

# Risk Management

Risk management is the responsibility of the Board and is a key factor in delivering the Group’s strategic objectives.

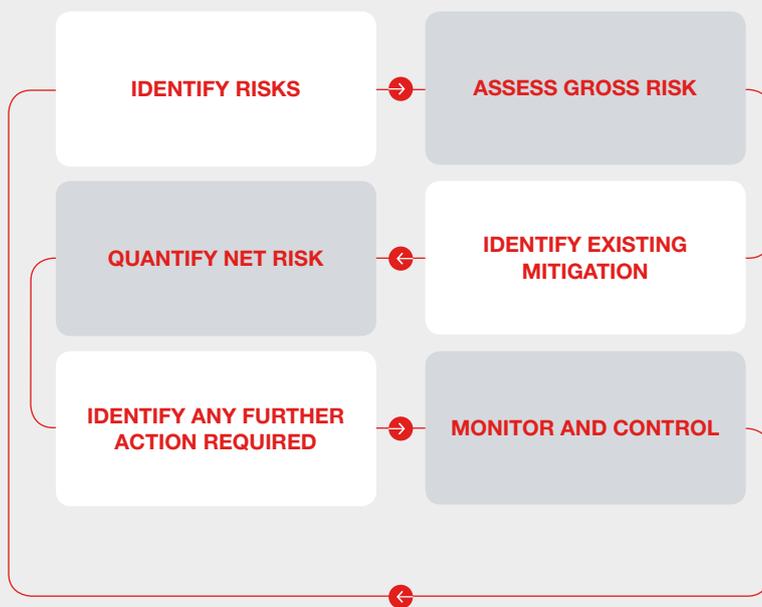
### Approach to Risk Management

The Board is responsible for setting the risk appetite, establishing a culture of effective risk management and for ensuring that effective systems and controls are in place and maintained.

Senior managers take ownership of specific risks and implement policies and procedures to mitigate exposure to those risks.

### Risk Management Process

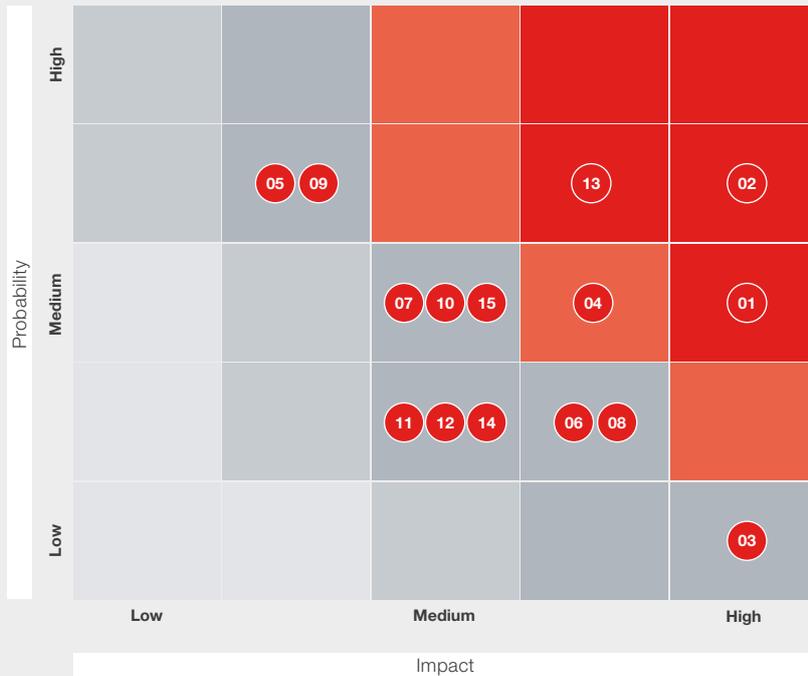
The risk management process sits alongside our strong governance culture and effective internal controls to provide assurance to the Board that risks are being appropriately identified and managed.



