

Principal risks and uncertainties

Howdens operates in an environment that creates different types of risk. Our approach to risk is adaptive, and is designed to ensure that we are protecting what we have while also responding to opportunities to grow and create value.

This section outlines our approach to risk, our risk management process and our principal risks. At the heart of all of these is our analysis of our business model and culture, our strategy, and our markets, which we present in detail on pages 8 to 13. We would encourage you to read this section in conjunction with that analysis.

OUR APPROACH TO RISK

Our approach to risk aims to make sure that we consider risk in all our business decisions whilst preserving the Howdens business model and culture and achieving our long-term strategic objectives. Our risk management approach reflects our business model of decentralised local autonomy and it benefits from the openness and honesty of our culture. Each division identifies risks through both 'bottom-up' and 'top-down' risk identification processes.

Opportunity risk is managed closely, and depends on our ability to understand and manage the key drivers of success, whilst maintaining the delicate balance between them. To support this, our approach considers both short and long term risks within a timeframe of up to three years. Our local builders rely on us to support their needs. They expect us to be flexible, so that they can meet the ever-changing needs of their customers. A culture of personal integrity, stock availability, business resilience and excellent levels of customer service are all strategically important factors that we take into account in the risk management process embedded across the business.

Service availability risk is managed carefully, to ensure that the essential services the business relies upon heavily are available at all times. This includes our approach to supply risk and continuity of stock servicing the depots, debt collection processes, and systems resilience measures to ensure that the stock, sales and cash can be accounted for and managed seamlessly.

RISK MANAGEMENT PROCESS

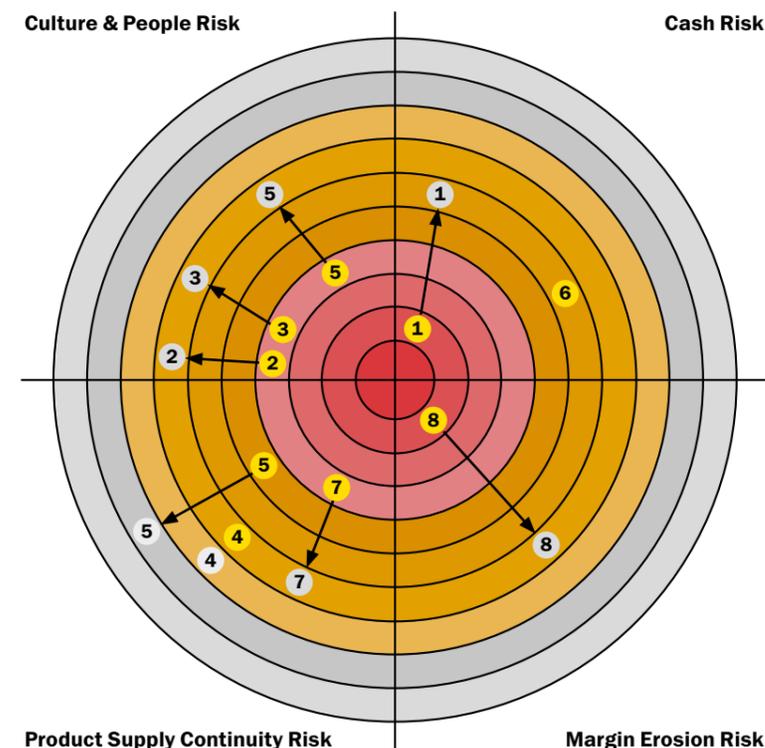
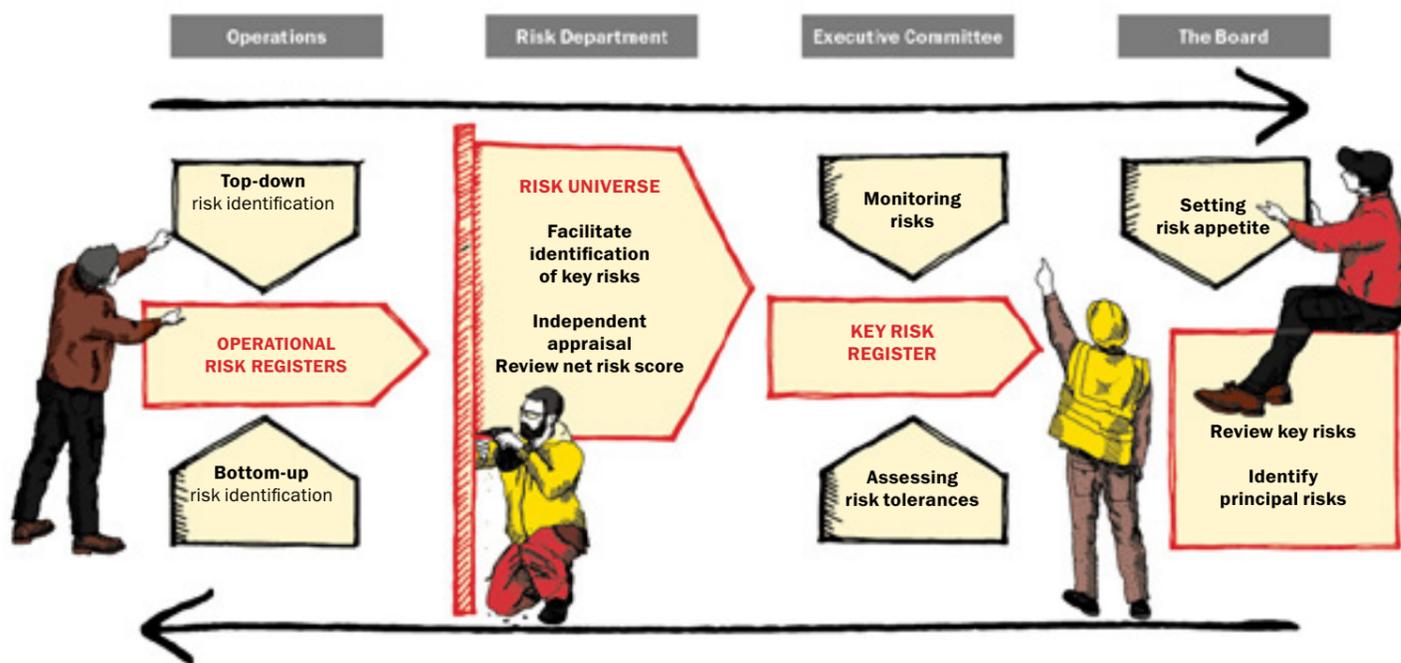
The main steps in the process are illustrated in the diagram on the previous page, and described below:

- **Operational Risk Registers** are reviewed quarterly by senior management within each division. They consider the risks they are managing and discuss the ways in which those risks are being mitigated to arrive at the residual likelihood and impact of that risk to the division (the "net risk" impact and likelihood). Additionally, they pay attention to the inherent impact the risk could have on the division if not controlled (the "gross risk" impact and likelihood).
- **The Executive Committee** then reviews this Key Risk Register and provides their top-down strategic view of the risks they are managing to achieve our objectives.
- **The Board** review the top-down and bottom-up views of the Group key risks twice yearly, and uses this information to select the Group's principal risks.
- **Long Term Viability** is also considered in the context of these risks, as described in the Group Viability Statement on page 20.
- **The Group Risk Universe** is then informed by this process to consolidate a Group view of the key risks identified by the divisions. This includes reporting risks that have either a residual risk impact above our appetite, or inherent risks that are managed to within a tolerable level. All of these risks are included in our Key Risk Register, which gives an overview of the main risks and how they are being managed.

RISK HEAT MAP

To help visualise our risks, we plot them on the heat map below. The highest level of risk is at the centre of the circle. The yellow circle for each risk shows the current risk level and the grey circle shows the target risk level.

RISK MANAGEMENT PROCESS



- 1 Changes in market conditions
- 2 Deterioration of business model and culture
- 3 Failure to maximise growth potential
- 4 Interruption to continuity of supply
- 5 Loss of key personnel
- 6 Credit control failure
- 7 Cyber security incident
- 8 Product design relevance

Principal risks and uncertainties

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CHANGES IN MARKET CONDITIONS

Risk Our products are mostly sold to small builders and installed in owner-occupied and private and public sector rented housing, mainly in the replacement market.

Our revenues are dependent on levels of activity in these markets, which are affected by many factors, including: consumer confidence and buying behaviour; Government, local authority and housing association decisions; credit availability and interest rates; and technology developments.

With a significant proportion of the raw materials and finished products we buy being purchased from overseas, our costs of goods sold can be affected by exchange rate movements between the pound, and the euro and US dollar.

Impact Weaker market conditions can affect our level of sales, while a lower exchange rate can increase our cost of goods sold. Without mitigating action, these can reduce our profitability and cash flow.

These risks were highlighted in 2016, when we saw softer market conditions in the second half of the year, and a much weaker exchange rate against both the euro and US dollar.

Mitigating factors We have a good track record of dealing with changes in market conditions. We maintain close relationships with our customers, who can give us early warning of market conditions changing, and we monitor activity in our depots closely. As a result, we can take swift action to mitigate the effects of changing market conditions, including managing cost levels and inventory. Our unique service proposition to the small builder means that we have a good track record of managing prices to offset cost pressures.

Change year on year



DETERIORATION OF BUSINESS MODEL AND CULTURE

Risk Our future success depends on continuing to successfully implement our unique business model and our locally enabled, entrepreneurial culture. The key to our trade-only model is our local depots, who supply the small builder, with product that is held in stock. Our aim is simple, to provide a local service to builders saving them time, meeting their needs through product availability and innovation. The future success of the business depends on the continuing implementation of this model; and, on its locally enabled, entrepreneurial culture.

Impact If we lose sight of our model and culture we will not successfully service the needs of the local small builder and their customers, and our long-term profitability may suffer.

Mitigating factors The Howdens business model and culture are at the core of our activities and decision-making processes. They are led by the actions of the Board and Executive Committee. The Board, the Executive and senior management teams regularly visit our depots and factories, our logistics and support locations and reinforce the importance of the model and culture through frequent events.

