responsibility towards the employment and training of disabled people and welcomes and considers fully, applications by disabled persons, having regard to their particular aptitudes and abilities. It is also the Group's policy to retain employees who may become disabled while in service and to provide appropriate training. The Group is a member of the Employers' Forum on Disability and of Opportunity NOW.

Auditors

In accordance with Section 385 of the Companies Act 1985 a resolution proposing the re-election of Deloitte & Touche LLP as the auditors of the Company will be put to the Annual General Meeting.

On 1 August 2003, Deloitte & Touche transferred its business to Deloitte & Touche LLP, a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000. The Company's consent has been given to treating the appointment of Deloitte & Touche as extending to Deloitte & Touche LLP with effect from 1 August 2003 under the provisions of Section 26(5) of the Companies Act 1989.

Annual General Meeting

The Annual General Meeting is to be held at The Lincoln Centre, 18 Lincoln's Inn Fields, London WC2A 3ED on Thursday 20 May 2004.

Directors and their interests

Details of the directors in office on 27 December 2003 are shown on page 30.

Martin Clifford-King, Tony De Nunzio and Bob Wilson retire by rotation at the Annual General Meeting and in accordance with Article 72 of the Articles of Association offer themselves for reappointment.

Information on the directors' service agreements and interests of the directors and their families in the share capital of the Company, are set out in the separate Report on Remuneration on pages 33 to 45.

By order of the Board

Gerard Hughes

Secretary



26 February 2004

Directors' remuneration report

Part A

1. Composition of the Remuneration Committee

The Remuneration Committee determines the remuneration of the executive directors. During 2003 it has taken external advice from the independent remuneration consultants, Deloitte. In December 2003 the Committee conducted a formal review of its advisers and, after consideration of Deloitte's recent appointment as auditors of the Company, appointed the independent remuneration consultants Ernst & Young. Following the publication of the "new" Combined Code and its guidance on independence, the non-executive chairman of the Board, Ian Peacock, resigned his membership of the Committee in December 2003, but continues to provide assistance to the Committee together with the chief executive officer and the company secretary where appropriate. All the members of the Committee are independent non-executive directors of the Company and have served on the Committee throughout 2003.

The members of the Committee are:

Lesley Knox (Chairman)

Tony De Nunzio

Ian Smith

Peter Wallis

The Committee met three times during 2003. The Terms of Reference of the Committee is available on the Company's website (www.mfigroup.co.uk).

Ernst & Young provide no other services to the Company. Deloitte also provide auditing services to the Company following their appointment as Auditors on 21 June 2002. As auditors to the Company, Deloitte are required to audit the information in Part B of this Report.

Part A, which comprises Sections 1 to 4 is not subject to audit. Part B, which comprises Sections 5 to 12 is subject to audit.

2. Policy on remuneration of executive directors for 2003 and 2004

The Committee determines policy for current and future years, which is reviewed on an annual basis. The current policy is designed to provide a total remuneration package, which has the objective of ensuring domestic and international business success through the recruitment, retention and motivation of a team of talented executives.

Base salaries are positioned at the median level compared to companies of similar size and complexity and are then supplemented by variable rewards and incentives, which can raise the total

value of the package into the upper quartile if superior performance and returns for shareholders are generated. The total opportunity of remuneration is strongly weighted in favour of performance-based incentives.

The remuneration policy has been designed and developed over a number of years to place emphasis on significant shareholding opportunities if stretching performance conditions are satisfied. These conditions, if satisfied, will deliver substantial increases in shareholder value. Performance measures include short-term business targets, stretching earnings growth and the delivery of superior shareholder return compared with a group of UK quoted retailers or FTSE 250. The balance of these measures endeavours to ensure that shareholders will enjoy real absolute and relative returns if executive directors achieve partial vesting and superior returns if awards vest in full.

The remuneration package includes an annual incentive plan with a compulsory one third deferral of any payment into shares; a performance share plan which is based on total shareholder return relative to comparable companies and the provision of an optional Executive Co-investment Plan. Under this plan executive directors are encouraged to invest in the Company's shares and in return receive matching awards of shares and options only if there is significant growth in earnings and median to upper quartile growth in returns to shareholders relative to the FTSE 250. The Executive Co-investment Plan was offered to executive directors in July 2002 (following approval by the shareholders at the Annual General Meeting in May 2002). The Committee was delighted to note that all executive directors agreed to participate in the Plan by committing substantial share interests.

The package also includes the provision of share options including performance options, which only become exercisable if particularly stretching performance targets are met, although it is the Committee's current policy not to grant share options to executive directors who have decided to participate in the Executive Co-investment Plan.

The Committee has considered carefully which performance measures would be most effective for each long-term incentive plan and has concluded, after consulting with certain institutional investors, and taking advice from its independent advisers, that a combination of total shareholder return ("TSR") and earnings per share ("EPS") are the most appropriate measures at the current stage of the Company's development.

Directors' remuneration report continued

Following the introduction of the Directors' Remuneration Report Regulations 2002 ("the Regulations"), the Company is required to include in this report a graph showing the Company's TSR compared with the TSR of a broad equity market index over a period of five most recent financial years. Details of how TSR is measured are shown on page 40. The graph below illustrates the Company's TSR performance relative to the current

financial results of Howden Joinery which was significantly above target for the year. A similarly stretching target has been set for performance in 2004. To align the executive directors' interests with those of the shareholders, one third of the incentive is deferred into ordinary shares of the Company and held in trust for three years before release to the executive director.

A third of the bonus payment made to Matthew Ingle was deferred into ordinary shares of the Company accordingly. All bonuses are paid at the discretion of the Remuneration Committee; cash bonuses may also be paid in exceptional circumstances, for example for recruitment or retention of key executive directors or for outstanding performance. Bonuses are non-pensionable.

iii Performance Share Plan

This Plan provides a direct link between the pay of executive directors and the creation of value for shareholders. Conditional awards of shares equivalent to one year's salary are made to executive directors annually at the discretion of the Committee and are released subject to the achievement of company performance targets. Company performance is measured over three years, in terms of TSR relative to a comparator group of companies. In addition, no award shall vest unless the EPS of the Company increases over the performance period by a percentage amount that is equal to or greater than the percentage change in the retail prices index ("RPI") plus 9% over the same period. The comparator companies have been selected on the basis of relative sector, size and complexity. The comparator group is reviewed before each performance award cycle to maintain its relevance.

The comparator group for the 2002 and 2003 awards is as follows:

Boots	Carpentryright
Debenhams	DFS
Dixons	GUS
Kingfisher	Marks and Spencer
Matalan	MFI
Selfridges*	WH Smith
Arcadia*	

*Delisted since the formation of this group.

comparator group used for the measurement of TSR performance for the Performance Share Plan and FTSE 250 constituents (excluding investment companies) of which the Company is a constituent. The graph shows performance over five financial years, the period required by the Regulations.

3. Components of executive directors' remuneration

i Basic salary

Basic salary for each director is positioned at the median level, is reviewed annually and is determined by the Committee taking into account the performance of the individual, changes in their responsibilities and information from independent remuneration consultant's sources on the levels of salary for similar jobs having regard to the size of the company - its turnover, profits, market capitalisation and complexity.

ii Annual Incentive and Deferred Incentive Plan

This Plan sets challenging group targets and provides for a bonus opportunity of up to 100% of salary for the chief executive and 75% for the other executive directors with threshold for payment based on Group performance. In 2003 this Group threshold was not met, but a bonus payment of £215,625 was made to Matthew Ingle based on the

The comparator group for the 2001 award is as follows:

Arnotts	Beattie (James)
Carpentright	Courts
Debenhams	DFS
Homestyle	House of Fraser
Bentalls*	Heal's*
Hughes (TJ)*	Mot hercare
MFI	SCS

*Delisted since the formation of this group.

The number of shares released depends up on the Company's comparative performance against its peer group. If the Company's TSR is at the median level, 40% of the shares, the subject of the award, will vest. If the Company is ranked in the top quartile of the list, 100% of the shares will vest. Proportional vesting on a straight-line basis will take place for performance between the median and the top quartile positions. Full details of how TSR is calculated and measured and of the Company's performance relative to the peer group for the 2001 award is shown on page 40.

Ernst & Young are instructed by the Committee to collect market data and report on the Company's performance under the Performance Share Plan with regards to TSR.

iv Executive Co-investment Plan

The principal objectives of the Executive Co-investment Plan are to encourage executive directors to make significant investments in the Company's shares and to reward superior performance with superior earnings potential.

Under the terms of the Executive Co-investment Plan, the executive directors receive conditional Matching Awards consisting of two matching shares and two market value matching options for each share committed by them to the Plan ("the Commitment Shares"). Commitment Shares must be held in the Plan for a minimum of three years from the date of commitment ("the Commitment Period"). A participant's Commitment Shares may consist of shares held beneficially, shares held beneficially but subject to employment conditions ("Conditional Commitment Shares") and, at the discretion of the Remuneration Committee, shares to be committed within specified periods.

The number of shares or options which vest under a Matching Award will depend up on the Company's performance over the Commitment

Period. Matching Awards will vest as follows:

- 20% of the Matching Award will vest if the Company's TSR is at the median level against the FTSE 250 constituents, rising on a straight-line basis to 50% of the Matching Award vesting for upper quartile performance; and
- 20% of the Matching Award will vest if average EPS are equal to the RPI plus 10% per annum over the Performance Period, rising on a straight-line basis to 50% of the Matching Award vesting when average EPS growth is equal to or greater than RPI plus 20% per annum.

It is the Remuneration Committee's policy that a participant in the Executive Co-investment Plan will not receive any grants of options under the Share Option Plan Portfolio for a period of two years from the date of the Matching Award.

v Share Option Plan Portfolio

The Company operates a share plan portfolio which has three sections. Grants were made to executive directors in 2000 and 2001 but as explained above it is currently the policy of the Committee not to make option grants to participants in the Executive Co-investment Plan.

Under Sections 1 and 2, the Inland Revenue Approved and Unapproved sections of the Plan, executive directors can receive annual grants of options up to two times salary at the discretion of the Committee. However, unless there are exceptional circumstances, executive directors can not receive options under these sections of the Plan if they receive an award under the Performance Share Plan in the same year.

Share options under Sections 1 and 2 become exercisable only if a performance condition is satisfied. The current condition is that the growth in EPS of the Company must meet or exceed the growth in the RPI by 9% over a three-year period. Options will lapse if this target has not been satisfied.

Under Section 3 of the Plan the Committee has discretion to grant Performance Options to executive directors up to four times salary subject to the achievement of certain demanding and challenging performance targets based on EPS growth which, if achieved, will demonstrate superior performance. Details of these targets are set out under the table of directors' share options. Ernst & Young are instructed by the Committee to review the calculation and to advise the Committee of the Company's EPS performance relative to these targets.

Directors' remuneration report continued

vi FreeShare Plan

The FreeShare Plan was introduced in the year 2002 following approval at the Annual General Meeting held on 22 May 2002. Executive directors may participate in the Plan on the same terms as all other eligible employees. Under this Plan all eligible employees were invited to accept an allocation of up to £200 of the Company's shares in September 2002 and in May 2003. The shares are held in a Trust for a holding period being between three and five years after which the award of shares will vest and participants may withdraw their shares.

vii ShareSave Plan

Executive directors may participate in the ShareSave Plan, if offered, on the same terms as all other eligible employees. Under the Plan, participants make regular savings and at the end of the savings period participants may use all or part of their savings and bonus to purchase shares at the option price which is set at the start of the savings plan. In 2003 all eligible employees were invited to save to invest in the Company's shares under the Plan and ShareSave options over a total of 5.7 million shares were granted to participants.

viii Pensions

Executive directors participate in the MFI Group Pension Plan on a similar basis to senior executives with the exception that one executive director has a long-standing right to retire at age 55 and draw a pension without any early retirement reduction factor being applied.

The Plan is a funded, Inland Revenue approved, final salary, occupational pension plan. Its main features are:

- pension at normal pension age of two thirds of final pensionable salary, subject to completion of 20 years service; post-retirement increases are expected to be in line with inflation, guaranteed up to the level of 5% and discretionary above that level;
- members contribute 9.5% of pensionable salary;
- life assurance cover of four times pensionable salary;
- pension payable in the event of ill health; and
- spouse's pension on death (2/3 of deceased's pension).

Pensionable salary is the member's basic salary.

All plan benefits are subject to Inland Revenue limits.

ix Pension supplements

To recognise that pension entitlement will be limited for those members who joined the MFI Group Pension Plan after 14 March 1989 and whose final pensionable salary exceeds the Earnings Cap, a pensions supplement system has been introduced.

The pensions supplement is based on salary above the earnings cap. Below age 45 the supplement is 40%. Above age 45 the supplement is 45%. The supplement is paid in arrears and in two instalments, in September and March.

x Service contracts

The Committee's policy on service contracts has been to offer a notice period for termination by the Company or director of 12 months and liquidated damages of 12 months' base salary are applied to any payment of compensation on termination. On change of control of the Company, liquidated damages of 18 months' base salary may become payable.

