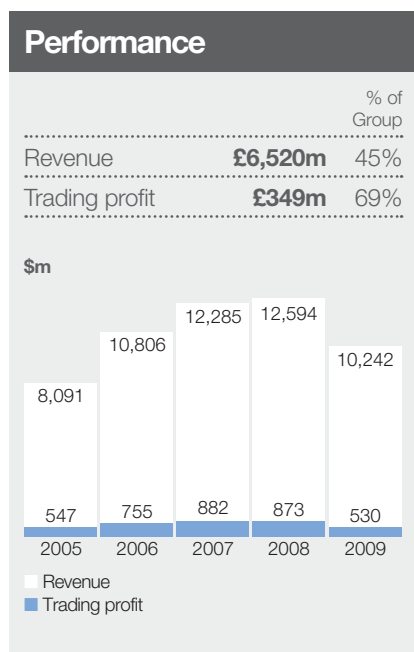


North American operations – North America plumbing and heating



Key brands

Ferguson is a distributor of plumbing supplies, valves and fittings, heating and cooling equipment, waterworks, tools, safety equipment and fire protection products. Ferguson operates across 50 US States, the District of Columbia, and in Puerto Rico, the Caribbean and Mexico.

Wolseley Canada is a wholesale distributor of plumbing, heating and ventilation equipment and is located in all ten provinces of Canada.

Market opportunities

The North American market for plumbing, heating and air conditioning products is substantial. Management has estimated the combined addressable US and Canadian markets to be worth over \$200 billion in calendar year 2008.

In the US, Wolseley is exposed to three components of the market which manifest different cycles: new residential, repair, maintenance and improvement (“RMI”), and commercial and industrial. The new residential market has contracted sharply as housing starts have declined from an annualised 924,000 in July 2008 to an annualised 560,000 in July 2009, a reduction of 39 per cent year-on-year; although the July 2009 figure reflects a recovery from a low point of 498,000 in April 2009. The RMI market is, in general, less cyclical as consumers who are unable or unwilling to relocate at current market prices are likely to compensate by increasing expenditure on home improvements. The estimates and forecasts from Harvard Joint Centre show annualised home improvements expenditure reducing from \$126 billion in Q2 of calendar 2008 to \$112 billion in Q2 of calendar 2009, a reduction of 11 per cent. The commercial and industrial sector has longer lead times than the consumer-driven sectors, as there can be an interval of two or more years from the commitment of funding to completion of a project. Levels of activity started to decline from those of the previous year in the second quarter of the financial year and this decline has accelerated in the second half of the year.

The US government has taken measures to support the availability of credit and stimulate demand in the overall economy, including making funds available to subsidise first-time buyers, to make houses more energy-efficient and to modernise and repair schools, which should support demand for the Group’s product range.

- ### Business strengths
- Strong brand and market position**
 - ▶ Leading distributor of plumbing and heating in North America
 - ▶ Continuing strong performance
 - Significant market opportunities**
 - ▶ US economy expected to be the first to recover
 - ▶ Increasing signs of competitor distress
 - ▶ Wolseley Canada managed by Ferguson
 - Strong business model**
 - ▶ Large scale distribution centre model and branch network
 - ▶ Highly trained employees with extensive local knowledge
 - ▶ Operating cash flow of \$1.4 billion over the last 12 months

Business profile

The Group’s North American plumbing and heating businesses are Ferguson in the United States and Wolseley Canada.

Ferguson is the largest wholesale distributor of plumbing supplies, pipes, valves and fittings in the USA and a major distributor of heating, ventilation and air conditioning systems. Ferguson is managed through five business groups: Residential Plumbing, Heating Ventilation and Air Conditioning (“HVAC”), Waterworks, Commercial Plumbing and Industrial. A number of brands other than Ferguson have been retained for servicing specific markets. Ferguson has eight distribution centres, three pipeyards and 1,228 branches (2008: 1,382 branches).

Wolseley Canada is the domestic market leader in the wholesale distribution of plumbing, heating and ventilation products with 225 branches (2008: 254 branches).

Scale

1,453
Number of branches

19,889
Number of employees

The Canadian economy has been less affected by the financial crisis than that of most developed countries, primarily due to the underpinning provided by commodity prices and the relative strength of its banking system.

The downturn has, however, been concentrated in the residential new construction market, which provides about a third of Wolseley Canada's revenue and where housing starts are forecast to fall by 33 per cent to 140,000 in calendar year 2009 from 210,000 in calendar year 2008.