### How we manage risk

Risk is managed across the Group in the following ways:

- The Board meets annually to review strategy and set the risk appetite.
- Risks faced by the Group are identified during the formulation of the annual business plan and budget process, which sets objectives and agrees initiatives to achieve the Group’s goals, taking account of the risk appetite set by the Board.
- Senior management and risk owners consider the root cause of each risk and assess the impact and likelihood of it materialising. The analysis is documented in a risk register, which identifies the level of severity and probability, ownership and mitigation measures, as well as any proposed further actions (and timescale for completion) for each significant risk.
- The Group has an executive Risk Management Committee, chaired by the Chief Financial Officer. This Committee meets on a regular basis (generally quarterly). The status of the most significant risks and mitigations are reviewed at each meeting, with other risks reviewed on a cyclical basis.
- The Executive Directors also meet with senior managers on a regular basis throughout the year. This allows the Executive Directors to ensure that they maintain visibility over the material aspects of strategic, financial and other risks.
- The Group’s Executive Directors also compile their own risk assessment, ensuring that a top-down, bottom-up approach is undertaken when considering the Group-wide environment.
- The Group’s Audit and Risk Committee assists the Board in assessing and monitoring risk management across the Group. The role of the Committee includes ensuring the timely identification and robust management of inherent and emerging risks, by reviewing the suitability and effectiveness of risk management processes and controls. The Committee also reviews the risk register to ensure net risk and proposed further actions are together consistent with the risk appetite set by the Board.



**Principal risks**

- 01 Macroeconomic conditions
- 02 Brexit
- 03 Raw material supply
- 04 Raw material prices
- 05 Manufacturing capacity constraints
- 06 Unplanned plant downtime
- 07 Unsuccessful branch network expansion
- 08 Ability to attract and retain key personnel and highly skilled individuals
- 09 Shortages or increased costs of appropriately skilled labour
- 10 Customer credit risk
- 11 Competitor activity
- 12 Corporate and regulatory risks
- 13 Cyber security
- 14 Failure to develop new products
- 15 Failure to identify, complete and integrate bolt-on acquisitions

**Internal control**

The Group has well-defined systems of internal control.

The Group has a robust process of financial planning and monitoring, which incorporates Board approval of operating and capital expenditure budgets. Performance against the budget is subsequently monitored and reported to the Board on a monthly basis. The Board also monitors overall performance against operating, safety and other targets set at the start of the year. Performance is reported formally to shareholders through the publication of results both annually and half-yearly. Operational management regularly reports on performance to the Executive Directors.

The Group also has processes in place for ensuring business continuity and emergency planning.

Day-to-day operations are supported by a clear schedule of authority limits that define processes and procedures for approving material decisions. This ensures that projects and transactions are approved at the appropriate level of management, with the largest and most complex projects being approved by the Board. The schedule of authority limits is reviewed on a regular basis so that it matches the needs of the business.

In order to further enhance the internal control and risk management processes, KPMG provides an outsourced internal audit service to the Group. KPMG work closely with the Risk Management Committee in delivering the Group's internal audit programme.

With the assistance of the Audit and Risk Committee, the Board has reviewed the effectiveness of the system of internal control. Following its review, the Board determined that it was not aware of any significant deficiency or material weakness in the system of internal control.

## PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

### Risk profile

The principal risks monitored by the Board are as follows:

Principal Risk and Impact	Strategic Priorities	Mitigation	Risk Change in Reporting Period	Movement
<p><b>MACROECONOMIC CONDITIONS</b></p> <p>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.</p> <p>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.</p> <p>As such, our business and ability to fund ongoing operations is dependent on the level of activity and market demand in these sectors, itself often a function of general economic conditions (including interest rates and inflation) in the UK.</p>	 	<ul style="list-style-type: none"> <li>Notwithstanding macro conditions, we expect our strategic priorities and self-help initiatives to support sales and market share growth.</li> <li>Initiatives include: growing market share, investment in our specifications team (targeting new build, commercial and public sector work) and expanding the branch network.</li> <li>We operate comfortably within the terms of our newly refinanced bank facility and related financial covenants.</li> <li>Reducing the pace of branch network expansion in 2018/19 should improve short-term profit and cash flows.</li> </ul>	<ul style="list-style-type: none"> <li>Increased political and economic uncertainty as a result of Brexit.</li> <li>Construction output and general RMI market were broadly flat in 2018. CPA now forecast a marginal pick up in both for 2019.</li> <li>New home registrations continue to increase.</li> <li>UK base rate was increased in 2017 and 2018, partly as a result of increasing inflationary pressure.</li> </ul>	▲
<p><b>BREXIT</b></p> <p>There remains significant uncertainty over the impact of Brexit.</p> <p>Risks related to the potential impact on macroeconomic conditions are described above.</p> <p>Almost all of our sales are to UK-based businesses. In addition, the vast majority of our workforce will have the right to remain and work in the UK post-Brexit.</p> <p>However, some of our key raw materials originate in Europe, so any disruption in supplies could impact on our ability to manufacture our products and meet customer demand.</p>	  	<p>Actions taken include:</p> <ul style="list-style-type: none"> <li>6-month resin supply agreement for H1 2019, to support continuity of supply for our most critical raw material.</li> <li>Some suppliers for other raw materials have agreed to hold extra stocks (very limited capacity at our manufacturing sites).</li> <li>Finished goods stock build programme in progress for key lines where possible.</li> <li>Selective credit insurance now in place.</li> </ul>	<ul style="list-style-type: none"> <li>Increased uncertainty over how/when/if Brexit will be implemented.</li> </ul>	▲
<p><b>RAW MATERIAL SUPPLY</b></p> <p>There are only a limited number of PVC resin and certain other raw material suppliers and we operate with limited material storage capacity.</p> <p>As described above (see Brexit risk), failure to receive raw materials on a timely basis could impact on our ability to manufacture products and meet customer demand.</p>	 	<ul style="list-style-type: none"> <li>Raw material tests to identify potential alternative suppliers.</li> <li>Spot market for resin often available to access.</li> <li>Contractual arrangements for certain key suppliers include liquidated damages for failure to supply.</li> <li>Regular reviews to test financial stability of key suppliers.</li> </ul>	<ul style="list-style-type: none"> <li>Brexit related supply risks increasing as described above.</li> <li>Potential remains for increased resin supply originating from the US to come on line and deliver into Europe.</li> </ul>	▲
<p><b>RAW MATERIAL PRICES</b></p> <p>Our manufacturing operations depend on the supply of PVC resin, a material derivative of ethylene which in turn is a derivative of crude oil.</p> <p>The price of PVC resin can therefore be subject to fluctuations based on the markets for crude oil and ethylene, as well as the market for resin itself.</p> <p>In addition, although we pay for resin in sterling, crude oil and ethylene are priced in US dollars and euros respectively. As such, the price of resin in sterling is also impacted by international currency markets.</p> <p>Our ability to pass on resin and other raw material or traded goods price increases to our customers will depend on market conditions at the time.</p>	 	<ul style="list-style-type: none"> <li>Where possible we pass through raw material or traded goods price increases to our customers.</li> <li>Increasing the use of recycled material in our manufacturing partially mitigates exposure to resin prices.</li> <li>Resin supply contracts contain mechanisms to help mitigate some variations in price.</li> <li>Use of more than one supplier to provide competitive pricing for many raw materials and traded goods.</li> </ul>	<ul style="list-style-type: none"> <li>Raw material pricing pressures continued into 2018, largely as a result of currency fluctuations and the impact of other uncertainties surrounding Brexit.</li> </ul>	▲