Executive director	Date of contract
John Hancock	1 Nov 1999
Martin Clifford-King	1 Jan 2001
Mark Horgan	1 Nov 1999
Matthew Ingle	1 Nov 1999
Gordon MacDonald	1 Nov 1999
Bob Wilson	1 Nov 1999

xi External appointments

It is recognised that executive directors may be invited to become non-executive directors of other companies and that exposure to such duties can broaden experience and knowledge, which will benefit the Company. Executive directors may accept one non-executive appointment, unless otherwise agreed by the Remuneration Committee, provided these are not with competing companies nor likely to lead to conflicts of interest. Executive directors may retain the fees paid to them in respect of their non-executive duties.

4. Non-executive directors' remuneration

The remuneration of the independent non-executive directors is determined by a Committee appointed by the Board comprising the Chairman and Chief Executive after taking advice from the independent external consultants Ernst & Young who review the fee payments of non-executive directors in similar organisations.

Non-executive directors' remuneration consists of an annual fee of £28,000 for their service as members of the Board and of the Committees of the Board. Lesley Knox and Tony De Nunzio each receive an additional fee of £4,000 for their services as chair of the Remuneration Committee and Audit Committee respectively. Non-executive directors do not have service agreements, but instead have letters

of appointment and are appointed by the Board for an initial period of three years subject to retirement by rotation and re-appointment by shareholders.

Ian Peacock was appointed Chairman on 18 May 2000. Mr Peacock receives a fee of £130,000 per annum in consideration for his services as Chairman and non-executive director. In the first year of his

appointment Mr Peacock agreed to apply £20,000 of this fee towards the purchase of shares in the Company and to hold these shares until he ceases to be Chairman and non-executive director. Under this arrangement Mr Peacock purchased 31,740 ordinary shares at 63 pence per share on 16 June 2000.

Part B

5. Directors' remuneration

The following table sets out the directors' emoluments for the 52 weeks to 27 December 2003.

	Basic salary £000	Fees £000	Benefits £000	Annual cash incentive £000	Pension supplement £000	52 weeks to 27 Dec 2003 £000	52 weeks to 28 Dec 2002 £000
Chairman							
Ian Peacock	—	130	1	—	—	131	132
Executive directors							
John Hancock	425	—	63	—	145	633	797
Martin Clifford-King	243	—	19	—	57	319	390
Mark Horgan	245	—	23	—	58	326	390
Matthew Ingle	288	—	31	144	79	542	464
Gordon MacDonald	265	—	26	—	74	365	436
Bob Wilson	230	—	25	—	—	255	349
Sub Total	1,696	130	188	144	413	2,571	2,958
Non-executive directors							
Tony De Nunzio	—	32	—	—	—	32	32
Lesley Knox	—	32	—	—	—	32	32
Ian Smith	—	28	—	—	—	28	28
Peter Wallis	—	28	—	—	—	28	28
TOTAL	1,696	250	188	144	413	2,691	3,078

1. On 4 March 2004 Matthew Ingle became entitled to an award under the Annual Incentive Plan of £215,625 for the 52 weeks ended 27 December 2003. Two thirds of this award is payable in cash and is disclosed in column for the Annual Incentive. One third of the award will be made in shares under the terms of the Deferred Incentive Plan.

2. The benefits column incorporates benefits in kind which relate in the main to the provision of a fully expensed car or cash equivalent and private medical cover.

3. Pension supplements are paid every six months in arrears and the next payment is due in March 2004. The table above includes an accrued amount for the period from 1 October 2003 to 27 December 2003. Further details of the Pension Supplement Plan are given on page 36.

4. Following her decision to resign as a non-executive director on 23 May 2001, Denise Kingsmill was engaged by the Company as a consultant in the areas of design and product development. Under the terms of this consultancy agreement, which expired on 30 September 2003, Denise Kingsmill received a fee of £80,000 per annum and on 31 December 2003 she received a payment of £80,000 in respect of the period from 30 September 2002 to 30 September 2003.

5. The rate and payment of consultancy fees to Denise Kingsmill was approved by the Remuneration Committee.

Directors' remuneration report continued

6. Directors' shareholdings

The beneficial interests of the directors in office on 27 December 2003 and their families in the share capital are as follows:

	Ordinary shares of 10p each 27 December 2003	Ordinary shares of 10p each 28 December 2002
John Hancock	796,255	407,173
Martin Clifford-King	210,109	210,109
Mark Horgan	286,238	33,300
Matthew Ingle	540,716	154,778
Gordon MacDonald	250,000	—
Bob Wilson	286,771	85,627
Tony De Nunzio	23,000	23,000
Lesley Knox	8,000	8,000
Ian Smith	10,000	10,000
Ian Peacock	110,000	110,000
	2,521,089	1,041,987

- There have been no changes to the directors' interests shown above since 27 December 2003 and the publication of the Company's preliminary results announcement on 26 February 2004.
- Executive directors may also have a beneficial interest in the shares held under the terms of the Executive Co-investment Plan. These shares are held beneficially but are subject to performance and employment conditions. Details of these interests are set out in the table on page 43.
- Gordon MacDonald is a director of MFI Employee Ownership Trustee Company Limited which is the corporate trustee of the MFI Employee Benefit Trust and therefore has a non-beneficial interest in the 190,000 ordinary shares (2002 – 190,000 ordinary shares) held by the trust.

7. Deferred Incentive Plan – Shares held in trust

Details of shares held in trust under the terms of the Deferred incentive plan are as follows:

Executive	Deferred shares (52 weeks ended Dec 2000*)			Deferred shares (52 weeks ended Dec 2001**)			Deferred shares (52 weeks ended Dec 2002***)		
		Date awarded	Release date		Date awarded	Release date		Date awarded	Release date
John Hancock	40,574	22.03.01	21.03.04	71,026	05.03.02	04.03.05	118,828	03.03.03	02.03.06
Martin Clifford-King	—	—	—	30,440	05.03.02	04.03.05	49,769	03.03.03	02.03.06
Mark Horgan	15,918	22.03.01	21.03.04	30,440	05.03.02	04.03.05	49,769	03.03.03	02.03.06
Matthew Ingle	18,727	22.03.01	21.03.04	34,245	05.03.02	04.03.05	57,871	03.03.03	02.03.06
Gordon MacDonald	16,854	22.03.01	21.03.04	32,723	05.03.02	04.03.05	54,379	03.03.03	02.03.06
Gordon MacDonald	—	—	—	—	—	—	****926	03.03.03	02.03.06
Bob Wilson	17,790	22.03.01	21.03.04	30,440	05.03.02	04.03.05	49,769	03.03.03	02.03.06

* Shares were acquired by the Trustee on 22 March 2001 at 89 pence per share.

** Shares were acquired by the Trustee on 5 March 2002 at 147.83 pence per share.

*** Shares were acquired by the Trustee on 28 February 2003 at 108 pence per share.

**** Shares were acquired by the Trustee on 2 April 2003 at 119 pence per share.

8. Directors' conditional awards of shares – Performance Share Plan

Details of the conditional awards of shares held by executive directors under the Performance Share Plan are as follows:

Executive	30 Dec 00	29 Dec 01	28 Dec 02	27 Dec 03	Initial Share price (pence)	Performance Period	Vesting date (note 2)
John Hancock	–	–	–	391,706	108.50	01.01.03 – 31.12.05	
	–	–	260,428	260,428	147.83	01.01.02 – 31.12.04	
	–	393,258	393,258	393,258	89.00	01.01.01 – 31.12.03	
Vested	*476,190	476,190	476,190	–	68.25	01.01.00 – 31.12.02	28.02.03
	476,190	869,448	1,129,876	1,045,392			
Martin Clifford-King	–	–	–	211,982	108.50	01.01.03 – 31.12.05	
	–	–	145,434	145,434	147.83	01.01.02 – 31.12.04	
	–	224,719	224,719	224,719	89.00	01.01.01 – 31.12.03	
	–	224,719	370,153	582,135			
Mark Horgan	–	–	–	216,590	108.50	01.01.03 – 31.12.05	
	–	–	145,434	145,434	147.83	01.01.02 – 31.12.04	
	–	224,719	224,719	224,719	89.00	01.01.01 – 31.12.03	
Vested	*249,084	249,084	249,084	–	68.25	01.01.00 – 31.12.02	28.02.03
	249,084	473,803	619,237	586,743			
Matthew Ingle	–	–	–	253,457	108.50	01.01.03 – 31.12.05	
	–	–	169,109	169,109	147.83	01.01.02 – 31.12.04	
	–	252,809	252,809	252,809	89.00	01.01.01 – 31.12.03	
Vested	*287,495	287,495	287,495	–	68.25	01.01.00 – 31.12.02	28.02.03
Vested	*5,904	5,904	5,904	–	64.10	01.01.00 – 31.12.02	28.02.03
	293,399	546,208	715,317	675,375			
Gordon MacDonald	–	–	–	244,240	108.50	01.01.03 – 31.12.05	
	–	–	156,257	156,257	147.83	01.01.02 – 31.12.04	
	–	241,573	241,573	241,573	89.00	01.01.01 – 31.12.03	
Vested	**263,736	263,736	263,736	–	68.25	01.01.00 – 31.12.02	28.02.03
	263,736	505,309	661,566	642,070			
Bob Wilson	–	–	–	211,982	108.50	01.01.03 – 31.12.05	
	–	–	145,434	145,434	147.83	01.01.02 – 31.12.04	
	–	224,719	224,719	224,719	89.00	01.01.01 – 31.12.03	
Vested	*278,388	278,388	278,388	–	68.25	01.01.00 – 31.12.02	28.02.03
	278,388	503,107	648,541	582,135			

1. Awards disclosed assume 100% vesting.

2. The mid-market price on 28 February 2003 was 108.50 pence per share.

*The awards were exercised as nil cost options on 28 February 2003.

**A proportion of this award (107,927) was exercised as a nil cost option.

Directors' remuneration report continued

Performance measurement and the comparator peer group to the share performance plan is as follows.

Vesting targets for each award are measured over three years, in terms of TSR. TSR is a way of calculating the return shareholders would enjoy if they held a notional number of shares, over a period of time. TSR measures the percentage growth in the Company's share price together with the value of dividends received in the period, assuming that all of those dividends are "re-invested" into new shares.

The TSR is measured against a comparator group, with the starting base period being the 3 months to 1 January of the year in which the awards are made. For a TSR performance that places the Company at the median of the comparator group, 40% of the award will vest. For attaining an upper quartile position, 100% of the award will vest, with straight-line vesting between the median and upper quartile positions. For below median performance the award will not vest.

Following a comparison of the Company's TSR performance against this comparator group for the 2001 award the Company was ranked as follows:

1 January 2001 to 31 December 2003

Company	TSR
Bentalls*	210%
MFI	195%
House of Fraser	145%
Mothercare	139%
Arnotts	138%
Heal's*	127%
SCS	127%
Debenhams	124%
Carpetright	93%
DFS	36%
Beattie (James)	24%
Courts	-17%
Hughes (TJ)*	-51%
Homestyle	-55%

*Delisted since the formation of this group.

