

PRINCIPAL RISKS AND UNCERTAINTIES

The Group is subject to a wide variety of risks and it is not practical to list out all risks that the Board is actively managing here. Principal risks are those risks which are identified as having a potentially material impact on the Group's operations, achievement of its strategic objectives, or viability to continue as a going concern. The actions taken to mitigate these risks cannot provide absolute assurance that they will not materialise, but will either mitigate the impact or reduce the likelihood to a level aligned to the Board's risk appetite. See details below for each of the principal risks, a description of the risk and how it may impact the Group, as well as the mitigations currently in place and any movement in the risk in the year.

Macroeconomic and market conditions

Movement:  Strategic priorities: 

Our products are used in the residential and commercial building and construction markets, both within the RMI sector, for new residential housing developments and for new construction projects.

Our private RMI business is strongly correlated to the level of household disposable incomes. Our new build business is particularly influenced by the level of activity in the house building industry. Government economic and social policy can also have a significant impact on our business.

A weakening in macro or market conditions could have a significant impact on the short-term financial performance of the business. The UK has been impacted by persistent inflation, driven by significant increases in the cost of essentials such as gas and electricity and food. The UK base interest rate increased significantly throughout 2023, rising from 3.5% to 5.25%. Rates are expected to begin to fall from the middle of 2024 but are likely to stabilise at a level higher than those experienced in the preceding decade. The CPA now forecasts the private housing RMI and new build markets to both contract by 4% in 2024, after declines of 11% and 19% respectively in 2023, before beginning to recover in 2025.

Specific market conditions can also impact upon the demand of our products, for example a competitor seeking additional market share through short-term price reductions.

Mitigation

- Notwithstanding macro conditions, we expect our new strategy and self-help initiatives to support sales and profit growth and drive good cash conversion
- Initiatives include the optimisation and expansion of the branch network, an enhanced customer proposition and simplified business structures
- We operate comfortably within the terms of our bank facility and related financial covenants.

Cyber security

Movement:  Strategic priorities:    

A breach of IT security (externally or internally) could result in an inability to operate systems effectively (e.g. viruses) or the release of inappropriate information (e.g. hackers). Sophisticated phishing attacks are increasing in both frequency and complexity.


A breach of cyber security could have a significant impact on the reputation of the business as well as the resulting fines impacting the financial performance.

The Group experienced a cyber incident in July 2022, causing significant disruption to our operations. The Group has subsequently strengthened further its cyber defences, but this remains a fast-evolving threat and continues to receive considerable management attention.

Mitigation

- Ongoing investment in cyber risk detection and prevention tools, accelerated significantly since the cyber incident in July 2022
- These measures include managed detection and response ('MDR'), security instant event monitoring ('SIEM'), privileged access management ('PAM') and firewall hardening
- Physical security of servers at third-party off-site data centre, with full disaster recovery capability
- Password and safe-use policies in place, internet usage monitored and anti-malware used
- External cyber review and internal audit reviews conducted periodically, resulting in significant enhancements in defences
- Cyber awareness/IT security campaign active for all employees
- Financial crime protection and cyber liability insurance in place.

Movement key:  Increase  No change  Decrease

Strategic priorities key:  Customer growth  Business effectiveness  People first  ESG leadership

Health & Safety

Movement:  **Strategic priorities:**   

The Group's production, manufacturing and distribution operations are carried out under potentially hazardous conditions. It is essential that safe environments are created and maintained for all employees and other stakeholders that access our facilities, and that the Group complies with all relevant laws and regulations.

A deterioration in our health and safety performance statistics, including increased or more serious injuries, or a breach of health and safety regulations could lead to significant financial and reputational damage to the business.

Mitigation

- Procedures and policies in place to support compliance with all relevant regulations
- Regular communication and training on policy compliance
- Monitoring procedures in place, including near miss and potential hazard reporting for health & safety matters
- A three-year health and safety strategy was launched in 2022, with implementation progressing well and an improvement in performance delivered in 2023
- Internal and third-party site audits to assess compliance with our policies.

Supply chain risk

Movement:  **Strategic priorities:**   

Our manufacturing and recycling operations rely on the supply of several core raw materials, and our branch network relies on the supply of third-party products.

