Principal Risks and Uncertainties

Like any other business, Devro's operations are exposed to risks which could potentially have an adverse impact on the group.

The directors have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity. The main risks identified are set out in the following pages. Additional risks which are not presently known to management could also have an adverse effect on the company.

Broadly speaking, our risk profile is unchanged, although we see a significantly heightened level of risk in the area of cyber-crime. To counter this, we have invested significantly in our defences and will continue to do so as the threat evolves.

The Board has taken into consideration the principal risks when considering the adoption of the going concern basis of accounting and when assessing the prospects of the company for the purpose of the viability statement.

The viability and going concern statements can be found on pages 27 and 44, respectively.

In addressing and overseeing risk, the Board is supported by the Risk Committee. The Committee submits formal reports to the Board in the course of the year.

A report from the Committee can be found on page 42.

The Financial Reporting Council has encouraged companies to consider how Brexit might impact them, so we have separated this out from the list of other risks for a more detailed analysis in the box below.

Brexit

In the course of 2017, the UK Government confirmed that the UK will leave the EU in March 2019. There is then a possibility of a transitional arrangement for a relatively short period. The terms of any transitional period remain unclear and discussions on the trading arrangement between the UK and EU thereafter have barely started. Much uncertainty remains.

This has a number of implications for Devro. For example, while our Scottish factories mainly manufacture for the UK, some product is currently exported to the EU, and our Czech and Dutch plants send small amounts of their product to the UK. Some raw materials used by our UK/Scottish plants come from other EU countries. Our people move freely between our European plants.

All of the above could cease on Brexit, and while the UK Government has stated, with confidence, its intention to negotiate replacement trade agreements with the EU and other countries, it is not possible at this stage to gauge how successful they will be. The risk for UK-based exporters such as Devro Scotland, is that the proposed new international trading arrangements may not be secured before the existing framework is removed, or may be on disadvantageous terms compared to the current conditions. We are therefore preparing contingency plans based on various "worst-case" scenarios.

With six manufacturing operations around the world, Devro is well placed to reconfigure its global routes to market in order to adapt to changing regulatory restrictions. A review of the various potential supply permutations is underway.

Our External & Regulatory Affairs Director has established strong working relationships with Government, and is working to ensure that collagen food products do not get overlooked in future trade discussions.

It is important to keep this in perspective: the great majority of Devro group production and trade is unaffected. The total export volumes which could be impacted amount to no more than 8% of group output.

The potential Brexit-related opportunities both here in the UK and overseas which could offset any downside are also under review.

With our global footprint and contingency planning underway, we are well placed to deal with whatever emerges from the post-Brexit negotiations.

RISK TREND
Significantly increased | Broadly unchanged | Significantly decreased

Key risk	Impact	Mitigation	Movement
LOSS OF MARKET SHARE/PROFIT MARGINS DUE TO INCREASED COMPETITIVE PRESSURES The group operates in competitive markets throughout the world.	Expansion by competitors could lead to overcapacity in the industry and the consequent risk of loss of volume or price pressure.	The group invested £8.5m in research and development activities in 2017, to extend and differentiate the product range and improve the quality of our products. The Devro 100 programme is designed to enhance Devro's sales capability. We also aim to continue expanding the total collagen casings market by developing products which convert animal intestine applications to collagen casing.	=
OPERATIONAL DISRUPTION The group is at risk of disruption to its manufacturing capability from poor operational performance or major disruptive events, such as fire or flooding.	Prolonged operational disruption could result in sustained loss of capacity or capability and could affect our ability to deliver to customers. This, in turn, could adversely affect the group's financial performance.	The group maintains industry-leading operational processes and procedures to ensure effective operational management at each of our plants. With six manufacturing operations in various locations, the group has manufacturing flexibility and this enables effective contingency planning. Our business continuity and disaster recovery plans are regularly tested and continually updated. Appropriate insurance policies are in place.	=
FOREIGN EXCHANGE RISK Almost 90% of the group's revenues are invoiced in currencies other than sterling.	Adverse foreign exchange rate movements could reduce revenues and the sterling value of reported profits.	The financial impact of exchange rate fluctuations within our operating units is mitigated by a policy of hedging a substantial portion of transactional foreign exchange risk for periods of up to 15 months using forward contracts.	=
DOWNTURN IN CONSUMER DEMAND Consumer preferences evolve over time and are influenced by a number of issues outside our control, including economic factors and health considerations.	A decline in consumer demand for sausage could lead to increased competition in the marketplace and reduced sales revenue/profitability.	Devro's wide range of products allows flexibility to respond to customer and market demands. We continue to invest in our products and processes with the aim of producing differentiated products while reducing our cost base to remain competitive.	=
IT SYSTEMS/CYBER RISK IT systems are central to our business operations. Vulnerability to an external attack is a growing worldwide issue.	An outage for a period of time could have an impact on our operations. Loss of commercial or personal data could damage the business or our reputation and result in financial penalties.	We ensure that our systems are appropriately secured and have invested in firewalls and other security features. Regular penetration testing is conducted.	▲