9. Directors' share options*

The interests of executive directors in options to acquire ordinary shares in the Company are as follows:

	28 Dec 02	Exercised/ lapsed during period	Granted during period	27 Dec 03	Exercise price (pence)	Earliest date for exercise	Latest date for exercise
John Hancock							
Executive Scheme	785,000	—	—	785,000	35.00	06.03.02	05.03.06
Executive Scheme	705,000	—	—	705,000	39.00	07.09.02	06.09.06
2000 Share Option Plan Portfolio (Section 3)	1,904,762	—	—	1,904,762	68.25	19.05.03	18.05.10
2000 Share Option Plan Portfolio (Section 3)	701,403	—	—	701,403	124.75	30.05.04	29.05.11
Martin Clifford-King							
2000 Share Option Plan Portfolio (Section 1)	43,795	—	—	43,795	68.50	22.12.03	21.12.10
2000 Share Option Plan Portfolio (Section 2)	540,146	—	—	540,146	68.50	22.12.03	21.12.10
2000 Share Option Plan Portfolio (Section 3)	1,167,883	—	—	1,167,883	68.50	22.12.03	21.12.10
2000 Share Option Plan Portfolio (Section 3)	400,802	—	—	400,802	124.75	30.05.04	29.05.11
Sharesave Scheme	—	—	2,067	2,067	184.00	01.11.08	30.04.09
Mark Horgan							
Executive Scheme	714,200	(71,428)	—	642,772	42.00	27.09.02	26.09.09
2000 Share Option Plan Portfolio (Section 3)	996,337	(996,337)	—	—	68.25	19.05.03	18.05.10
2000 Share Option Plan Portfolio (Section 3)	400,802	—	—	400,802	124.75	30.05.04	29.05.11
Sharesave Scheme	—	—	2,067	2,067	184.00	01.11.08	30.04.09
Matthew Ingle							
Executive Scheme	**27,734	(27,734)	—	—	180.00	02.07.99	01.07.03
Executive Scheme	16,666	—	—	16,666	180.00	02.07.99	01.07.06
2000 Share Option Plan Portfolio (Section 3)	1,149,978	(1,149,978)	—	—	68.25	19.05.03	18.05.10
2000 Share Option Plan Portfolio (Section 3)	23,619	(23,619)	—	—	64.10	08.06.03	07.06.10
2000 Share Option Plan Portfolio (Section 3)	450,902	—	—	450,902	124.75	30.05.04	29.05.11
Sharesave Scheme	—	—	2,067	2,067	184.00	01.11.08	30.04.09
Gordon MacDonald							
Executive Scheme	714,200	(714,200)	—	—	42.00	27.09.02	26.09.09
2000 Share Option Plan Portfolio (Section 3)	1,054,945	—	—	1,054,945	68.25	19.05.03	18.05.10
2000 Share Option Plan Portfolio (Section 3)	430,862	—	—	430,862	124.75	30.05.04	29.05.11
Sharesave Scheme	—	—	2,067	2,067	184.00	01.11.08	30.04.09
Bob Wilson							
Executive Scheme	126,200	—	—	126,200	115.00	03.07.98	02.07.05
Executive Scheme	**37,100	(37,100)	—	—	180.00	02.07.99	01.07.03
Executive Scheme	158,900	—	—	158,900	63.00	02.07.01	01.07.05
2000 Share Option Plan Portfolio (Section 3)	1,113,553	—	—	1,113,553	68.25	19.05.03	18.05.10
2000 Share Option Plan Portfolio (Section 3)	400,802	—	—	400,802	124.75	30.05.04	29.05.11
Sharesave Scheme	—	—	2,067	2,067	184.00	01.11.08	30.04.09
Total	14,065,591	(3,020,396)	10,335	11,055,530			

*Excludes share options held under the Executive Co-investment Plan which are shown in the table on page 43.

**Options lapsed on 1 July 2003.

Directors' remuneration report continued

1. On 13 August 2003, Matthew Ingle exercised options granted under Section 3 of the 2000 Share Option Plan Portfolio over 1,149,978 shares at 68.25 pence per share and 23,619 shares at 64.10 pence per share. The market value at the date of exercise was 173.71 pence per share. Following this exercise Mr Ingle sold 1,004,414 shares at 171 pence per share, retaining the balance of 169,183 shares.
2. On 13 August 2003, Mark Horgan exercised an option granted under Section 3 of the 2000 Share Option Plan Portfolio over 996,337 shares at 68.25 pence per share. The market value at the date of exercise was 173.71 pence per share. Following this exercise Mr Horgan sold all 996,337 shares at 171 pence per share.
3. On 13 August 2003, Mark Horgan, and Gordon MacDonald each exercised options over 71,428 and 714,200 shares respectively under the 1992 Executive Share Option Scheme ("the Executive Scheme") at 42 pence per share. Following this exercise Mr MacDonald sold 642,772 shares at 171 pence per share, retaining the balance of 71,428 shares. The market value at the date of exercise of each of these options was 173.71 pence per share.
4. The options outstanding are exercisable at prices between 35 pence and 184 pence. In the period the highest middle market price was 188 pence per share and the lowest middle market price was 95.51 pence per share. The middle market price on 24 December 2003 (the last business day before the financial year end) was 146 pence per share.
5. Options granted under the Executive Scheme (which was replaced with the approval of shareholders on 18 May 2000 by the Share Option Plan Portfolio) became exercisable on 28 February 2002 following satisfaction of the performance target that options granted are not normally exercisable unless growth in EPS, as determined under the scheme, have exceeded the growth in RPI over a three year period.
6. Options granted under Sections 1 and 2 of the 2000 Share Option Plan Portfolio are not normally exercisable unless growth in EPS, as determined under the Plan, meets or exceeds the growth in RPI by 9% over a three year period. Options will lapse if this target is not satisfied.
7. Options granted under Section 3 of the 2000 Share Option Plan Portfolio are not normally exercisable unless challenging targets are met. For Section 3 options granted in 2000 50% of an option becomes exercisable subject to growth in earnings per share, calculated on an IIMR basis, being equal to 100% over three years; increasing on a straight line basis up to 100% of an option becoming exercisable where EPS growth equals or exceeds 150%. For Section 3 options granted in 2001 50% of an option becomes exercisable subject to growth in EPS, calculated on an IIMR basis, being equal to 60% over three years; increasing on a straight-line basis up to 100% of an option becoming exercisable where EPS growth equals or exceeds 120%. Options will lapse to the extent that these targets are not satisfied. Targets are not retested.

10. Executive Co-investment Plan

Details of the directors' commitments under the Executive Co-investment Plan are as follows:

Name	Commitment Shares held beneficially as at 27 Dec 2003	Commitment Shares held conditionally as at 27 Dec 2003	Commitment Period
John Hancock	301,556	648,279	26.07.02 – 25.07.05
Martin Clifford-King	210,109*	56,266*	30.07.02 – 29.07.05*
Mark Horgan	33,300	497,107	26.07.02 – 25.07.05
Matthew Ingle	104,397	512,379	26.07.02 – 25.07.05
Gordon MacDonald	–	414,092**	26.07.02 – 25.07.05**
Gordon MacDonald	–	155,809**	28.02.03 – 27.02.06**
Bob Wilson	79,169	432,502	26.07.02 – 25.07.05

*Martin Clifford-King has agreed to commit a total of 530,427 shares under the Plan and at the discretion of the Remuneration Committee the deadline for him to achieve this full commitment was extended to 31 March 2004. The Commitment Period for the 264,052 shares that he had not committed as at 27 December 2003 will start on the date that all of these remaining shares are acquired. Therefore the Commitment Period shown above is applicable to the Commitment Shares already held and the appropriate portion of the Matching Award made to him will vest following the end of this period (subject to achievement of the performance conditions). If Martin Clifford-King fails to become fully committed by 31 March 2004 he will forfeit the whole of his Matching Award.

**Gordon MacDonald had committed a total of 414,092 shares as at 28 December 2002 and at the discretion of the Remuneration Committee, committed the remaining 155,809 on 28 February 2003. The Commitment Period for these shares will commence on the date the shares were acquired. Therefore the appropriate portions of the Matching Award made to him will vest following the end of the relevant Commitment Periods (subject to the achievement of the performance conditions).

Details of the Matching Awards granted to directors on 26 July 2002 under the Executive Co-investment Plan are as follows:

Name	Matching shares granted	Matching options granted	Value of shares at award/ exercise price	Performance period	Earliest exercise/ vesting date	Latest vesting date
John Hancock	1,899,670	1,899,670	114p	01.01.02 – 31.12.04	26.07.05	25.07.12
Martin Clifford-King	1,060,854	1,060,854	114p	01.01.02 – 31.12.04	30.07.05*	29.07.12
Mark Horgan	1,060,814	1,060,814	114p	01.01.02 – 31.12.04	26.07.05	25.07.12
Matthew Ingle	1,233,552	1,233,552	114p	01.01.02 – 31.12.04	26.07.05	25.07.12
Gordon MacDonald	828,184	828,184	114p	01.01.02 – 31.12.04	26.07.05**	25.07.12
Gordon MacDonald	311,618	311,618	114p	01.01.02 – 31.12.04	28.02.06**	27.02.13
Bob Wilson	1,023,342	1,023,342	114p	01.01.02 – 31.12.04	26.07.05	25.07.12

*As noted above, Martin Clifford-King has until 31 March 2004 to become fully committed under the Plan and therefore the earliest exercise / vesting date refers only to the proportion of his Matching Award relating to the shares committed prior to 27 December 2003.

**As noted above, Gordon MacDonald committed the remaining 155,809 shares on 28 February 2003 and therefore the earliest exercise / vesting date for this proportion of the Matching award is correspondingly later than for the proportion in relation to the 414,092 shares committed as at 28 December 2002.

Directors' remuneration report continued

Additional notes:

1. At the discretion of the Remuneration Committee, participants invest a number of Commitment Shares equal in value to not less than one times basic salary and not more than three times basic salary. The limits were calculated by dividing the appropriate multiple of basic salary as at 26 July 2002 by the average daily share price for the last six months of 2001, which was 121.6 pence per share.
2. A participant's Commitment Shares may consist of shares held beneficially and shares held beneficially but subject to employment conditions ("Conditional Commitment Shares"). Matching Shares are also held beneficially subject to the performance conditions described below in paragraph 6 and employment conditions. The interests of each executive director in their Conditional Commitment Shares and the Matching Shares are held by Computershare Nominees Limited in accounts designated to each director under the administrative arrangements for the Executive Co-investment Plan.
3. The executive directors' interests in the Commitment Shares held beneficially are included in the table of directors' shareholdings on page 38.
4. Commitment Shares must be held within the Plan for a period of at least three years or until the fifth anniversary of the date of award, whichever is shorter. Matching Awards will vest following the end of this Commitment Period if the performance conditions have been satisfied.
5. Matching Awards consist of two matching shares and two market price matching options for each Commitment Share.
6. The Matching Awards disclosed assume maximum performance and vesting are achieved. The number of shares or options that actually vest under a Matching Award will depend upon the Company's performance over the Performance Period. Matching Awards will vest as follows:
 - i 20% of the Matching Award will vest if the Company's TSR is at the median level against the FTSE 250 constituents (excluding investment companies), rising on a straight line basis to 50% of the Matching Award vesting for upper quartile performance; and
 - ii 20% of the Matching Award will vest if average EPS is equal to RPI plus 10% per annum over the Performance Period, rising on a straight-line basis to 50% of the Matching Award vesting when average EPS growth is equal to or greater than RPI plus 20% per annum.
7. EPS will be calculated on a consistent and normalised basis. The 2001 EPS was 7.9 pence (restated from 7.7 pence to exclude shares held by the Group's employee share trusts in accordance with FRS 14 'Earnings per share') and this is the base number from which growth is measured. The Remuneration Committee has discretion to make adjustments for significant events, such as a change in reporting regulations.
8. TSR measures the percentage growth in the share price together with the value of any new dividends, assuming that all of those dividends were "re-invested" into new shares. The relative TSR against the FTSE 250 constituents, excluding investment companies, (as at 1 January 2002) will be calculated over the Performance Period measuring the growth between the average TSR for the six months to 31 December 2001 to the average TSR for the six months to the end of the Performance Period. The Remuneration Committee will then determine the ranking by TSR, of each company within the comparator group.

11. Executive directors' pensions

The table below shows the accrued pension should the director leave employment as at the financial period end.

	Transfer value at 28 Dec 2002 £000	Real increase in accrued pension £000	Inflation £000	Increase in accrued pension £000	Transfer value of real increase in accrued pension (less directors' contributions) £000	Other changes to transfer value £000	Increase/ (decrease) in transfer value less directors' contributions £000	Directors' contributions £000	Accrued pension at 27 Dec 2003 £000	Transfer value at 27 Dec 2003 £000
John Hancock	196.7	3.2	0.3	3.5	(53.5)	25.5	(28.0)	8.3	15.7	177.0
Martin Clifford-King	44.8	3.2	0.2	3.4	(6.1)	6.2	0.1	8.3	9.9	53.2
Mark Horgan	64.4	3.2	0.3	3.5	(14.9)	8.9	(6.0)	8.3	14.0	66.7
Matthew Ingle	280.9	3.1	0.7	3.8	(101.5)	43.5	(58.0)	8.3	28.6	231.2
Gordon MacDonald	102.1	3.2	0.3	3.5	(23.6)	17.2	(6.4)	8.3	14.0	104.0
Bob Wilson	1,308.2	6.6	3.0	9.6	73.9	180.6	254.5	19.2	117.6	1,581.9

1. In the cases of John Hancock, Martin Clifford-King, Mark Horgan, Matthew Ingle and Gordon MacDonald, the benefits accruing are limited by the earnings cap imposed by the Finance Act 1989.

2. The aggregate pension costs paid by the Company in respect of the directors' qualifying services were £71,559 (2002 – £61,600). The amount paid in respect of the highest paid director was £9,757 (2002 – £8,525).

Name	Date pensionable service commenced	Pensionable service (complete years and months)
Bob Wilson	26 July 1977	26 years 5 months
Matthew Ingle	12 April 1995	8 years 8 months
John Hancock	01 April 1999	4 years 9 months
Mark Horgan	01 October 1999	4 years 3 months
Gordon MacDonald	01 October 1999	4 years 3 months
Martin Clifford-King	22 December 2000	3 years 0 months

12. Directors' award of Freeshares – Share Incentive Plan

The aggregate awards of free shares made to the executive directors under the Share Incentive Plan are as follows:

Executive	No. of shares
John Hancock	311
Martin Clifford-King	311
Mark Horgan	311
Matthew Ingle	311
Gordon MacDonald	311
Bob Wilson	311

Lesley Knox
Chairman of the Remuneration Committee

26 February 2004

Corporate governance report

Statement of compliance

The Board is committed to high standards of corporate governance.