In terms of supply, there are only a limited number of PVC resin and certain other raw material suppliers, impacting both the supply and price of these materials. Further, we have a limited capacity to store such materials at our sites. Failure to procure raw materials on a timely basis could impact on our ability to manufacture products and meet customer demand.

On pricing, several raw materials are priced in US Dollars and Euros, and therefore although we pay in Sterling, we are impacted by international currency markets.

Availability of recycling feedstock is limited, and dependent upon the level of RMI activity in the UK. The level of RMI activity can therefore significantly impact both the price and availability of recycling feedstock.

Finally, many of our key raw materials and third-party products are transported to the UK from the EU, and, to a lesser extent, the US and the Far East, therefore the capacity of global shipping can also impact both the availability and price of key materials.

Increasing costs could have a negative impact on the financial performance of the business. An inability to source the required materials could also impact financially, as well as upon the reputation of the business if we are unable to meet future demand.

Mitigation

- Initiatives to improve supply chain resilience, including sourcing alternative/more local sources of key raw materials and third-party products
- Procurement strategy in place to secure new supply lines for recycling feedstock (i.e. post-consumer and post-industrial waste)
- Where possible we agree fixed price contracts with key suppliers to mitigate the risk of input cost increases
- Although we do not hedge currency, where possible we agree pricing in GBP to mitigate exchange rate volatility
- All new suppliers are now required to complete a cyber risk questionnaire, and regular reviews are conducted to test the financial stability of key suppliers.

PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

Sustainability and climate change

Movement: 

Strategic priorities: 

Demonstrating improving business sustainability is becoming increasingly important to all stakeholders.

Failure to improve in all material aspects of ESG (environmental, social, governance) could lead to regulatory and other challenges e.g. employee recruitment and retention.

If we do not deliver on our environmental targets and establish a credible pathway to carbon neutrality and net zero, investors and lenders may show a preference to allocate capital to businesses with better understood climate impacts and a clear plan to improve.

There are physical risks associated with climate change. The Group operates from over 200 locations, and with a changing climate there is an elevated risk that elements of our operations could be impacted by fire, flooding or other environmental issues.

Mitigation

- Strong underlying position on sustainability underpinned by window recycling operation, which drives significant carbon savings compared to the use of virgin PVC resin
- We conduct regular environmental risk assessments at existing and potential sites. Risks are managed through local business continuity plans. In 2023 we enhanced our risk assessments using a physical risk analysis software tool, providing a greater depth of information for each site
- The Group established a new ESG and Social Values Board Committee towards the end of 2022
- In 2023 we appointed CEN-ESG, a specialist ESG consultancy, to support the development of our ESG strategy and improve our ESG data and disclosures. This work includes the following:
 - Materiality assessment completed in 2023 to help us determine the most important sustainability topics to the business
With this analysis we surveyed a selection of employees, suppliers, customers, banks and shareholders
 - Development of a baseline carbon footprint for the business (Scope 1, 2 and 3), identifying key decarbonisation levers
 - Using the above outputs to define ESG objectives and develop a sustainability strategy, supported by appropriate governance and internal controls
 - This includes an ambition to achieve Net Zero on our emissions by 2045 (which is highly dependent on reducing emissions in the PVC resin supply chain). We will now work to submit our targets to the Science Based Targets initiative in 2024, which will ensure we are aligned with the UK Government's Net Zero Strategy. Once approved, we will develop and publish a Net Zero Transition Plan outlining how the targets will be met.

Movement key:  Increase  No change  Decrease

Strategic priorities key:  Customer growth  Business effectiveness  People first  ESG leadership

Managing change

Movement: 

Strategic priorities:



The Group has been through a period of significant organisational change over the past 18 months. At Board level, this includes the appointment of a new Chairman and five new Non-executive Directors, largely to replace retiring non-executives. In addition, Darren Waters joined the business as Chief Executive, following the retirement of Mark Kelly in May 2023.

Following Darren's appointment, the Board conducted a review of the Group's strategy, including the optimisation and expansion of the branch network, an enhanced customer proposition and simplified business structures. With this review now complete, we have reset our ambition for the business and identified a clear strategy for organic growth and improved operating margins, which has the potential to create significant shareholder value.