In the longer term, demographic trends in North America suggest high rates of home ownership and residential construction in the future, as the so-called "echo boomers", children of the "baby boom" generation, are now entering the peak home buying and renting ages, and as rates of immigration continue to be high and foreign-born populations increasingly move to home ownership.

Despite some consolidation in recent years, as some of the major retailers have diversified into plumbing and heating equipment, the market is highly fragmented, with an estimated 95 per cent of distribution operations employing fewer than 100 people.

The current economic conditions favour the stronger and better capitalised distributors and management consider that the North America business has gained market share over the last year.

Strengths and strategy

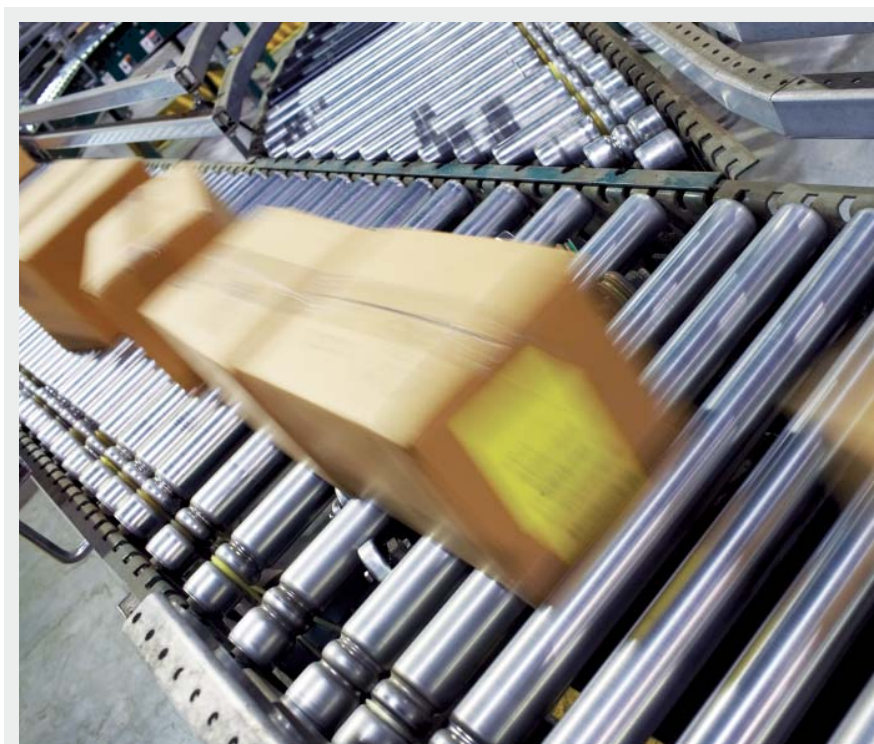
Ferguson's business is the strongest in the Group's portfolio, as a result of its market leadership, its unique distribution network based around the DCs, the buying power it derives from scale, the wide range of business cycles to which it is exposed through its range of customers and markets, and its proven ability to react quickly to the market. The Canadian business is the domestic market leader, with an extensive branch network and a broad product range.

In the short term, Ferguson will continue to take action to protect its margins and maintain discipline on costs and working capital, while continuing to take market share from distressed competitors. Specific areas of focus will be the development and marketing of private label products, the remerchandising of counters and build-up of showroom visitors, expanding e-commerce and further exploiting business intelligence systems to manage the gross margin matrix.

As the cycle turns, funds will be made available both for organic growth through new branches in the markets with the best opportunities and for bolt-on acquisitions, which have historically been successful for the business. The Group will keep the possibility of strategic acquisitions under constant review, but will only enter into negotiations if the business fit is compelling and prices are attractive.

Performance

Local currency revenue in the US plumbing and heating operations was down by 18.6 per cent to \$9,143 million (2008: \$11,226 million) with organic revenue down 18.7 per cent. Underlying trading profit, excluding property profits, was down by 40 per cent to \$479 million (2008: \$794 million). Despite the challenging conditions and commodity price deflation of \$34 million (£22 million), the gross margin was only 30 basis points down on the prior year, reflecting the continued focus on changes in the business mix towards higher margin business generated from showrooms, counter sales and private label products. The underlying trading margin was lower at 5.2 per cent (2008: 7.1 per cent).



Strong business model

Wolseley's Industrial Products Group ("WIPG"), Meridian and Ferguson Integrated Services ("FIS") are working together to supply an international power generation company. FIS, a maintenance repairs and operations integrator, now provides the procurement umbrella under which both Meridian and WIPG supply product to the end user.