The listing rules of the UK Listing Authority (the "Listing Rules") require listed companies to disclose, in relation to Section 1 of the principles of good governance and code of best practice produced by the Committee on Corporate Governance and appended to the Listing Rules (the "Combined Code"), how they have applied its principles and whether or not they have complied with its provisions throughout the financial year. Consequently this report describes how the Group applies the principles and complies with the provisions of the Combined Code.

In addition, following the issue of the "new" Code provisions set out in Section 1 of the Combined Code on Corporate Governance issued by the Financial Reporting Council in July 2003 which applies to the Company's next financial year, the Board has reviewed the Company's compliance with the provisions of the new Code and save for the areas described below is in compliance with these provisions.

Organisational structure

The Group has an appropriate organisational structure for planning, executing, controlling and monitoring the business in a manner, which seeks to achieve the Group's objectives taking into account the interests of all stakeholders.

The primary purpose of the Board is to ensure that the needs and aspirations of all stakeholders are satisfied. This is achieved through the development of a balanced strategy which serves the interests of the stakeholders. The Board's role is then to set the context for the business, create suitable structures for implementing the strategies and to ensure the coordination, alignment and motivation of resource. The Board then assesses the results of these actions and sets revised priorities where appropriate to service the needs of the stakeholders. During 2003 the Board met nine times.

The Board comprises the non-executive Chairman, Ian Peacock, six executive directors and four independent non-executive directors. The Chief Executive Officer is John Hancock. The Board reviews its composition annually and believes that its current composition provides the balance of skills and experience appropriate to achieve the satisfactory execution of the Company's strategy and the size, complexity and geographical spread of the business. Consequently, the Board has no plans to increase the number of independent non-executive directors from four to seven which would be the number required for at least half the Board to comprise independent non-executive directors.

The Board has identified the following non-executive directors as independent in accordance with the definition of independence contained in the new Code:

Tony De Nunzio (Senior Independent Director)
Lesley Knox
Ian Smith
Peter Wallis

Non-executive directors are appointed for an initial term of three years, subject to reappointment by shareholders. Their letters of appointment are available for inspection at the Annual General Meeting and on request. A Committee appointed by the Board comprising the Chairman and Chief Executive Officer agrees the fees of the non-executive directors. The Remuneration Committee determines the Chairman's fee. All directors are subject to reappointment by shareholders at the first annual general meeting following their appointment by the Board and thereafter no more than every three years by rotation under the articles of association.

The separate roles of the Chairman and Chief Executive are clearly defined. The Chairman is responsible for leadership of the Board, ensuring its effectiveness in all aspects of its role and setting its agenda and the Group Chief Executive, for the satisfactory execution of the strategy agreed by the Board working with his fellow Executive Directors and other Executive Committee members.

Appropriate training is available to all directors. Biographical details of the directors are given on page 30.

The Board holds regular meetings and receives accurate and timely information.

Each year the Board meets to examine its performance including its Committees.

A report is provided to this meeting which summarises the feedback given by all directors to an experienced external facilitator on the effectiveness of the Board over the past year. This report is discussed and areas for improvement identified. In addition, the external facilitator reviews feedback from discussions with the members of the Board on the performance of the Chairman with the senior independent director. The Board believes that committed relationships are the essential element of an effective Board.

There is a procedure for all directors to take independent external advice, at the Company's expense, in the course of their duties via the Company Secretary. The Company Secretary is responsible for ensuring that board procedures are followed and all directors have access to his advice and services.

The Board has established Audit, Remuneration and Nominations Committees each with defined

terms of reference. The terms of reference of these Committees are reviewed regularly. Membership of these Committees, which is reviewed annually, is shown on page 77. The terms of reference for each Committee are available on the Company's website.

Audit Committee

The Audit Committee consists of the four independent non-executive directors and is chaired by Tony De Nunzio. The biographies of the independent directors include details of their qualification for their membership of the Committee. The Audit Committee assists the Board in ensuring that the Group's financial systems provide accurate and up-to-date information on its financial position and that the Group's published financial statements represent a true and fair reflection of this position. It also assists the Board in ensuring that appropriate accounting policies, internal controls and compliance procedures are in place and monitors the management of Risk and the effectiveness of the internal audit function by reviewing its work schedule and reports. The Auditors, Deloitte and Touche LLP attend its meetings, as does the head of the Group's internal audit function. During 2003 the Audit Committee met three times.

During the year the Board reviewed the work of the Auditors and agreed that to further safeguard their independent position it would be appropriate for Deloitte to discontinue their role as adviser to the Remuneration Committee. Details of Deloitte's fees for audit and non-audit work during 2003 are on page 58.

Remuneration Committee

The Remuneration Committee consists of the four independent non-executive directors and is chaired by Lesley Knox. It is responsible for advising on the remuneration packages needed to attract, retain and motivate executive directors of the required quality. The Remuneration Committee is responsible for developing strategy and policy on executive remuneration and for deciding on the remuneration packages of individual executive directors and reviews the remuneration and policy of certain other senior executives who are not on the Board. A firm of professional advisers, the Chairman, the Chief Executive Officer and the Company Secretary assists the Committee in its work. Full details on the Committee's work are contained in the remuneration report on pages 33 to 45.

Following a review of the role of Deloitte as advisers to the Committee, it was decided that to further safeguard Deloitte's independent position as Auditors, it would be appropriate for Deloitte to discontinue their role as adviser to the Committee. The Committee has since appointed Ernst & Young as its advisers. Ernst & Young perform no other services

for the Company. The Directors' Remuneration Report on pages 33 to 45 includes details on remuneration policy, terms of appointment and the remuneration of executive directors. During 2003 the Committee met three times.

Nominations Committee

The Nominations Committee consists of the five non-executive directors, four being independent, and is chaired by Ian Peacock. The Committee keeps under review the composition of the Board, including succession, and makes recommendations to the Board for all new appointments and re-appointments.

Relations with shareholders

The Company considers its relationship with both institutional and private investors to be important and readily enters into dialogue with investors. An investor relations website (www.mfigroup.co.uk) provides an ideal channel for communication with existing and potential investors. The Annual General Meeting provides an opportunity for shareholders to put their questions to the directors.

At each of its meetings the Board receives a report from the Finance Director on relations with the major shareholders and developments and changes in their shareholdings and, during the year, it is expected that the Senior Independent Director will attend a number of meetings with shareholders.

At the Annual General Meeting the Company proposes separate resolutions on each substantially separate issue and, except where a poll is called, the numbers of proxy votes cast for and against each resolution is reported after each resolution has been taken. The notice of the Annual General Meeting is sent to shareholders at least twenty working days before the meeting.

Risk and internal control

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness, whilst the role of management is to implement Board policies on risk and control. Such a system is, however, designed to manage rather than eliminate the risks of failure to achieve business objectives. In pursuing these objectives, internal controls can only provide reasonable assurance against misstatement or loss.

The Combined Code recommends that the Board at least annually reviews the effectiveness of the Group's system of internal controls, including financial, operational and compliance controls and risk management. Subsequently the Institute of Chartered Accountants in England and Wales produced further guidance on the wider aspects of internal control in September 1999 (the Turnbull Guidance).

Corporate governance report continued

i Risk

The Board can confirm that for the 2003 financial year, and up to the date of approval of the annual report and financial statements, there has been an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, that is reviewed regularly by the Board and accords with the Turnbull Guidance.

The Risk Committee is chaired by the Chief Operating Officer and is comprised of nine senior executives from the key areas of the business. It is the responsibility of the Risk Committee to review the effectiveness of the risk management process and internal controls, on behalf of the Board. The Risk Committee reports to the Board on how risks are being managed. In addition, there is a mechanism in place to report significant control breakdowns or risk occurrences to the Executive Committee.

An ongoing process for the effective management of risk has been defined by the Risk Committee and is operated in the following stages:

- Risks raised by all areas of the business, through the adoption of both a 'bottom-up' and 'top-down' process are regularly reviewed. The key risks to each business area's objectives are identified and scored for probability and impact. The key controls to manage the risks to the desired level are identified.
- A database of all risks and controls is utilised, and the information filtered to produce a number of generic risk areas, forming a key risk register for the Group.
- The Risk Committee reviews the risks to assess the effectiveness of the risk management strategies.
- Controls, which mitigate or minimise high-level risks, are confirmed as operated via a self-certification process completed by the relevant operational employees.
- The Internal Audit Department conduct Compliance Audits on controls upon which the Group rely upon most to mitigate significant risks.
- Key management are nominated in each business area, and are responsible for reviewing their functions' risk register. Regular reporting on internal and external changes that affect the risks or their importance to the business, and any risk occurrences, are received from these managers.
- The generic risks and their management are regularly reported to and discussed at the Executive Committee.
- An ongoing program to further embed the risk process into the culture of the business is being adhered to. This includes ongoing communication to the Group's employees through such mediums as the Risk Management Intranet Web Site designed to heighten awareness of risk issues and to communicate fully all aspects of the Group's risk process. Open communication is encouraged

between staff, management and the Risk Committee on matters relating to risk and control.

ii Internal control

The Group has an established framework of internal controls, which includes the following key elements:

- Members of the Board have responsibility for monitoring the conduct and operations of individual businesses within the Group. The Group reviews the strategies of the individual businesses and the executive management of each business is accountable for their conduct and performance within the agreed strategies.
- The Group and its subsidiaries operate control procedures designed to ensure complete and accurate accounting of financial transactions, and to limit exposure to loss of assets or fraud. Measures taken include physical controls, segregation of duties in key areas and periodic Internal Audit reviews.
- The Audit Committee meets regularly and its responsibilities are set out above. It receives reports from the Internal Audit function on the results of work carried out under a semi-annually agreed audit programme. The Audit Committee has independent access to the internal and external auditors.
- Internal Audit facilitates a process whereby businesses provide certified statements of compliance with internal financial controls, which are supported by the operation of key controls during the period.

Going concern

After reviewing current performance and detailed forecasts, taking into account available bank facilities and making further enquiries as considered appropriate, the directors are satisfied that the Group has adequate resources to enable it to continue in business for the foreseeable future. For this reason the Board believes it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

Compliance with the Combined Code

The Group has complied with the requirements of the Financial Services Authority relating to the provisions of the Combined Code and with the Turnbull Guidance throughout the period ended on 27 December 2003 and up to the date of approval of the annual report and financial statements.

Gerard Hughes
Secretary

26 February 2004

Independent auditors' report

Independent auditors' report
to the members of MFI Furniture Group Plc

We have audited the financial statements of MFI Furniture Group Plc for the 52 weeks ended 27 December 2003 which comprise the profit and loss account, the balance sheets, the cash flow statement, the statement of total recognised gains and losses, the reconciliation of movements in shareholders' funds, the note of historical cost profits and losses and the related notes 1 to 28. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the directors' remuneration report that is described as having been audited.

