

Principal risks and uncertainties

Background

Tomkins operates globally in a variety of markets and is affected by a number of risks inherent in its activities.

Business risk can be considered either as downside risk (the risk that something can go wrong and result in a financial loss or exposure) or volatility risk (the risk associated with uncertainty, meaning there may be an opportunity for financial gain as well as the potential for loss).

We outline below our principal risks and uncertainties, i.e. those that the Board believes have the greatest potential to impact the Group's results or financial position. We have not listed these risks in any order of priority. Details of the Group's risk management procedures are set out under the heading "Internal Control" on page 48.

Additional risks not currently known to us, or risks that currently we do not regard as significant, could also have a material adverse effect on our results or financial position and our analysis of our principal risks and uncertainties should therefore be read in conjunction with the cautionary statement regarding forward-looking statements set out on the inside front cover.

When applying the Group's accounting policies, management must make assumptions and estimates about the future that may differ from actual outcomes. We discuss the key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying value of the Group's assets and liabilities in note 4 to the consolidated financial statements.

Our strategy

Risks associated with acquisitions and disposals

We seek to reshape our portfolio by making strategic bolt-on acquisitions of complementary businesses to expand our product portfolio and geographic presence and by disposing of non-core businesses.

Acquisitions and disposals, particularly investments in emerging markets, involve legal, economic and political risks. We also encounter risks in the selection of appropriate investment and disposal targets, execution of the transactions, integration of acquired businesses and a risk that we may not generate the anticipated returns and savings from our acquisitions and disposals.

Risks inherent in operating in emerging economies

We aim to expand our activities in the high-growth potential emerging markets of Eastern Europe, Asia, the Middle East and South and Central America. We face inherent risks in operating in these markets that include, but are not limited to, economic and political instability, restrictive or complex laws and regulations, volatility in currency exchange rates, protection of intellectual property and strong competition from companies that are already established in these markets. If we are unable to adequately assess these risks and develop and execute appropriate mitigating strategies, we may have to decline growth opportunities which may adversely impact the Group's sales, profitability and cash flows.

Our funding

Risks arising from illiquid credit markets

Despite the efforts of national governments, restrictions on the availability of credit continue and many companies are finding it difficult to obtain or renew borrowing facilities on commercially acceptable terms. We finance our business principally through equity and bank and other borrowings. While we currently have considerable headroom under our committed borrowing facilities, our £400 million multi-currency revolving credit facility expires in August 2010. We may have to accept less favourable terms when we come to renew or replace the facility.

Failure to obtain sufficient funding to meet our liquidity requirements may result in lost business opportunities or the curtailment of capital spending, research and development and other important strategic programmes.

Illiquid credit markets may also restrict the reshaping of our portfolio because the reduced access to credit may adversely impact the ability of both the Group and potential buyers to finance the acquisition of businesses.

If we were unable to replace or renew our borrowing facilities as they expire, there may be a threat to the Group's status as a going concern. If we were able to obtain funding on less favourable terms, there may be an adverse impact on the Group's profitability and cash flows.

Our markets

Risks associated with economic downturn

Demand for our products is driven directly or indirectly by consumer demand and preferences. Our markets tend to be cyclical and the recent decline in asset prices, severe limitations on the availability of credit and the volatility in the prices of oil and other commodities have eroded market confidence and driven down consumer spending in a number of our end markets.

While the downturn began in the US, it has spread to the developed economies in Europe and parts of Asia and we are now faced with a global recession. It is likely that this will continue to reduce demand for our products, increase pressure on prices, reduce margins and accelerate customer consolidation. We expect these pressures will continue to be particularly acute in our residential, commercial construction and automotive markets.

Risks associated with the major US automotive manufacturers

In 2008, the Group derived 9.7% of its sales from General Motors, Ford and Chrysler. For some time, the global automotive industry has been characterised by overcapacity and fierce competition and, in North America, it is also affected by significant pension and healthcare liabilities. In recent years, the Detroit Three have seen a decline in their market share of vehicle sales, particularly in North America, due to Asian and European automobile manufacturers increasing their presence and the preference of customers for fuel-efficient vehicles. North American vehicle production declined sharply from 15.1 million in 2007 to 12.6 million in 2008 and is projected to fall further to 9.5 million in 2009. As a consequence, the Detroit Three are in severe financial difficulty and have been offered financial assistance from the US government. Should one or more of the Detroit Three file for reorganisation under US bankruptcy laws, we may not be able to recover amounts owed to us by them.

We expect that the production capacity of the Detroit Three in North America will be severely cut back and that any recovery in sales may take some years as they replace their vehicle platforms.

Risk of increased competition from low-cost producers

Many of our end markets are highly competitive, particularly in the automotive industry. Customers are expanding their sourcing of products by looking to regions that enjoy economic advantages such as lower labour costs, cheaper raw materials or export subsidies. If we are unable to continue to provide technologically superior or better quality products or to match the prices of these low-cost suppliers, there is a risk that customers will switch to these suppliers, leading to a loss of market share and reductions in sales and margins.

Risks inherent in the supply chain

Failure to deliver products within acceptable timeframes in our competitive markets could have an adverse effect on the business. Customer-driven reductions in lead times, carrier consolidation, the availability and cost of fuel and longer supply chains resulting from low-cost country sourcing may all impact service levels resulting in lost market share or missed opportunities. Shorter lead times can also make it difficult to predict trends or market changes, hampering accurate forecasting.

Our products

Risks associated with the cost and availability of production inputs

Steel, aluminium, rubber and rubber-based materials are some of the key inputs needed in many of our products. Energy is another significant part of the Group's costs, affecting both production and distribution costs. If prices of these and other inputs increase and we are unable to pass these increases on to customers, there is a risk that our margins may not be sustained and profitability may be adversely affected.

During 2008, we have seen both significant rises and falls in the prices of many inputs. If such price volatility continues, it may hinder accurate forecasting and costing and make it difficult to pass cost increases on to customers.

Our businesses compete globally for key production inputs. The availability of certain raw materials, energy or other key inputs may be disrupted by any number of geopolitical factors. Such disruptions may require additional capital or operating expenditures by the Group or forced reductions in our production volumes.

Financial distress of key suppliers as a result of increasing prices, declining demand and a lack of available financing may lead to disruption in the supply of inputs negatively impacting our production and profitability.

Risk of product liability claims

Due to the nature of our products, we face an inherent risk of product liability claims if failure results in any claim for injury or consequential loss. Litigation is inherently unpredictable and these claims, regardless of their outcome, may be costly, divert management attention and adversely affect our reputation. Supplier consolidation and the increase in low-cost country sourcing may increase the likelihood of receiving defective materials, thereby increasing the risk of product failure and resulting liability claims.

Our people

Risk that our human resources strategies may not be effective

We believe that our future success depends in large measure on our ability to retain and develop our people. If we are unable to identify, attract and retain excellent non-management, management and executive talent, we may not be able to effectively implement our business strategies, or we may experience delays in the development and production of, or face difficulty in selling, our products and services.