**Movement key:**

Increase



No change



Decrease

**Strategic Priorities key:**

Target growth in market share



Develop innovative new products



Explore potential bolt-on acquisition opportunities



Expand our branch network



Increase the use of recycled materials

Principal Risk and Impact	Strategic Priorities	Mitigation	Risk Change in Reporting Period	Movement
<p><b>MANUFACTURING CAPACITY CONSTRAINTS</b></p> <p>A requirement to run manufacturing facilities at high levels of utilisation in peak periods (e.g. to meet customer demand) can drive down Overall Equipment Effectiveness ('OEE') and result in other operational inefficiencies.</p> <p>Attempting to satisfy unexpectedly high demand without the requisite infrastructure in place may lead to a failure of people, systems and processes to perform.</p> <p>Together these factors can result in adverse financial consequences.</p>		<ul style="list-style-type: none"> <li>Co-extrusion capacity increased by around 40% in 2018 (5 new lines). Foam capacity increased by around 9% in 2018 (2 new lines).</li> <li>A further 5 co-extrusion and 3 foam lines to be added in 2019.</li> <li>Recruitment of additional trained labour in our foiling plant.</li> <li>Strengthened management team in critical areas of production planning and logistics.</li> <li>End-to-end review of critical order fulfillment processes in progress.</li> </ul>	<ul style="list-style-type: none"> <li>Some of these risks crystallised in 2018, with aspects of the mitigation (e.g. planned capital investment) currently in progress.</li> </ul>	
<p><b>UNPLANNED PLANT DOWNTIME</b></p> <p>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; 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; natural disasters; and other unforeseen events.</p>	 	<ul style="list-style-type: none"> <li>Regular planned maintenance to reduce the risk of plant failure.</li> <li>Maintenance capital investment of approximately £5 million per annum across the Group.</li> <li>Extrusion facilities spread over 3 manufacturing sites.</li> <li>Group-wide disaster recovery plans in place.</li> </ul>	<ul style="list-style-type: none"> <li>Acquisition of Ecoplas has increased our recycling capacity and reduced our reliance on a single recycling plant.</li> </ul>	
<p><b>UNSUCCESSFUL BRANCH NETWORK EXPANSION</b></p> <p>We have invested significantly to expand the branch network over the last 3 years.</p> <p>The network, including new branches, may fail to reach the required scale and profitability within an acceptable timeframe.</p> <p>Looking further forward, good new sites may become more difficult to find.</p>	 	<p>New Building Plastics management team progressing initiatives to improve profitability:</p> <ul style="list-style-type: none"> <li>More rigid pricing architecture.</li> <li>Revised field sales and account management structure.</li> <li>Drive to better stock availability and trials of new front-of-house and product displays.</li> <li>Enhanced training to ensure all staff have the ability to sell the full range of products.</li> <li>Profit improvement plan template for lowest performing branches.</li> <li>Improved new site selection using location analysis tools.</li> </ul>	<ul style="list-style-type: none"> <li>Pace of expansion slowed in 2018 to allow focus on consolidating existing estate, with more work to do in this area in 2019.</li> </ul>	
<p><b>ABILITY TO ATTRACT AND RETAIN KEY PERSONNEL AND HIGHLY SKILLED INDIVIDUALS</b></p> <p>Our success depends inter alia, on the efforts and abilities of certain key personnel and our ability to attract and retain such people.</p> <p>The senior team have significant experience in the relevant sectors and markets and are expected to make an important contribution to our growth and success.</p>	 	<ul style="list-style-type: none"> <li>Clear strategic direction provides an attractive backdrop to working at Eurocell.</li> <li>Market rate compensation for all personnel, including leadership team.</li> <li>Equity-based long-term incentive plans in place for senior team.</li> </ul>	<ul style="list-style-type: none"> <li>Continued focus on improving employee engagement and communication (e.g. new Group-wide Vision and Values launched in 2018.)</li> </ul>	

## PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

Principal Risk and Impact	Strategic Priorities	Mitigation	Risk Change in Reporting Period	Movement
<p><b>SHORTAGES OR INCREASED COSTS OF APPROPRIATELY SKILLED LABOUR</b></p> <p>We are subject to supply risks related to the availability and cost of labour, both in our manufacturing operations and in our branch business. Our headquarters are located in an area of generally full employment.</p> <p>We may also experience labour cost increases (including those related to the Minimum Wage) or disruptions in circumstances where we have to compete for employees with the necessary skills and experience in tight labour markets.</p>		<ul style="list-style-type: none"> <li>• Market level or better salaries and good benefits package.</li> <li>• Induction and training programme.</li> <li>• First SAYE share-save scheme launched for all personnel in 2017, with a second scheme introduced in 2018.</li> <li>• Progressing strategy to improve retention and recruitment, leadership and development, employee engagement and communication.</li> </ul>	<ul style="list-style-type: none"> <li>• Third SAYE scheme planned for 2019.</li> </ul>	
<p><b>CUSTOMER CREDIT RISK</b></p> <p>There is an inherent risk that default by a large customer could result in a material bad debt.</p>		<ul style="list-style-type: none"> <li>• In-depth credit review for new and ongoing customer accounts.</li> <li>• Experienced Credit Manager (over 15 years with the Group) and strong credit control team.</li> <li>• Credit insurance implemented for large Profiles accounts from January 2019.</li> </ul>	<ul style="list-style-type: none"> <li>• Increased economic uncertainty and falling consumer confidence may lead to more business failures.</li> <li>• No material bad debts in 2018, but inherent risk remains.</li> </ul>	
<p><b>COMPETITOR ACTIVITY</b></p> <p>We have a number of existing competitors who compete on range, price, quality and service. Increased competition could reduce volumes and margins on manufactured and traded products.</p>		<ul style="list-style-type: none"> <li>• Strong market and customer awareness, with good intelligence around competitor activity.</li> <li>• Focus on customer proposition and points of differentiation in product and service offering.</li> </ul>	<ul style="list-style-type: none"> <li>• We continued to gain market share in both divisions in 2018.</li> <li>• The more uncertain market environment may have weakened some of our competitors.</li> </ul>	
<p><b>CORPORATE AND REGULATORY RISKS</b></p> <p>We may be adversely affected by the crystallisation of unexpected corporate or regulatory risks. These could include health and safety, data, reputational and environmental events, or other legal, taxation and compliance matters.</p>	    	<ul style="list-style-type: none"> <li>• We have procedures and policies in place to support compliance with regulations.</li> <li>• Regular communication and training on policy compliance.</li> <li>• Monitoring procedures in place, including near miss and potential hazard reporting for health and safety matters.</li> <li>• Internal and third-party site audits to test compliance with our policies.</li> </ul>	<p>Recent developments widen the scope and increase the penalty regime for breaches in these areas. For example:</p> <ul style="list-style-type: none"> <li>• Corporate Criminal Offence of Failure to Prevent the Facilitation of Tax Evasion ('CCO') legislation came into force on 30 September 2017.</li> <li>• General Data Protection Regulations ('GDPR') came into effect in May 2018.</li> </ul>	