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

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the directors' remuneration report. Our responsibility is to audit the financial statements and the part of the directors' remuneration report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company and other members of the group is not disclosed.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services

Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the directors' report and the other information contained in the annual report for the above 52 week period as described in the contents section including the unaudited part of the directors' remuneration report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the directors' remuneration report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the company and the group, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and the group as at 27 December 2003 and of the profit of the group for the 52 week period then ended; and
- the financial statements and part of the directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP
Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London

26 February 2004

Consolidated profit and loss account

For the 52 weeks ended 27 December 2003

	Notes	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Turnover: Group and share of joint ventures	2	1,485.1	1,288.8
Less: Share of joint ventures		(3.6)	(1.4)
Group turnover		1,481.5	1,287.4
Cost of sales		(727.2)	(641.2)
Gross profit		754.3	646.2
Selling and distribution costs		(581.4)	(507.4)
Administrative expenses		(66.6)	(58.9)
Goodwill amortisation		(0.7)	(0.1)
Operating profit	2, 4	105.6	79.8
Share of operating loss of joint ventures		(2.1)	(2.0)
Total operating profit – Group and share of joint ventures		103.5	77.8
Net profit on disposal of fixed assets	5	14.1	0.1
Profit on ordinary activities before interest		117.6	77.9
Interest receivable and similar income	6	1.5	3.2
Interest payable and similar charges	7	(1.2)	(0.3)
Profit on ordinary activities before taxation		117.9	80.8
Tax on profit on ordinary activities	8	(31.1)	(23.4)
Profit for the financial period		86.8	57.4
Dividends paid and proposed	9	(21.9)	(17.4)
Amount transferred to reserves	22	64.9	40.0

Earnings per share

Basic earnings per 10p ordinary share	10	15.4p	10.2p
Diluted earnings per 10p ordinary share	10	14.3p	9.5p

Earnings per share before profit on sales of fixed assets

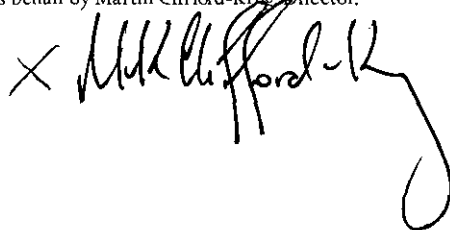
Basic earnings per 10p ordinary share	10	12.9p	10.2p
Diluted earnings per 10p ordinary share	10	12.0p	9.5p

All results are derived from continuing operations

Consolidated balance sheet

	Notes	27 Dec 2003 £m	28 Dec 2002 £m
Fixed assets			
Intangible assets	11	14.5	14.6
Tangible assets	12	387.0	356.8
Investments	13	51.3	46.1
Total fixed assets		452.8	417.5
Current assets			
Stocks	14	195.7	177.1
Debtors – due within one year	15	141.9	122.9
– due after one year	15	46.0	1.1
Investments	16	11.8	6.9
Cash at bank and in hand		48.8	33.3
		444.2	341.3
Creditors			
Amounts falling due within one year	17	334.9	316.0
Net current assets		109.3	25.3
Total assets less current liabilities		562.1	442.8
Creditors			
Amounts falling due after more than one year	18	51.5	2.8
Provisions for liabilities and charges	20	21.2	21.9
Net assets		489.4	418.1
Capital and reserves			
Called up share capital	21	62.0	61.3
Share premium account	22	65.8	62.1
Revaluation reserve	22	22.3	40.0
Other reserves	22	26.7	24.3
Profit and loss account	22	312.6	230.4
Equity shareholders' funds		489.4	418.1

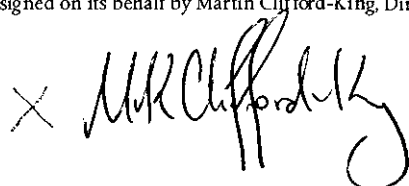
These financial statements were approved by the Board of Directors on 26 February 2004 and were signed on its behalf by Martin Clifford-King, Director.

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Company balance sheet

	Notes	27 Dec 2003 £m	28 Dec 2002 £m
Fixed assets			
Investments	13	841.4	840.2
Current assets			
Debtors – due within one year	15	67.3	327.6
– due after one year	15	46.0	–
Cash at bank and in hand		24.0	1.2
		137.3	328.8
Creditors			
Amounts falling due within one year	17	79.8	301.3
Net current assets		57.5	27.5
Creditors			
Amounts falling due after more than one year	18	50.0	–
Net assets		848.9	867.7
Capital and reserves			
Called up share capital	21	62.0	61.3
Share premium account	22	65.8	62.1
Other reserves	22	482.6	482.6
Profit and loss account	22	238.5	261.7
Equity shareholders' funds		848.9	867.7

These financial statements were approved by the Board of Directors on 26 February 2004 and were signed on its behalf by Martin Clifford-King, Director

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Consolidated cash flow statement

For the 52 weeks ended 27 December 2003

	Notes	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Net cash inflow from operating activities	24	93.6	138.0
Returns on investments and servicing of finance	24	0.3	2.9
Taxation		(22.2)	(16.2)
Capital expenditure and financial investment	24	(85.1)	(117.5)
Acquisitions	24	–	(8.5)
Equity dividends paid		(19.7)	(16.0)
Cash outflow before use of liquid resources and financing		(33.1)	(17.3)
Management of liquid resources		(4.9)	(6.7)
Financing	24	52.9	5.5
Increase/(decrease) in cash in the period		14.9	(18.5)

Reconciliation of net cash flow to movement in net funds

For the 52 weeks ended 27 December 2003

	Notes	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Increase/(decrease) in cash in the period		14.9	(18.5)
Cash movement on:			
– bank loans		(48.7)	–
– debt and lease financing		–	(0.1)
– cash flow from increase in liquid resources		4.9	6.7
Change in net funds resulting from cash flows		(28.9)	(11.9)
Foreign currency translation differences	24	0.6	(0.3)
Movement in net funds in the period		(28.3)	(12.2)
Net funds at the beginning of the period	24	38.9	51.1
Net funds at the end of the period	24	10.6	38.9

Statement of total recognised gains and losses

For the 52 weeks ended 27 December 2003

	Group		Company	
	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Profit/(loss) for the financial period	86.8	57.4	(1.3)	2.1
Translation differences on foreign currency denominated net investments	2.2	(2.8)	—	—
Total recognised gains and losses for the financial period	89.0	54.6	(1.3)	2.1

Reconciliation of movements in consolidated equity shareholders' funds

For the 52 weeks ended 27 December 2003

	Group		Company	
	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Total recognised gains and losses for the financial period	89.0	54.6	(1.3)	2.1
Dividends	(21.9)	(17.4)	(21.9)	(17.4)
Net addition to equity shareholders' funds	67.1	37.2	(23.2)	(15.3)
Equity shareholders' funds at the beginning of the period	418.1	375.5	867.7	868.1
Shares issued	4.2	5.4	4.4	14.9
Equity shareholders' funds at the end of the period	489.4	418.1	848.9	867.7

Note of historical cost profits and losses

For the 52 weeks ended 27 December 2003

	Group	
	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Reported profit on ordinary activities before taxation	117.9	80.8
Realisation of property revaluation gains of previous periods	17.7	2.1
Historical cost profit on ordinary activities before taxation	135.6	82.9
Historical cost profit for the period retained after taxation and dividends	82.6	42.1

Notes to the financial statements

1. Accounting policies

Accounting convention

These financial statements have been prepared in accordance with applicable United Kingdom Accounting Standards under the historical cost convention as modified by the revaluation of certain land and buildings. The following principal accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group's financial statements.

The transitional disclosures associated with the adoption of FRS 17 'Retirement Benefits' have been applied.

Basis of preparation

The consolidated financial statements include the financial statements of MFI Furniture Group Plc and all its subsidiary undertakings for the 52 week period ended 27 December 2003, being within seven days of the Company's accounting reference date of 31 December.

These financial statements do not include a separate profit and loss account for MFI Furniture Group Plc (the parent company) as permitted by Section 230 of the Companies Act 1985.

Turnover

Turnover represents the net value of goods sold, based on despatch, or services provided to customers outside the Group excluding value added tax. We have reviewed our revenue recognition policies for compliance with Application Note G to FRS 5 'Reporting the substance of transactions', issued in November 2003, and no changes in policy were required.

Goodwill

Purchased goodwill, arising on the acquisition in 1987 of the assets and business now conducted by MFI UK Limited, is being transferred from other reserves to the profit and loss account reserve over a period of 40 years.

Goodwill arising on all acquisitions prior to 24 April 1999 (MFI's old accounting period) remains eliminated against reserves. This goodwill will be charged to the profit and loss account on subsequent disposal of the business to which it relates. Goodwill arising on acquisitions after 24 April 1999 is treated as an asset on the balance sheet and amortised over a period of 20 years.

Joint ventures and fixed asset investments

Joint ventures are accounted for in the financial statements of the Group under the gross equity method of accounting. Investments are stated at cost less any provision for impairment.

Interest in shares of MFI Furniture Group Plc

Shares held by the employee share ownership trusts are recorded in the balance sheet within fixed asset investments at cost including expenses less amounts written off.

Revaluation of fixed assets

FRS 15 'Tangible fixed assets' has been adopted and the directors have decided that, as permitted by the transitional provisions of the standard, properties at valuation have been retained on the basis of their valuation at 1 January 2000. Freehold and long leasehold properties are included in fixed assets at their latest valuation at that date plus subsequent additions at cost, less depreciation. Surpluses on revaluation are included in the revaluation reserve and deficits are realised in the profit and loss account.

Depreciation

Depreciation is provided to write off the difference between the cost or valuation of tangible fixed assets, excluding freehold land, and their residual value over their estimated useful lives on a straight-line basis.

The current range of useful lives is as follows:

Freehold buildings	50 years
Long leasehold property	over period of lease
Short leasehold property	over period of lease
Fixtures and fittings	1-10 years
Plant and machinery	3-10 years

Stocks

Stocks are stated at the lower of cost and net realisable value. Cost includes an attributable proportion of manufacturing overheads based on normal levels of activity. Provision is made for obsolete, slow-moving or defective items where appropriate.

Notes to the financial statements continued

1. Accounting policies continued

Deferred taxation

Deferred taxation is provided on a full provision basis, without discounting, on all timing differences which have arisen but not reversed at the balance sheet date. Except where otherwise required by Accounting Standards no timing differences are recognised in respect of:

- property revaluation surpluses where there is no commitment to sell the asset, and
- gains on sale of assets where those assets have been rolled over into replacement assets, and
- additional tax which would arise if profits of overseas subsidiaries were distributed, and
- deferred tax assets to the extent that they are regarded as not likely to be recovered.

Financial instruments

The Group uses derivative financial instruments to manage its exposure to interest rate and foreign exchange risks. These may include interest rate swaps and forward currency contracts. Amounts payable or receivable in respect of interest rate derivatives are accrued with net interest payable over the period of the contract. Accounting for foreign currency transactions is described in the foreign currency policy set out below. Note 19 includes disclosures required under FRS 13 'Derivatives and other financial instruments'.

Foreign currency

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account. Gains or losses arising from foreign exchange hedged contracts are taken to the profit and loss account in line with the transactions which they are hedging.

For consolidation purposes, the assets and liabilities of overseas subsidiary undertakings and branches are translated at the closing exchange rates, with the profit and loss account being translated at the average rate applying during the period in which the transactions took place. Exchange differences arising on these translations are taken to reserves.

Leased assets

Assets held under finance leases are capitalised as tangible fixed assets and depreciated over the shorter of their estimated useful lives and the period of the lease. Rentals are apportioned between reductions in the capital obligations included in creditors and finance charges which are charged to the profit and loss account at a constant effective rate of interest.

Benefits, receivable as incentives to enter into property leases, being reverse premiums and post-opening rent-free periods, are spread evenly over the period to the first rent review date. Pre-opening expenses are charged to the profit and loss account as incurred.

Pensions

The Group operates two defined benefit funded pension schemes for directors and other employees.

The pension costs are assessed in accordance with the advice of an independent qualified actuary and are charged to the profit and loss account so as to spread the costs over the expected remaining lives of employees. Both pension schemes are subject to actuarial valuation every three years.

The accounting policy follows the funding policy except where an actuary valuation indicates a surplus or deficiency. Such surpluses or deficiencies are, for funding purposes, dealt with as advised by the actuary. For accounting purposes they are spread over the expected remaining service lives of the participating employees.

2. Segmental analysis

	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Turnover¹		
Howden Joinery	448.1	326.9
UK Retail	910.9	861.4
France Retail	114.2	94.2
Howden Millwork	5.1	2.0
Other operations	3.2	2.9
	1,481.5	1,287.4
Joint venture operations	3.6	1.4
Total turnover	1,485.1	1,288.8
Profit before taxation²		
Howden Joinery	72.0	44.4
UK Retail	41.7	37.7
France Retail	0.3	2.3
Howden Millwork	(8.4)	(4.5)
Other operations	–	(0.1)
Operating profit	105.6	79.8
Joint venture operations	(2.1)	(2.0)
Total operating profit	103.5	77.8
Profit on disposal of fixed assets	14.1	0.1
Net interest receivable	0.3	2.9
Profit before taxation	117.9	80.8
Net assets		
Howden Joinery	132.8	85.6
UK Retail	270.8	229.4
France Retail	39.1	29.3
Howden Millwork	4.6	4.6
Other operations	1.3	1.5
Joint venture operations	1.1	2.1
	449.7	352.5
Unallocated net assets ³	39.7	65.6
Total net assets	489.4	418.1

1. The analysis of turnover by destination is not materially different from the analysis of turnover by origin.

2. All results are from continuing operations.

3. Unallocated net assets comprise balances in respect of dividends, cash, borrowing and investment in own shares.

Notes to the financial statements continued

3. Staff costs

The aggregate pay roll costs of employees, including executive directors, were:

	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Wages and salaries	306.0	260.6
Social security costs	24.6	21.9
Other pension costs (note 23)	10.5	10.7
	341.1	293.2

The average number of persons (full time equivalent including executive directors) employed by the Group during the period was as follows:

	52 weeks to 27 Dec 2003	52 weeks to 28 Dec 2002
Howden Joinery	2,433	1,913
UK Retail	6,244	5,596
France Retail	829	760
Howden Millwork	96	60
Manufacturing	2,454	2,622
Other operations	15	13
Continuing operations	12,071	10,964

Details of directors' remuneration, including pension entitlements and share option interests, are disclosed in the Report on Remuneration on pages 33 to 45.