Change year on year



FAILURE TO MAXIMISE THE GROWTH POTENTIAL OF THE BUSINESS

Risk As Howdens continues to expand, this brings both opportunities and challenges to the business. These opportunities include meeting customers' changing expectations and demands through product and services. This requires us to identify new market opportunities, continue to leverage the reach of the depot network and the performance of existing depots. Some challenges we may face in growth include the scalability of our supply chain, systems and personnel capabilities.

Impact If we do not recognise, understand and exploit the potential these opportunities offer, in line with our business model and risk appetite, or do not align current structures and skills to meet the challenges they present, this could affect our ability to obtain maximum benefit from our growth opportunities.

Mitigating factors We place continuing focus on the opportunities and challenges related to growth. We will continue to focus on our people, service, systems, and manufacturing and distribution capabilities. Additionally, the builder's requirement for a local and convenient service provides a significant opportunity for growth through expansion of our depot network. We have increased our investment in all of these areas as we grow, and we will continue this investment in 2017.

Change year on year



INTERRUPTION TO CONTINUITY OF SUPPLY

Risk Howdens is an in-stock business. Our warehousing distribution and manufacturing sites only supply products to Howdens depots; the result is an efficient system with no unnecessary waste of time, space or product. Our business model requires depots to be able to supply at once from local stock, and our customers expect this and rely on it.

Impact Any disruption to our relationship with key suppliers or interruption to manufacturing and distribution operations could adversely affect our ability to deliver the in-stock business model and to service our customer's needs.

Mitigating factors With suppliers, we have multiple sourcing strategies for our key products wherever possible, to reduce the effect of a supply failure. Where appropriate we enter into long-term contracts to secure supply of key products, services and raw materials. We build strong mutually supportive relationships focussed on integrity, fairness and respect which remain worthwhile for all concerned. We have invested heavily in our manufacturing operations and this investment gives us an enhanced disaster recovery capability. We are also investing in new warehouse space to support our distribution capabilities, reducing our exposure to this risk.

Change year on year



LOSS OF KEY PERSONNEL

Risk The skills, experience and performance of key members of our management team make a major contribution to the success of the business.

Impact The loss of a key member of the Group's management team could adversely affect the Group's operations.

Mitigating factors We use the Remuneration Committee to ensure that key team members are appropriately compensated for their contributions and incentivised to continue their careers with us. We will continue to focus on leadership development, succession planning and providing the best tools for our people to achieve their objectives.

Change year on year



CREDIT CONTROL FAILURE

Risk When a builder comes into one of our depots for the first time, we open a nett monthly account for them, so they can complete the job before paying Howdens. Our customers rely on our trade account facilities, as cash flow is critical to their business.

Impact Failure to provide, or service these facilities could affect our ability to continue to support our customers, and potentially our ability to collect debt. This could have a direct impact on both our revenue and our working capital.

Mitigating factors Howdens has an effective trade account policy used to agree terms with our customers and efficient processes for the collection of debt, which are closely and regularly monitored. These are supported by robust systems and tested business continuity plans. Good personal relationships are maintained with customers, both at depot level and within the credit control department. In addition, concentration of debt is limited, as debt exposure is spread across 400,000 customer accounts.

Change year on year



Principal risks and uncertainties

continued

CYBER SECURITY INCIDENT

Risk We are dependent on a core set of critical IT systems which are fundamental to the day-to-day running of the business. Complex systems are integral to our daily operations throughout the supply chain and are essential to support business growth. These systems are at risk from increasingly sophisticated security threats.

Impact If we experienced a major security breach, this could result in a key system being unavailable causing operational difficulties and/or sensitive data to be unavailable or compromised. This could also lead to loss of customer data and scrutiny from regulators.

Mitigating factors We employ complex technical IT security controls to protect our information and our key systems. We adopt a continuous improvement approach to IT security and continue to invest in the security of our systems. In addition, we are also placing focus on the training and development of our people, in cyber security, as we recognise that Information Systems security risks are not always technical. We regularly engage external specialists to validate the effectiveness of our controls against industry best practice. Disaster recovery capability and business continuity plans are in place, and are tested periodically.

Change year
on year



PRODUCT DESIGN RELEVANCE

Risk Ensuring that we have products that meet the design, price and quality needs of the small builder, and their customer, is a key focus of the business model and is a critical element of our future success and growth aspirations. Kitchen technology and design do not stand still; consumer buying patterns are changing, which is increasing the need for our product to be aligned to these expectations.

Impact If we do not support the builder with new products that their customers want it could influence both their ability to generate revenue and therefore our own.

Mitigating factors Our dedicated product team regularly refresh our range of kitchens and appliances to meet builders' and end-users' expectations for design, price and quality. We work with external design and brand specialists and attend product design fairs to monitor likely future trends. Our local depot staff have close relationships with their account holders, and we actively gather feedback from them about changes in trends. We work with our suppliers, to develop new and improved products for the future, some of which are unique to Howdens. A number of new products were introduced during the year across all product categories, and many more are already planned for 2017.

Change year
on year