**Movement key:**

▲ Increase

◀ No change

▼ Decrease

**Strategic Priorities key:**

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Principal Risk and Impact	Strategic Priorities	Mitigation	Risk Change in Reporting Period	Movement
<p><b>CYBER SECURITY</b> 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).</p>		<ul style="list-style-type: none"> <li>Physical security of servers at third-party off-site data centre, with full disaster recovery capability.</li> <li>Password and safe use policies in place, internet usage monitored and anti-malware used.</li> <li>Network defences enhanced and wi-fi access controls improved in 2018.</li> <li>Cyber awareness/IT security campaign introduced for all employees in 2018.</li> <li>Financial crime protection and cyber liability insurance in place from January 2019.</li> </ul>	<ul style="list-style-type: none"> <li>This remains a high profile area and is receiving considerable management focus.</li> </ul>	▲
<p><b>FAILURE TO DEVELOP NEW PRODUCTS</b> Failure to innovate could reduce our growth potential or render existing products obsolete. The launch of new products and new variants of existing products is an inherently uncertain process. We cannot guarantee that we will continuously develop successful new products or new variants of existing products. Nor can we predict how customers and end-users will react to new products or how successful our competitors will be in developing products which are more attractive than ours.</p>	 	<ul style="list-style-type: none"> <li>We invest continuously in research and development through our in-house team.</li> <li>The team is highly focused on new ways to develop existing products and to be innovative with new ones.</li> <li>We have a strong product pipeline with more than 25 projects in development.</li> </ul>	<ul style="list-style-type: none"> <li>Recent successes include: Coastline (a lightweight composite cladding for use on coastal properties), and extensions to the Skypod range.</li> </ul>	◀
<p><b>FAILURE TO IDENTIFY, COMPLETE AND INTEGRATE BOLT-ON ACQUISITIONS</b> Exploring potential bolt-on acquisitions is one of our strategic priorities. We may not be able to identify appropriate bolt-on acquisitions. Any future acquisition we do make poses integration and other risks which may affect our results or operations. The acquisition and integration of companies is a complex, costly and time-consuming process involving a number of possible risks. These include diversion of management attention, failure to retain personnel, failure to maintain customer service levels, disruption to relationships with various third parties, system risks and unanticipated liabilities.</p>	 	<ul style="list-style-type: none"> <li>Public communication of bolt-on acquisitions being a strategic priority.</li> <li>Good knowledge of companies operating in our sector and related sectors.</li> <li>Ecoplas and Kent Building Plastics acquired in 2018.</li> <li>Tried and tested procedure for the integration of new acquisitions and a good track record of recent success.</li> </ul>	<ul style="list-style-type: none"> <li>Significant value at stake with integration of and investment in Ecoplas.</li> </ul>	▲