4. Operating profit

	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Operating profit from continuing activities is stated after charging/(crediting):		
Operating lease payments		
– Hire of plant and equipment	8.4	10.6
Operating lease payments		
– Land and buildings	92.5	86.1
– Rent receivable	(14.1)	(15.7)
– Net rent payable	78.4	70.4
Depreciation – owned assets	47.5	40.2
Amortisation of goodwill	0.7	0.1
Auditors' remuneration		
– Audit work	0.3	0.3
– Other fees paid to the auditor and its associates:		
– Tax	0.4	–
– Other assurance	0.3	–
– Remuneration consultancy	0.2	0.1

Auditors' remuneration in respect of the statutory audit of the Company was £2,000 (2002 – £2,000).

5. Profit on disposal of fixed assets

The profit on disposal of fixed assets of £14.1m (2002 – £0.1m) represents net profits on disposal of land and buildings.

The associated tax charge is £nil (2002 – £nil) as the profit is offset by available tax losses.

6. Interest receivable and similar income

	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Bank interest receivable	1.5	2.9
Other sundry income	–	0.3
	1.5	3.2

7. Interest payable and similar charges

	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Bank loans	1.2	0.3

8. Tax on profit on ordinary activities

	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Taxation on profit for the period comprises:		
UK corporation tax at 30.0% (2002 – 30.0%)	32.8	19.0
Adjustment relating to prior periods	(5.3)	(4.0)
Total current tax charge	27.5	15.0
Deferred tax	3.6	8.4
	31.1	23.4

The taxation charge is calculated at 30.0% (2002 – 29.0%) on profits before profit on disposal of fixed assets.

No tax arises on the disposal of fixed assets as explained in note 5.

Factors affecting current period corporation tax

The current period corporation tax assessed for the period is lower than the standard rate of corporation tax of 30% (2002 – 30%) for the following reasons:

	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Profit on ordinary activities before taxation	117.9	80.8
Corporation tax at the standard rate	35.3	24.2
Capital allowances in excess of depreciation	(5.3)	(4.6)
Movements in short term timing differences	2.3	(4.5)
Expenses not deductible for tax	0.9	–
Benefit of overseas tax losses not taken	0.7	0.5
Capital losses utilised	(4.2)	–
Non-qualifying depreciation	3.1	3.4
Adjustment relating to prior periods	(5.3)	(4.0)
Total current tax charge	27.5	15.0

Notes to the financial statements continued

9. Equity dividends

	52 weeks to 27 Dec 2003 £m	52 weeks to 28 Dec 2002 £m
Interim paid – 1.8 pence per share (2002 – 1.5 pence per share)	10.3	8.0
Final proposed – 2.0 pence per share (2002 – 1.6 pence per share)	11.6	9.4
Total dividend – 3.8 pence per share (2002 – 3.1 pence per share)	21.9	17.4

10. Earnings per share

Earnings per share for the 52 weeks to 28 December 2002 have been restated to exclude shares held by the Group's employee share trusts in accordance with FRS 14 'Earnings per share'.

	52 weeks to 27 December 2003			52 weeks to 28 December 2002		
	Earnings £m	Weighted average number of shares m	Earnings per share p	Earnings £m	Weighted average number of shares m	Earnings per share p
Basic earnings per share						
Earnings attributable to ordinary shares	86.8	565.4	15.4	57.4	564.3	10.2
Effect of dilutive share options	–	41.3	(1.1)	–	39.5	(0.7)
Diluted earnings per share	86.8	606.7	14.3	57.4	603.8	9.5
Reconciliation of earnings per share to exclude profit on sale of fixed assets						
Basic earnings per share	86.8	565.4	15.4	57.4	564.3	10.2
Profit on sale of fixed assets	(14.1)	–	(2.5)	(0.1)	–	–
Basic earnings per share before profit on sale of fixed assets	72.7	565.4	12.9	57.3	564.3	10.2
Diluted earnings per share	86.8	606.7	14.3	57.4	603.8	9.5
Profit on sale of fixed assets	(14.1)	–	(2.3)	(0.1)	–	–
Diluted earnings per share before profit on sale of fixed assets	72.7	606.7	12.0	57.3	603.8	9.5

Earnings per share before profit on sale of fixed assets has been calculated to show the impact of these exceptional items as they can have a distorting effect on earnings and therefore warrant separate consideration.

11. Intangible fixed assets

	Goodwill £m
Cost	
At 28 December 2002	14.7
Additions	0.6
At 27 December 2003	15.3
Amortisation	
At 28 December 2002	0.1
Charge in the period	0.7
At 27 December 2003	0.8
Net book value at 27 December 2003	14.5
Net book value at 28 December 2002	14.6

2002 acquisition of Sofa Workshop

The fair value of the net assets has been revised downwards by £0.6m during the year.

This is principally due to the recognition of a warranty provision.

12. Tangible fixed assets

	Freehold properties £m	Leasehold properties		Plant and machinery £m	Fixtures and fittings £m	Capital work in progress £m	Total £m
		over 50 years £m	under 50 years £m				
Group							
Cost or valuation							
At 28 December 2002	117.1	46.8	64.3	227.1	167.1	4.8	627.2
Additions	1.5	0.5	7.8	22.0	55.9	24.5	112.2
Disposals	(24.0)	(15.9)	(5.0)	(17.1)	(16.7)	—	(78.7)
Reclassifications	(0.5)	—	0.5	—	0.1	(0.1)	—
At 27 December 2003	94.1	31.4	67.6	232.0	206.4	29.2	660.7
Depreciation							
At 28 December 2002	4.3	3.2	22.8	150.3	89.8	—	270.4
Charge for the period	2.6	4.3	5.3	13.5	21.8	—	47.5
Disposals	(2.4)	(3.2)	(4.8)	(17.1)	(16.7)	—	(44.2)
At 27 December 2003	4.5	4.3	23.3	146.7	94.9	—	273.7
Net book value at							
27 December 2003	89.6	27.1	44.3	85.3	111.5	29.2	387.0
Net book value at							
28 December 2002	112.8	43.6	41.5	76.8	77.3	4.8	356.8

Included in plant and machinery at 27 December 2003 were capitalised leases comprising cost of £nil (2002 – £4.2m), depreciation of £nil (2002 – £1.3m) and net book value of £nil (2002 – £2.9m). Depreciation charged during the period in respect of these assets amounted to £nil (2002 – £0.3m).

Notes to the financial statements continued

12. Tangible fixed assets continued

Freehold properties cost or valuation includes land of £38.6m (2002 – £55.1m) on which depreciation is not provided. The directors have decided that, as permitted by FRS 15 'Tangible fixed assets', properties at valuation will be retained on the basis of their valuation at 1 January 2000. The last revaluation performed was in April 1999 when the Group's UK freehold land and buildings together with the UK long leasehold properties were valued by Fisher Wilson Property Consultants and King Sturge & Co who are both external qualified valuers and members of the Royal Institute of Chartered Surveyors ('RICS'). Properties were valued on an open market value for existing use or depreciated replacement cost bases, as appropriate, in accordance with the RICS Appraisal and Valuation Manual. Vacant properties were valued on an open market value basis.

Freehold and long leasehold properties at 27 December 2003 comprise:

	Freehold properties £m	Leasehold properties over 50 years £m	Overseas freehold and long leasehold £m	Total £m
Cost	90.3	28.0	10.0	128.3
Accumulated depreciation	(11.7)	(11.2)	(3.8)	(26.7)
Historical book value	78.6	16.8	6.2	101.6
1999 revaluation surplus	11.1	11.2	–	22.3
1999 revaluation deficits	(5.6)	(1.6)	–	(7.2)
Net book value at 27 December 2003	84.1	26.4	6.2	116.7

13. Fixed asset investments

	Investment in own shares (note 21) £m	Shares in subsidiary undertakings at cost £m	Long-term loans to subsidiary undertakings £m	Other unlisted investments £m	Share of joint ventures £m	Total £m
<i>Group</i>						
At 28 December 2002	36.0	–	–	8.0	2.1	46.1
Additions	14.7	–	–	–	1.1	15.8
Amortised	(8.5)	–	–	–	–	(8.5)
Losses for the period	–	–	–	–	(2.1)	(2.1)
At 27 December 2003	42.2	–	–	8.0	1.1	51.3
<i>Company</i>						
At 28 December 2002	16.9	2.5	816.8	4.0	–	840.2
Additions	–	–	0.3	0.9	–	1.2
At 27 December 2003	16.9	2.5	817.1	4.9	–	841.4

The investment in own shares comprises shares held in three employee share ownership trusts, which the Company and employing companies in the Group have funded as set out in note 21. Other unlisted investments in the Company balance sheet of £4.9 million comprises investments in joint ventures. The joint venture net assets have not been grossed up on the face of the balance sheet as the amounts are not yet material. Gross assets at 27 December 2003 totalled £2.7m (2002 – £3.3m) and gross liabilities totalled £1.6m (2002 – £1.3m).

Details of principal subsidiary undertakings are given on page 76.

14. Stocks

	Group	
	27 Dec 2003 £m	28 Dec 2002 £m
Raw materials	9.3	11.4
Work in progress	7.2	6.5
Finished goods and goods for resale	179.2	159.2
	195.7	177.1

The replacement cost of stock is not materially different from its balance sheet value.

15. Debtors

	Group		Company	
	27 Dec 2003 £m	28 Dec 2002 £m	27 Dec 2003 £m	28 Dec 2002 £m
Trade debtors	82.6	69.4	—	—
Amounts owed by subsidiary undertakings	—	—	—	304.8
Other debtors	4.6	2.9	28.3	0.1
Corporation tax	—	—	38.1	22.7
Prepayments and accrued income	54.7	50.6	0.9	—
Total amounts falling due within one year	141.9	122.9	67.3	327.6
Other debtors:				
Total amounts falling due after more than one year	46.0	1.1	46.0	—
Total debtors	187.9	124.0	113.3	327.6

16. Current asset investments

	Group	
	27 Dec 2003 £m	28 Dec 2002 £m
Money fund deposits	11.8	6.9

£11.8m (2002 – £6.7m) is held in escrow accounts to cover potential future insurance liabilities.

17. Creditors

Amounts falling due within one year:

	Group		Company	
	27 Dec 2003 £m	28 Dec 2002 £m	27 Dec 2003 £m	28 Dec 2002 £m
Amounts owed to subsidiary undertakings	—	—	54.3	291.6
Trade creditors	140.7	128.7	—	—
Corporation tax	19.8	14.5	—	—
Other taxation and social security	21.8	21.3	12.2	—
Proposed dividends	11.6	9.3	11.6	9.4
Other creditors	22.8	17.9	—	—
Accruals and deferred income	118.2	124.3	1.7	0.3
	334.9	316.0	79.8	301.3

Notes to the financial statements continued

18. Creditors

Amounts falling due after more than one year:

	Group		Company	
	27 Dec 2003 £m	28 Dec 2002 £m	27 Dec 2003 £m	28 Dec 2002 £m
Bank loans	50.0	1.3	50.0	–
Other creditors	1.5	1.5	–	–
	51.5	2.8	50.0	–

19. Derivatives and other financial instruments

A discussion of treasury policy is given in the Operating and financial review on pages 20 to 25. Short term debtors and creditors have been excluded from all the following disclosures, other than currency risk disclosures.

	Group		Company	
	27 Dec 2003 £m	28 Dec 2002 £m	27 Dec 2003 £m	28 Dec 2002 £m
Borrowings				
Loans or instalments due within one year	–	–	–	–
Total borrowings due within one year	–	–	–	–
Loans or instalments payable between one and two years	–	1.3	–	–
Total borrowings due after more than one year	50.0	1.3	50.0	–
Total borrowings	50.0	1.3	50.0	–

Undrawn committed borrowing facilities available to the Group at 27 December 2003 were £135m (2002 – £nil), expiring after 5 years.

Maturity of other financial liabilities

	27 Dec 2003 £m	28 Dec 2002 £m
Amounts falling due:		
In one year or less or on demand	1.5	1.1
In more than one year but not more than two years	–	1.5
	1.5	2.6

Other financial liabilities include loan notes arising on the acquisition of Sofa Workshop.

Currency and interest rate risk profile of borrowings in Sterling

	Total £m	Floating rate £m	Fixed rate £m	Weighted average fixed interest rate %	Weighted average period for which rate is fixed Years
At 28 December 2002	1.3	1.3	–	–	–
At 27 December 2003	50.0	50.0	–	–	–

The interest on floating rate borrowings is based on LIBOR and is fixed in advance for periods of up to 6 months.

19. Derivatives and other financial instruments continued

The following summary shows the Group's currency exposures that give rise to currency gains and losses recognised in the profit and loss account, arising from exposures where monetary assets and liabilities of the Group are not denominated in the operating currency of the subsidiary company concerned.