Furthermore, as detailed below, we have embarked upon a significant and complex multi-year project to replace our Enterprise Resource Planning ('ERP') system.

Embracing and effectively managing change is fundamental to the Group's future success. There is a risk that the pace and extent of change puts the resources and bandwidth of the organisation under strain, leading either to a failure to effectively deliver the new strategy or implement the new ERP system, which could have significant financial and operational implications.

Component risks include the ability to attract, retain and recruit the right calibre of senior managers with the required skills and experience, in particular the technical ability to execute a complex IT implementation, and the risk that our various stakeholders do not respond positively to our new strategy.

Mitigation

- The Group has an experienced Board with significant, relevant experience in delivering effective change programmes
- We are in the process of communicating our new strategy to all stakeholders so that they each understand the part they can play in delivering our ambition
- We have an experienced Director of IT and an effective internal team in place with good experience of complex IT implementations
- We have strong relationships with our major customers and suppliers
- The 'People First' strategic pillar was launched with the aim of making Eurocell a great place to work, through a focus on health and safety, an enhanced employee value proposition, improved levels of engagement and effective talent management
- Developing a successful track record and clear strategic direction provides an attractive backdrop to joining the senior team at Eurocell
- We have market rate compensation for all personnel including equity-based long-term incentive plans in place for the senior team.

PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

Movement key:  Increase  No change  Decrease

Strategic priorities key:  Customer growth  Business effectiveness  People first  ESG leadership

ERP systems implementation

Movement:  **Strategic priorities:**  

The Group relies on its SAP Enterprise Resource Planning ('ERP') system for all aspects of its operations.

However, we have concluded that the age profile of our SAP system has become a limiting factor in the development of the business. In addition, the current system becomes unsupported in 2027.

We have therefore begun a major project to upgrade or replace SAP, the major components of which are:

- A front-end trading system to support the branch network
- A back-end ERP System to support all other functions of the business, including manufacturing, recycling, warehousing, distribution and finance.

In total, we anticipate implementation to be a two-to-three-year process, and we estimate the total costs of the project will be in the region of £8-10 million.

Implementation of the new trading system for the branch network (Intact IQ) is already underway, with transition expected early in 2025. We expect to select an ERP system in H1 2024, with transition by mid-2026.

The successful implementation of the new system is critical to the long-term prospects of the business. We expect the new systems will drive major improvements in our customers' experience and significantly increase the efficiency of our operations. However, it is likely to be a complex process, which will absorb significant time and resource.

Mitigation

- Experienced Director of IT and internal team in place with good experience of complex IT implementations
- Significant incremental resource now assigned to the project, with further recruitment planned for the ERP implementation
- Third party expert consulting firm in place to oversee and advise on the project
- Board-led Steering Group in place to monitor progress
- Intact IQ is our selected partner for the new branch trading system. Intact has a strong reputation within our sector, with a specialism in delivering electronic point-of-sale solutions to multi-site building product distributors
- Two leading ERP system providers are being assessed against key requirements for the business.

Operational and regulatory compliance risk

Movement:  **Strategic priorities:**   

The business is dependent on the continued and uninterrupted performance of our production facilities.

Each of the facilities is subject to operating risks, such as: industrial accidents (including fire); extended power outages; lack of access to power; withdrawal of permits and licences (e.g. the regulated operation of the recycling facility); breakdowns in machinery; equipment or information systems; prolonged maintenance activity; strikes or other extended workforce absences; natural disasters; and other unforeseen events.

We may be adversely affected by the crystallisation of unexpected corporate or regulatory risks, for example future REACH (registration, evaluation, authorisation and restriction of chemicals).

Failure to comply with relevant laws and regulations could result in significant fines and reputational damage, whereas inability to manufacture or deliver goods would have a significant financial and reputational impact.

Mitigation

- Regular planned maintenance to reduce the risk of plant failure, including maintenance capital investment of >£5 million per annum across the Group
- Business continuity plans in place for all major sites and the branch network, which are tested periodically
- Procedures and policies in place to support compliance with all relevant regulations
- Regular communication and training on policy compliance.