Principal Risks and Uncertainties continued

Key risk	Impact	Mitigation	Movement
FINANCIAL RISKS The main financial risks relate to the availability of short and long-term funding.	Failure to operate within the agreed financial framework could lead to inability to support long-term investment or to raise capital for funding growth. Interest rate increases could impact earnings.	All term debt is arranged and managed centrally and appropriate covenant headroom is maintained.	=
DISRUPTION TO SUPPLY OR INCREASE IN PRICE OF KEY RAW MATERIALS The group's most important raw material is collagen, a naturally occurring animal protein obtained from cattle and sow hides. There is a risk that changes may occur in the supply or demand for food grade collagen, resulting in significant cost increases for the group's business.	Raw collagen represents 17% of the group's total manufacturing costs. Increase in price would adversely impact the group's operating costs. Disruption to supply could adversely affect manufacturing performance.	The group manages the collagen sourcing risk by, where possible, entering into long-term arrangements with specialised suppliers in various parts of the world.	=
POLITICAL AND REGULATORY RISK As a supplier to the food industry, the group complies with all relevant food safety regulations. Regulatory authorities routinely enact changes to food safety legislation. Political uncertainty leaves international trading companies exposed to the risk of restrictions on cross-border sales.	As a global trading company, political change (including, but not limited to, Brexit) could impact our ability to operate internationally. Changes to food safety regulations could result in restrictions on the movement of the group's products or its raw materials between territories, or necessitate changes to the production processes at one or more of the group's manufacturing operations.	Our External & Regulatory Affairs Director actively monitors planned and actual changes to regulations in all relevant jurisdictions in order to minimise disruption to our business. The group is a founder member of the Collagen Casings Trade Association, which represents the industry and promotes its excellent record in regulatory and health issues. Supplier approval and traceability are under constant review. See Brexit analysis on page 24.	=

RISK TREND
Significantly increased | Broadly unchanged | Significantly decreased

Risk	Impact	Mitigation	Movement
PEOPLE Shortage of people with relevant expertise.	There is considerable competition for highly-trained staff in certain areas. Devro's strategy of significant investment in the company's manufacturing base requires the recruitment and retention of highly-skilled technical managers and employees.	We offer a competitive pay package to our employees. A number of internal programmes have been introduced to train and develop key employees.	=
INCREASED FUNDING REQUIREMENTS OF PENSION SCHEMES Estimates of the amount and timing of future funding obligations for the group's defined benefit pension schemes are based on various assumptions, including the projected investment performance of the pension scheme assets, future bond yields, changes to assumptions about the longevity of the schemes' members and statutory requirements.	Any significant deterioration in the schemes' asset values or unforeseen increases in scheme liabilities might increase the group's funding obligations and could adversely affect the group's profits and financial strength.	The position and performance of each of the pension schemes are continually monitored by the group, in conjunction with pension trustees and professional advisers. All defined benefit schemes are closed to new entrants, and the group is actively working to match assets to expected future cash flow.	=
PRODUCT CONTAMINATION Raw materials and ingredients may contain impurities, contamination or disease.	Contamination could lead to a product recall, loss of reputation, or significant costs of compensation.	All of our manufacturing sites have achieved FS22000 approval. This requires a Hazard Analysis and Critical Control Point programme to be implemented with the aim of preventing contamination.	=

Viability statement

In accordance with the 2016 edition of the UK Corporate Governance Code, the directors have assessed the viability of the group over a three-year period, taking into account the group's current position and the potential impact of the principal risks.

The group's strategy is focused on long-term growth through revenue growth in developed and emerging markets, optimising the use of existing manufacturing assets and investment in new technology, and differentiation through product and process research and development. Whilst the directors have no reason to believe the group will not be viable over a longer period, given the inherent uncertainties involved and the higher-level nature of longer-term forecasting, the directors have determined that a three-year period to 31 December 2020 constitutes an appropriate period over which to provide its viability statement. This three-year period aligns with the period focused on by the Board during the strategic planning process.

In making this statement, the Board carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency and liquidity. The group's principal risks, and how these are managed, are set out above and the group's capital and financial risk management policies and exposures are set out in Note 23 to the financial statements.

The three-year strategic plan is constructed on a "bottom up" basis and is reviewed by the Board annually. This process involves input from individual group operating companies and includes assumptions regarding expected sales volumes by region, production levels by manufacturing site and the level of targeted cost savings achieved. The plan is updated as circumstances evolve.

The output from this planning is used to perform debt and headroom analysis, which includes a review of sensitivity to "business as usual" risks and also stress testing using "severe but plausible" events. The analysis takes account of the availability and likely effectiveness of the further mitigation actions that could be taken to avoid or reduce the impact or occurrence of the identified risks or events. The current revolving credit facility will be in place until 2019 and is expected to be renegotiated on acceptable commercial terms.

Based on this assessment, the directors confirm that they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period to 31 December 2020.