Net foreign monetary liabilities

Functional currency of entity	27 Dec 2003				28 Dec 2002			
	Euro £m	US dollar £m	Others £m	Total £m	Sterling £m	Euro £m	Others £m	Total £m
Sterling	(24.2)	(0.7)	(0.9)	(25.8)	–	(29.6)	(4.6)	(34.2)
Euro	–	–	–	–	(19.7)	–	–	(19.7)

Currency and interest rate risk profile of financial assets

	27 Dec 2003			28 Dec 2002		
	Cash at bank and in hand £m	Short term deposits £m	Total £m	Cash at bank and in hand £m	Short term deposits £m	Total £m
Sterling	37.3	11.8	49.1	25.4	6.9	32.3
Euro	10.2	–	10.2	7.1	–	7.1
Other currencies	1.3	–	1.3	0.8	–	0.8
	48.8	11.8	60.6	33.3	6.9	40.2

All cash and deposits earn floating rate interest based on relevant national LIBID equivalents.

Primary financial instruments held or issued to finance the Group's operations

	27 Dec 2003		28 Dec 2002	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Cash at bank and in hand*	48.8	48.8	33.3	33.3
Short term deposits	11.8	11.8	6.9	6.9
Short term borrowings	(50.0)	(50.0)	–	–
Medium and long term borrowings	–	–	(1.3)	(1.3)
Other financial liabilities	–	–	(2.6)	(2.6)

* Cash at bank and in hand is the result of netting off cash book overdrafts with cash book balances held at the same bank.

Derivative financial instruments held to manage the currency profile

	27 Dec 2003		28 Dec 2002	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Foreign currency forward contracts	–	(1.8)	–	0.6

Other financial liabilities, short term borrowings, cash at bank and in hand and short term deposits: the fair value approximates to the carrying value due to the short maturity periods of these financial instruments. Medium and long term borrowings: the fair value is based on market values or where these are not available, on the quoted market price of comparable debt issued by other companies.

The unrecognised loss on forward foreign exchange contracts as at 27 December 2003 amounted to £1.8m (28 December 2002 – unrealised profit of £0.6m). All contracts arose during the current year.

Notes to the financial statements continued

20. Provisions for liabilities and charges

Group	Pension provision £m	Property provision £m	Deferred taxation (note 8) £m	Total £m
At 28 December 2002	9.2	3.0	9.7	21.9
Created in the period	—	—	3.6	3.6
Utilised in the period	(2.3)	(2.0)	—	(4.3)
At 27 December 2003	6.9	1.0	13.3	21.2

The pension provision represents the cumulative difference between the pension charge and the amounts contributed to the schemes, which have been funded by the Group.

The property provision represents provision for future rental payments on properties no longer used by the Group.

The deferred taxation liability is analysed as follows:

	27 Dec 2003 £m	28 Dec 2002 £m
Accelerated capital allowances	23.4	14.7
Other timing differences	(10.1)	(5.0)
	13.3	9.7

The deferred tax asset in respect of timing differences includes assets relating to share scheme costs, pension costs, and losses not currently utilised.

The timing differences in respect of property revaluation surpluses amounting to £6.7m (2002 – £12.6m), and gains on the sale of assets which have been rolled over into replacement assets, are covered by capital losses. No timing difference has been recognised for the benefit of overseas tax losses amounting to £2.7m (2002 – £0.5m).

21. Called up share capital

Ordinary Shares of 10p each

Authorised	Number	£m
At the beginning and end of the period	775,152,000	77.5
Alotted & fully paid	Number	£m
At 28 December 2002	612,726,578	61.3
Issued during the period	7,326,262	0.7
At 27 December 2003	620,052,840	62.0

21. Called up share capital continued

At 27 December 2003 the following options were in existence:

Share scheme	Date granted	No. of options	Exercise price	Option period
Executive share options	15 December 1994	102,800	124p	Dec 1997 – Dec 2004
	3 July 1995	276,800	115p	July 1998 – July 2005
	2 July 1996	110,704	180p	July 1999 – July 2006
	1 July 1997	27,245	129p	July 2000 – July 2004
	1 July 1998	1,118,819	63p	July 2001 – July 2005
	5 March 1999	785,000	35p	Mar 2002 – Mar 2006
	6 September 1999	705,000	39p	Sept 2002 – Sept 2006
	27 September 1999	1,619,422	42p	Sept 2002 – Sept 2009
	28 September 2000	520,000	62.75p	Sept 2003 – Sept 2010
	13 November 2000	296,429	56p	Nov 2003 – Nov 2010
	22 December 2000	583,941	68.5p	Dec 2003 – Dec 2010
	15 January 2001	590,000	79.25p	Jan 2004 – Jan 2011
	20 March 2001	320,000	96.75p	Mar 2004 – Mar 2011
	14 May 2001	160,000	123p	May 2004 – May 2011
	30 September 2002	128,565	131p	Sept 2005 – Sept 2012
	29 September 2003	213,615	181p	Sept 2006 – Sept 2013
Performance options	19 May 2000	4,864,469	68.25p	May 2003 – May 2010
	22 December 2000	1,167,883	68.5p	Dec 2003 – Dec 2010
	30 May 2001	3,446,895	124.75p	May 2004 – May 2011
	12 June 2001	260,773	131.5p	June 2004 – June 2011
	26 July 2002	666,666	114p	July 2005 – July 2012
	26 July 2002	9,416,428	114p	July 2005 – July 2012
Sharesave options	30 October 2003	5,692,775	184p	Nov 2008 – Apr 2009

	As at 28 Dec 2002	Options lapsed	Options granted	Options exercised	As at 27 Dec 2003
Executive share options					
15 December 1994	102,800	–	–	–	102,800
3 July 1995	*510,200	–	–	(233,400)	276,800
2 July 1996	351,200	(240,496)	–	–	110,704
1 July 1997	77,245	–	–	(50,000)	27,245
1 July 1998	1,873,400	–	–	(754,581)	1,118,819
5 March 1999	785,000	–	–	–	785,000
6 September 1999	705,000	–	–	–	705,000
27 September 1999	4,871,880	(66,200)	–	(3,186,258)	1,619,422
28 September 2000	1,040,000	–	–	(520,000)	520,000
13 November 2000	350,000	–	–	(53,571)	296,429
22 December 2000	583,941	–	–	–	583,941
15 January 2001	590,000	–	–	–	590,000
20 March 2001	320,000	–	–	–	320,000
14 May 2001	160,000	–	–	–	160,000
30 September 2002	218,048	(89,483)	–	–	128,565
29 September 2003	–	–	213,615	–	213,615
Sub-total c/f	12,538,714	(396,179)	213,615	(4,797,810)	7,558,340

Notes to the financial statements continued

21. Called up share capital continued

	As at 28 Dec 2002	Options lapsed	Options granted	Options exercised	As at 27 Dec 2003
Sub-total b/f	12,538,714	(396,179)	213,615	(4,797,810)	7,558,340
Performance options					
19 May 2000	7,010,784	–	–	(2,146,315)	4,864,469
8 June 2000	23,619	–	–	(23,619)	–
22 December 2000	1,167,883	–	–	–	1,167,883
30 May 2001	3,446,895	–	–	–	3,446,895
12 June 2001	*446,470	–	–	(185,697)	260,773
26 July 2002	666,666	–	–	–	666,666
26 July 2002	9,416,428	–	–	–	9,416,428
	34,717,459	(396,179)	213,615	(7,153,441)	27,381,454
Sharesave options					
19 August 1999	517,818	(344,997)	–	(172,821)	–
30 October 2003	–	–	5,692,775	–	5,692,775
	35,235,277	(741,176)	5,906,390	(7,326,262)	33,074,229

*Restated for lapsed options.

Employee share schemes (note 13)

The Company maintains three employee share ownership trusts, which hold shares in MFI Furniture Group Plc.

These are summarised as follows:

Name of Trust	Shareholding (number of shares)	Value on 27 Dec 2003 £000	Dividends waived
MFI Employee Share Trust	31,936,715	46,308	Yes
MFI Employee Benefit Trust	190,000	276	No
MFI FreeShare Trust	2,517,732	3,651	No
Individual nominee accounts	15,400,927	22,331	Yes

The trusts have been funded by the employing companies in the Group to acquire shares in MFI Furniture Group Plc. The cost of running these trusts is included in the profit and loss account. The trusts undertake the following activities:

MFI Employee Share Trust

- to transfer shares to executive directors when shares vest under MFI share plans.
- to transfer shares to employees on exercise of various options and awards granted under MFI share plans.

MFI Employee Benefit Trust

- to transfer shares to employees under the MFI Group Profit Sharing Trust.

MFI FreeShare Trust

- to transfer shares to employees when shares vest under the MFI FreeShare Plan.

22. Reserves

Group

	Share premium account £m	Other reserves £m	Revaluation reserve £m	Profit and loss account £m
At 28 December 2002	62.1	24.3	40.0	230.4
Retained profit for the period	—	—	—	64.9
Shares issued	3.7	—	—	(0.2)
Amortisation of goodwill	—	2.4	—	(2.4)
Realised revaluation surplus	—	—	(17.7)	17.7
Foreign exchange	—	—	—	2.2
At 27 December 2003	65.8	26.7	22.3	312.6

The cumulative amount of goodwill written off against Group profit and loss account reserves in respect of acquisitions prior to 24 April 1999 when FRS 10 'Goodwill and intangible assets' was adopted amounts to £504.6m (28 December 2002 – £504.6m).

Company

	Share premium account £m	Other reserves £m	Profit and loss account £m
At 28 December 2002	62.1	482.6	261.7
Retained loss for the period	—	—	(23.2)
Shares issued	3.7	—	—
At 27 December 2003	65.8	482.6	238.5

The loss after tax for the financial period in the Financial Statements of the Company was £1.3m (2002 – profit of £2.1m). The other reserve in the Company was created as a result of a capital reduction in November 1993 and is not distributable.

23. Pensions

The Group operates two funded schemes, which provide benefits based on the final pensionable pay of participating employees. The assets of the schemes are held separately from those of the Group, being invested with independent fund managers. Contributions are charged to the consolidated profit and loss account so as to spread the cost of pensions over employees' working lives with the Group. The charges are determined by a qualified actuary on the basis of triennial valuations using the projected unit method. The most recent valuations of the schemes were at 6 April 2002.

The valuation of the MFI Group Pension Plan, the principal scheme, showed that the scheme had a market value of assets of £253m at that time and that the actuarial value of those assets represented 95% of the benefits that had accrued to the members, after allowing for agreed changes to members' benefits and for future expected increases in earnings. This deficit, taking into account the pension provision in the consolidated balance sheet (see note 20), is being recognised in the profit and loss account over the expected remaining service lives of the members of the scheme. This deficit will have increased by 27 December 2003 due to the decline in stock market values since April 2002.

The principal actuarial assumptions used are an investment return of 6.75% per annum, rates of salary increase of 3.75% per annum and rates of 2.5% per annum for pensions in payment in excess of the Guaranteed Minimum Pension accrued pre and post 6 April 1987 respectively. The actuarial assumptions for the previous valuation used for the period to 6 April 2002 are an investment return of 8% per annum, rates of salary increase of 6% per annum and rates up to 5% per annum for pensions in payment.

The total pension charge for the period was £10.5m (2002 – £10.7m).

Notes to the financial statements continued

23. Pensions continued

Additional disclosures regarding the Group's defined benefit pension schemes are required under the transitional provisions of FRS 17 'Retirement benefits' and these are set out below. The disclosures relate to the second year of the transitional provisions.

