

## Risk Report

The Directors recognise the need for a healthy system of internal controls and risk management. We have identified the following as the principal risks and uncertainties the Group faces.



### Principal Risks and Uncertainties

The Group's management team assesses risks regularly and develops strategies for dealing with them. We carry out an annual formal review of risks. This process involves identifying risks, and determining the likelihood of them affecting the business, the potential severity of their impact, and what we need to do to manage them effectively. This risk management is essential to our ability to achieve our strategic objectives.

The risks we consider material are as follows:

### Strategic Risks:

#### Retailer Consolidation

There have been a number of high-profile mergers and prospective mergers reported in the press in the past few years such as Tesco and Booker. There is always a risk in these situations that, as the newly merged entities look to offer the consumer lower prices through economies of scale, they rationalise their supplier base. Also, the exceptional buying power of these new entities could pressurise suppliers into lowering prices to preserve trade.

As a supplier to most grocery customers including the ones mentioned above, we are not immune to this risk. We strive to be the highest-quality, most-innovative and lowest-cost supplier and believe this, along with our strong partnership relationships with our customers, will ensure we are strongly placed to continue to supply them.

#### Competitive Environment and Customer Requirements

The bakery sector remains competitive. Monitoring key performance indicators at customer level such as service or customer complaints is part of our risk management process. Providing high-quality products, investing in innovation, and competing in value, helps strengthen customer relations and support growth initiatives. We invest heavily in category management, new product development and marketing. This investment has helped create an insight into customer and consumer demands.

#### Consumer Trends

The risk of a no deal Brexit and the uncertainty surrounding Brexit more generally along with political uncertainty continue to weigh on consumer sentiment. British consumer confidence has deteriorated in the last year. The risk to the Group is that spending on non-essential goods and treats will fall, affecting the demand for our key products.

We will continue to focus on quality and value and will look for new channels, new products and new formats to gain competitive advantage.

Health continues to be a major focus for the business. Special teams continue to work on reducing sugar and salt as part of the Government obesity strategy and Public Health England recommendations. Our development teams work closely with our customers to ensure we meet or exceed all guidelines for health and nutrition, and work continuously with suppliers to reduce salt, fat and sugar in our products. We are committed to meeting the FSA 2017 salt targets and are already over 90% compliant.

## Risk Report

### Operational Risks:

#### Health and Safety

The importance of health and safety is widely recognised across the Group. Failure to adhere to health and safety regulations within the workplace not only puts our employees at risk, but could also carry serious financial, reputational and legal risk. We have a Group Head of Health and Safety to create a uniform system across all business units and to promote our 'Home Safe Every Day' strategy.

The Group's technical function is responsible for implementing and maintaining high standards of food safety, striving for best practice. We manage quality assurance procedures at site level, and review and audit them continually, making improvements as appropriate.

All manufacturing sites are registered under the British Retail Consortium (BRC) Unannounced Scheme. The sites are subject to regular internal and independent food safety and quality control audits, both announced and unannounced, including those carried out for our customers. We maintain appropriate insurance cover, including product recall insurance, to mitigate the potential financial impact of a breach in food safety compliance.

#### External Risks:

#### Brexit and Political Uncertainty

Anything different from the current environment is likely to have an impact on both the food manufacturing industry and on the Group.

The majority of the Group's trading is in the UK, but we have cross border sales from the UK into Lightbody Europe, our 50% owned subsidiary, and into Ireland. The Polish business of Ultrapharm trades solely within Europe and not to the UK market.

We buy some commodities from Europe. Any tariffs on trade will therefore have a bearing on the Group. We already have contingency planning in place, looking at alternative UK sources of products.

Higher logistics and administration costs may result from border delays and could necessitate higher stock levels.

To the extent that we use low skilled labour we are developing labour strategies to retain and develop existing workers, attract and hire new workers and reduce labour, while boosting productivity with our capital investment program.

We are not being complacent in our response to all scenarios, and have a cross-functional team which has prepared a number of strategies to minimise its impact.

#### Cyber Security

The Group may be potentially exposed to random, malicious attacks from cyber criminals. Maintaining protection software is one tool in protecting our data. In addition, we are implementing common information systems across all companies, with standard protection, operating requirements and security protection. Real-time back-up, training, and regular communication, pulls our defences together.

Building on work carried out in 2018 we have been working on an initiative to explore and create best practice in cyber security, the result of which is adoption of the Cyber Essentials scheme. This is a cyber security standard instigated by the HM Government, together with industry, to create a call for evidence based on a preferred organisational standard in cyber security practices. It provides a clear guidance on the implementation of policies and procedures, gap analysis and risk assessment that can culminate in two levels of certification – with further levels being developed for the future.

The scheme focuses on five essential mitigation strategies:

- Firewalls
- Secure Configuration
- Access Control
- Malware Protection
- Patch Management

Cyber risks are evolving. We are aware of the threat, vulnerability and impact of recognised risks as a baseline for Group cyber security. Analysing and recognising this fundamental information will determine what parts are to be driven to provide the wider improvements and mitigate recognised risk events. As digital transformation proceeds, cyber security must be an enabling function rather than a block to innovation and change.

#### Financial Risks:

#### Commodity and Labour Pressures

Bakery involves the use of commodities whose prices are determined by worldwide demand and macro-economic factors. Commodity pressures have increased as a consequence of a number of factors:

- A change in the value of Sterling against both the Euro and Dollar following the EU referendum.
- The commodity cycle has seen significant increases in the price of a number of commodities over and above any exchange rate deterioration.
- European policies, particularly for butter and sugar.

We maintain a high level of expertise in our buying team, and will consider long-term contracts where appropriate to reduce uncertainty in input prices. The team also cultivates strong relationships with major suppliers to ensure continuity of supply at competitive prices.

Regular renovation and innovation in our product range can help to manage margin pressures effectively as far as the competitive environment allows. We also purchase forward foreign currency to minimise the fluctuation of input costs linked to future currency conversion rates.

The National Living Wage is increasing the cost of labour above inflation and demand-related adjustments. More recently the future availability of labour has become a concern. Ongoing capital investment and improvements in operational efficiency help us reduce the impacts of both labour availability and cost as well as material inflation.

#### Pension Fund Deficit

The Group has one Defined Benefit Pension Scheme within its Memory Lane Cakes Limited business in Cardiff. The Scheme was closed to new members in 2010, to reduce the funding risk to Memory Lane Cakes. The valuation of the Scheme on a technical provision basis, as well as the underlying performance of the invested assets can cause large fluctuations in valuations. There is an agreed deficit recovery plan fixed until September 2023 or until a new schedule is agreed, based on the next valuation, which will be prepared as at 31 December 2018.

#### Foreign Exchange

We acquired manufacturing facilities in Poland through the Ultrapharm acquisition. The sites supply to mainland Europe with income in Euros and local costs denominated in Polish zloty. We supply UK-manufactured products to Lightbody Stretz Ltd, our 50%-owned selling and distribution business which trades in mainland Europe. We also buy a small number of commodities and capital equipment in foreign currency. As a consequence we are exposed to fluctuations in foreign currency rates. We manage this risk by continually monitoring our exposure to foreign currency transactions. We use forward currency contracts when required and our procurement team works hard to ensure we get the best prices for commodities and equipment giving special consideration to the benefits of contracts denominated in foreign currency.