The result is a significant three year agreement to supply pipes, valves, fittings, maintenance, repair and overhaul supplies across North America. The contract gives Wolseley the opportunity to leverage existing infrastructure and core capabilities of individual businesses and at the same time provide substantial value to the end user that is not available elsewhere in the marketplace.



Scale advantages

Ferguson's Baltimore branch recently won a contract to provide materials for the Johns Hopkins Hospital in Baltimore which has embarked on a \$1.2 billion, 10-year redevelopment plan that calls for two new clinical buildings. The Johns Hopkins project

is one of the largest-ever healthcare projects in the US. Ferguson is supplying all of the plumbing fixtures, pipes, valves and fittings to the project's mechanical contractors, Poole & Kent Corporation of Baltimore. Poole & Kent Corporation selected Ferguson for the job because of their financial strength and service capability. Logistics played

a big part as material prices were escalating at the time the contract was awarded and the customer needed to control costs on behalf of their client. This contract win demonstrates Ferguson's buying strength and excellent logistical ability through its distribution network.

In response to the slowing markets, Ferguson reduced its headcount by 3,840. These reductions equate to around 18 per cent of its total employees and along with other cost saving initiatives will give rise to estimated annualised savings of \$258 million. This brings the cumulative headcount reduction in Ferguson to around 25 per cent of its employees over the two years ended 31 July 2009.

Cash flow performance was strong with a continued improvement in cash-to-cash days with further progress in inventory, demonstrating the benefits of the DC network, and collections of receivables.

Ferguson's overall branch numbers reduced by 154 to 1,228 locations (2008: 1,382).

In Canada, market activity remained strong in the early part of the year before falling away sharply in December 2008. In July 2009, housing starts had fallen to an annualised rate of 132,000, with declines evident across all regions. Global economic uncertainty and, in particular, expected reduced demand for natural resources and commodities continue to inhibit levels of activity.

Against this background, Wolseley Canada continued to outperform the market. Local currency revenue decreased by 6 per cent to C\$1,293 million (2008: C\$1,376 million) including a 6 per cent organic revenue decline. Gross margins were lower, although the trend improved in the second half of the financial year, and trading profit was 25.6 per cent lower at C\$59 million (2008: C\$79 million). On 1 April 2009, responsibility for the management of the Industrial Products Group ("IPG") was transferred to Ferguson. Excluding the IPG business, the revenue decline in the year was 3.4 per cent.

In response to the slowing markets, Wolseley Canada reduced its headcount by 387 during the year to 2,487. Restructuring actions taken during the year will give rise to estimated annualised savings of C\$5 million.

Branch numbers in Canada were reduced by 29 to 225 (2008: 254).

Construction loans

Business profile

The Group has retained, through North American Loan Services ("NALS"), the portfolio of construction loan receivables formerly owned and managed by Stock Building Supply ("Stock"). These are loans made to builders to finance the construction of properties. At origination the term of the loan is a maximum of 12 months, with an option at NALS's discretion to extend by six month increments, and with a registered charge over the property. The charge usually has priority over other charges over the asset and is often reinforced by liens under State law and personal guarantees. In general, the funding is made available as the expenditure is incurred, rather than in advance, which restricts the exposure, and the completed property cannot be sold by the builder unless the loan has been repaid and the charge released.

Charges for impairment of receivables and gains or losses on the disposal of foreclosed property, as well as the cost of labour and facilities, are included in the Group's trading profit. Income from interest and fees is included in the Group's finance revenue, and interest expense in the Group's finance cost.

Strengths and strategy

The Group intends to effect a phased reduction in the construction loans portfolio over the next two to three years. It expects to continue to undertake selective lending only, to allow for an orderly reduction in the scope of the business. The portfolio will also be reduced through a phased withdrawal from selected markets to position the business for a possible future sale.

Following its separation from Stock, NALS has ceased operations in five States, and now has 90 per cent of its portfolio in North Carolina, South Carolina, Texas and Virginia.

Performance

Both new loan originations and the outstanding loans have been reduced over the past 12 months reflecting a more cautious approach to lending following the continuing decline in the US housing market. At 31 July 2009, construction lending receivables on Wolseley's balance sheet, financed by an equivalent amount of construction loan borrowings, was \$272 million (£163 million) compared to \$470 million at the previous year end. The trading loss for the year of \$37 million has decreased slightly from \$38 million in the prior year and reflects bad debt charges and losses on property disposals of \$29 million. The run rate of losses is expected to decline over the next 12 months.

Following the separation from Stock, NALS recorded an exceptional charge of \$48 million to reflect an impairment of receivables that arose as a result of the separation and the withdrawal from certain markets at that time rather than from any further deterioration in its underlying markets.