The actuarial valuation of the schemes as at 6 April 2002 was updated to 31 December 2003 on a basis consistent with the requirements of FRS 17 and is reported below. It showed that the market value of the schemes' assets was £276m and that the actuarial value of these assets represented 66% of the benefits that had accrued to members. The weighted average major assumptions used for this update were:

	31 Dec 2003	31 Dec 2002	31 Dec 2001
Rate of increase in salaries	3.0%	3.0%	4.0%
Rate of increase in pensions in payment (pre 6 April 1997)	3.0%	3.0%	3.0%
Rate of increase in pensions in payment (post 6 April 1997)	2.5%	2.0%	2.5%
Discount rate	5.5%	5.5%	6.5%
Inflation assumption	2.5%	2.0%	2.5%

The fair value of the assets in the schemes, the present value of the liabilities in the schemes and the expected weighted average rate of return at each balance sheet date were:

	31 December 2003		31 December 2002		31 December 2001	
	Long term rate of expected return	Value £m	Long term rate of expected return	Value £m	Long term rate of expected return	Value £m
Equities	8.00%	212.3	7.5%	170.2	8.5%	199.8
Bonds	5.00%	55.1	4.5%	34.2	4.0%	47.8
Cash	3.75%	8.5	2.5%	16.6	2.5%	10.5
Total market value of assets		275.9		221.0		258.1
Present value of scheme liabilities		(421.3)		(366.7)		(303.5)
Deficit in the scheme		(145.4)		(145.7)		(45.4)
Related deferred tax asset		43.6		43.7		13.6
Net pension scheme liability		(101.8)		(102.0)		(31.8)

	31 Dec 2003 £m	31 Dec 2002 £m
Analysis of the amount that would have been charged to operating profit under FRS 17		
Current service cost	10.6	15.2
Total operating charge	10.6	15.2

Analysis of the amount that would have been charged to net finance income under FRS 17		
Expected return on pension scheme assets	15.2	19.5
Interest on pension scheme liabilities	(19.9)	(19.6)
Net return	(4.7)	(0.1)

Analysis of the actuarial gain/(loss) that would have been recognised in the statement of total recognised gains and losses

Actual return less expected return on pension scheme assets	23.9	(65.6)
Experience gains and losses arising on the scheme liabilities	(11.5)	13.5
Changes in assumptions underlying the present value of the scheme liabilities	(11.0)	(42.3)
Actuarial gain/(loss) that would have been recognised in the STRGL	1.4	(94.4)

23. Pensions continued

	31 Dec 2003 £m	31 Dec 2002 £m
<i>Analysis of the movement in the scheme deficit during the year</i>		
Deficit as at 31 December 2002	(145.7)	(45.4)
Total operating charge	(10.6)	(15.2)
Contributions	14.2	9.4
Net return	(4.7)	(0.1)
Actuarial gain/(loss) recognised in the STRGL	1.4	(94.4)
Deficit as at 31 December 2003	(145.4)	(145.7)
<i>History of the weighted average experience gains and losses</i>		
<i>Difference between actual and expected returns on scheme assets:</i>		
Amount (£m)	23.9	(65.6)
% of scheme assets	9%	(30%)
<i>Experience gains and losses on scheme liabilities:</i>		
Amount (£m)	(11.5)	13.5
% of present value of scheme liabilities	(3%)	4%
<i>Total actuarial gain/(loss) recognised in the statement of total recognised gains and losses:</i>		
Amount (£m)	1.4	(94.4)
% of present value of scheme liabilities	—	(26%)

If the above numbers had been recognised in the financial statements, the Group's net assets and profit and loss reserve as at 31 December 2003 would have been as follows:

	27 Dec 2003 £m	28 Dec 2002 £m
<i>Net assets</i>		
Net assets	489.4	418.1
Pension provision under SSAP 24	6.9	9.2
Net pension liability	(101.8)	(102.0)
Net assets including net pension liability	394.5	325.3
<i>Reserves</i>		
Profit and loss reserve	312.6	230.4
Pension provision under SSAP 24	6.9	9.2
Net pension liability	(101.8)	(102.0)
Profit and loss reserve including net pension liability	217.7	137.6

Notes to the financial statements continued

24. Consolidated cash flow statement

a) Reconciliation of operating profit to operating cash flows

	27 Dec 2003 £m	28 Dec 2002 £m
Operating profit before exceptional items	105.6	79.8
Amortisation of goodwill	0.7	0.1
Depreciation of tangible fixed assets	47.5	40.2
Amortisation of fixed asset investment	8.5	8.3
Increase in stocks	(18.6)	(45.9)
Increase in debtors	(18.0)	(10.4)
Increase in creditors and provisions	13.9	67.5
Net cash inflow – pre-exceptional operating activities	139.6	139.6
Net cash outflow – operating exceptionals	–	(1.6)
Net cash outflow – VAT paid re Structural guarantee	(46.0)	–
Net cash inflow from operating activities	93.6	138.0

b) Analysis of cash flows for headings netted in the cash flow statement

	27 Dec 2003 £m	28 Dec 2002 £m
Returns on investments and servicing of finance		
Interest received	1.5	3.2
Interest paid	(1.2)	(0.3)
Net inflow on investments and servicing of finance	0.3	2.9
Capital expenditure and financial investment		
Payments to acquire tangible fixed assets	(127.2)	(98.3)
Receipts from sales of tangible fixed assets	58.2	9.5
Payment to acquire own shares	(14.9)	(25.5)
Investment in joint ventures	(1.2)	(3.2)
Net outflow for capital expenditure and financial investment	(85.1)	(117.5)
Acquisitions		
Purchase of subsidiary undertaking	–	(10.9)
Cash acquired with subsidiary undertaking	–	2.4
Net outflow for acquisitions	–	(8.5)
Financing		
Shares issued	4.2	5.4
Loan acquired with subsidiary undertaking	(1.3)	1.3
Increase/(decrease) in bank finance	50.0	(0.8)
Capital element of finance lease rental payments	–	(0.4)
Net inflow from financing	52.9	5.5

24. Consolidated cash flow statement continued

c) Analysis of net funds

	Cash at bank £m	Bank loans £m	Net funds £m	Current asset investments £m	Finance leases £m	Total net funds £m
As at 29 December 2001	52.1	(0.8)	51.3	0.2	(0.4)	51.1
Cash flow	(20.9)	0.8	(20.1)	6.7	0.4	(13.0)
Acquisition of subsidiary	2.4	(1.3)	1.1	–	–	1.1
Exchange difference	(0.3)	–	(0.3)	–	–	(0.3)
As at 28 December 2002	33.3	(1.3)	32.0	6.9	–	38.9
Cash flow	14.9	(48.7)	(33.8)	4.9	–	(28.9)
Acquisition of subsidiary	–	–	–	–	–	–
Exchange difference	0.6	–	0.6	–	–	0.6
As at 27 December 2003	48.8	(50.0)	(1.2)	11.8	–	10.6

25. Contingent liabilities

	Company	
	27 Dec 2003 £m	28 Dec 2002 £m
Group VAT registration cross guarantee	15.7	13.2

Members of the Group have assigned UK property leases in the normal course of business. Should the assignees fail to fulfil any obligations in respect of these leases, members of the Group may be liable for those defaults. The number of such claims arising to date has been small and the cost, which is charged to profit and loss as it arises, has not been material.

26. HM Customs & Excise claim

In August 2001 the Group introduced an optional insurance-backed structural guarantee on certain items of furniture sold in its UK retail stores. Value Added Tax (VAT) on the furniture element of the transaction and Insurance Premium Tax (IPT) is paid on the sale of these warranties.

An assessment has been raised on the VAT and the relevant tax has been paid to HM Customs & Excise. The directors have taken extensive legal and taxation advice and this action is being contested vigorously. The relevant tax, which has been paid, is carried on the balance sheet as a debtor without any provision.

To date, the following amounts have been recorded:

	Cumulative £m	2003 £m	2002 £m	2001 £m
Reduction in VAT	50.0	20.7	22.0	7.3
IPT paid	(13.0)	(5.3)	(5.6)	(2.1)
External insurance premium/expenses	(6.5)	(2.5)	(2.8)	(1.2)
Reinsurance premium to Group company	(10.4)	(4.2)	(4.5)	(1.7)
Underwriting profit recognised by Group company	1.0	1.0	–	–
Profit taken to profit and loss	21.1	9.7	9.1	2.3

80% of the insurance has been reinsured by the external insurer through the Group's captive insurance company – Southon Insurance Limited.

The maximum potential exposure is £50m at the year end, but this would be expected to be offset by the recovery of approximately £13m of insurance premium tax paid on the sale of extended structural guarantees and by any future underwriting profit with Southon Insurance Limited. Due to the timing of our quarterly VAT payments, £46m of the £50m has been paid to HM Customs & Excise at the year end.

Notes to the financial statements continued

27. Financial commitments

Group

Capital commitments

The estimated amount of capital expenditure at 27 December 2003 contracted for, and for which no provision has been made in the financial statements, is as follows:

	27 Dec 2003 £m	28 Dec 2002 £m
Contracted for	0.8	3.1

Leasing commitments

At 27 December 2003, the annual commitments under operating leases were as set out below:

	Land & buildings		Other assets	
	27 Dec 2003 £m	28 Dec 2002 £m	27 Dec 2003 £m	28 Dec 2002 £m
Operating leases which expire:				
Within one year	2.1	2.4	3.4	1.3
Between one and five years	4.9	5.1	4.2	4.6
After five years	84.6	79.2	0.7	0.4
	91.6	86.7	8.3	6.3

Company

The parent company had no capital or leasing commitments at 27 December 2003 (2002 – £nil).

28. Related party transactions

Other than a £1.2m investment in joint ventures (2002 – £3.2m investment in joint ventures) there were no material transactions between the Company and Group and related parties.

Five year record

	Dec 2003 52 weeks £m	Dec 2002 52 weeks £m	Dec 2001 52 weeks £m	Dec 2000 52 weeks £m	Pro-forma Dec 1999 52 weeks £m
Summarised profit and loss account					
Turnover – Continuing operations	1,481.5	1,287.4	1,078.0	900.6	770.9
– Discontinued operations	–	–	–	–	26.0
	1,481.5	1,287.4	1,078.0	900.6	796.9
Operating profit – Continuing operations	105.6	79.8	61.9	40.9	29.7
– Discontinued operations	–	–	–	–	3.5
Share of joint venture operating loss	(2.1)	(2.0)	(0.9)	–	–
	103.5	77.8	61.0	40.9	33.2
Profit on ordinary activities before taxation	117.9	80.8	64.7	45.4	29.2
Profit on ordinary activities before taxation and exceptional items	103.8	80.7	64.2	44.9	25.0
Dividend per share (pence)	3.8	3.1	2.5	1.9	1.4
Basic earnings per share – restated (pence)	15.4	10.2	7.2	8.3	4.1
Earnings per share before exceptional items – restated (pence)	12.9	10.2	7.9	5.5	4.1
Summarised balance sheet					
Total fixed assets	452.8	417.5	328.3	286.5	324.8
Stock	195.7	177.1	128.7	127.2	92.6
Debtors	187.9	124.0	111.0	86.9	71.2
Creditors and provisions	(357.6)	(339.4)	(244.0)	(190.0)	(187.4)
	26.0	(38.3)	(4.3)	24.1	(23.6)
Net cash/(borrowings)	10.6	38.9	51.5	36.0	8.0
Total net assets	489.4	418.1	375.5	346.6	309.2
Number of outlets at end of year					
Out-of-town	191	191	189	187	186
High Street	22	26	20	3	1
Hygena at Currys	134	124	112	56	–
Sofa Workshop	29	26	–	–	–
Ethan Allen	2	2	–	–	–
Howden Joinery	300	269	228	172	114
Howden Millwork	15	12	–	–	–
Taiwan	13	14	4	–	–
France	135	133	124	116	114
Show room area at end of year (000 sq ft)					
Out-of-town	3,872	3,933	3,939	3,843	3,839
High Street	96	119	85	15	4
Hygena at Currys	160	150	125	54	–
Sofa Workshop	114	103	–	–	–
Ethan Allen	24	24	–	–	–
Taiwan	49	52	14	–	–
France	507	498	480	450	436

Shareholder information

Shareholding range	Shareholders		Shareholding	
	Number	%	Number	%
1-1,000	8,015	64.2	3,711,790	0.6
1,001-5,000	3,005	24.1	7,499,728	1.2
5,001-10,000	597	4.8	4,388,361	0.7
10,001-50,000	414	3.3	9,316,549	1.5
50,001-100,000	101	0.8	7,363,419	1.2
100,001-250,000	114	0.9	19,328,744	3.1
Over 250,000	242	1.9	568,444,249	91.7
	12,488	100.0	620,052,840	100.0

Principal subsidiary undertakings

At 27 December 2003

Parent Company	Country of registration or incorporation
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MFI Furniture Group Plc	England and Wales
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Principal subsidiary undertakings

Trading:

Howden Joinery Limited	England and Wales
MFI UK Limited	England and Wales
Howden Millwork Limited	England and Wales
Sofa Workshop Limited	England and Wales
Hygena Cuisines SA	France

Property management:

MFI Properties Limited	England and Wales
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Finance:

MFI Financial Services Limited	England and Wales
MFI Card Services Limited	England and Wales

*Southon Insurance Company Limited	Guernsey
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The Company ultimately owns 100% of the ordinary share capital of the above mentioned companies.

The investment in the company marked with an asterisk is owned directly by the Company.

With the exception of Howden Millwork Limited, which operates as a branch in the United States of America, all of the above companies operate in the United Kingdom or their country of incorporation.

Joint ventures

MFI International, Taiwan Company Limited	Republic of China
EA Home Interiors (UK) Limited	England and Wales
MFI Procurement (China) Limited	Hong Kong

We have taken advantage of the exemption provided in section 231(5)(a) of the Companies Act 1985 for those undertakings whose financial position do not principally affect the figures in the Company's individual accounts or the Group accounts.

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Remuneration Committee

Lesley Knox (Chairman)
Tony De Nunzio
Ian Smith
Peter Wallis

Nominations Committee

Ian Peacock (Chairman)
Tony De Nunzio
Lesley Knox
Ian Smith
Peter Wallis

Audit Committee

Tony De Nunzio (Chairman)
Lesley Knox
Ian Smith
Peter Wallis