Principal risks and uncertainties

Identifying and monitoring risks

The Group faces a number of risks and uncertainties that may have an adverse impact on the Group's operation, performance or future prospects.

It is important for the Board to effectively manage risks and opportunities in seeking to achieve the Group's objectives. The Directors have overall responsibility for risk management and internal control systems. The Group's system of risk management is described in the statement of corporate governance.

The risks and uncertainties described below represent those which the Directors consider to be the most significant in achieving the potential success of the Group's strategy. However, these principal risks and uncertainties do not comprise all of the risks associated with the Group and are not set out in any order of priority. Additional risks and uncertainties currently not known to the Directors and/or which the Directors believe to be less material, may also have a material adverse effect on the Group's business, financial condition or future prospects. The relevant mitigating factors are also described below.

Risk area	Potential impact	Mitigation
Strategy		
Expansion of CFC1 and construction of CFC2	A critical part of the Group's strategy is to expand its operations in the UK by further developing CFC1 and building CFC2 at Dordon, Warwickshire to significantly increase its capacity to service customers. The Group is currently undertaking several capacity enhancing projects in CFC1 which are highly complex and can result in operational difficulties whilst they are being tested and integrated into the current operation. Additional capacity projects will be needed in the future to realise CFC1's full capacity. While projects are undertaken these could have a negative impact on the operational efficiency of CFC1, customer fulfilment, delivery timeliness and ultimately the Group's financial performance. The Group's ability to develop CFC1 and replicate its business model in CFC2 cost-effectively and in a timely fashion will depend upon a variety of factors, notably: the Group's ability to hire and train employees to operate the CFCs; management resources; the Group's ability to write additional complex software systems to operate the CFCs; the Group's ability to roll out the business systems and infrastructure; the retention of reliable developers; and the availability of appropriate equipment and the contractors to design and install such equipment.	Management seek to manage the timing, integration and testing of CFC1 capacity projects so as to minimise operational disruption. The Group has employed additional labour at CFC1 to protect customer service levels during work to install further capacity. This increased labour is expected to be phased out as the installation works are completed. Construction of CFC2 is ongoing. The Group has a detailed plan for the management and resourcing of the CFC2 project and the Directors have oversight of the project to ensure that it can stay on schedule and within budget. The Directors are confident that the business systems of CFC1 can be replicated and enhanced in CFC2 (and in any further CFCs in the future) within the parameters of the capital expenditure budget set for the CFC2 project and that it can continue to successfully complete and integrate projects to expand CFC1.
Expansion of non-food product range	Part of the Group's strategy is to significantly expand its non-food product range. Demand from its customers for many categories of non-food products is relatively untested and significant customer demand will be needed in order to deliver the Group's anticipated growth in non-food sales. The Group's capability to develop the non-food business cost-effectively and in a timely fashion in the medium term will depend on its ability to develop and integrate the necessary infrastructure and business systems needed to support the targeted diverse and large non-food product range.	The initial expansion of the non-food range will be into product categories that are adjacent to the existing Ocado product range, such as kitchenware, which the Directors anticipate can be largely supported by the Group's existing infrastructure and systems and expect will require limited capital expenditure. The Group has and will continue to retain, recruit and train the necessary employees to manage the non-food business and has some plans for implementing the necessary business systems and infrastructure to support the longer-term extension of the non-food range.

Risk area	Potential impact	Mitigation
Operational		
Single CFC	The Group is dependent on the continued operation of CFC1 (and to a lesser extent, the Spokes) in order to satisfy customer orders. Any disruption (such as a result of an IT failure or a fire) to the operation of CFC1 in particular, or a Spoke may therefore have an adverse effect on the Group's financial position or affect the ability of the Group to economically deliver products to certain customers.	The Group has some documented disaster recovery procedures which are aimed at minimising certain possible disruptions to the business. In early 2012, the Group achieved the insurance industry recognised "Highly Protected Risk" status. CFC1 is protected by fire and security systems and has a full contingency plan to manage power outages. The Group also has insurance policies in place which cover business interruption to certain maximum levels. In addition, the eventual operation of CFC2 will limit, in part, the effect of any failure at CFC1. Spokes are able, to some extent, to serve geographies of neighbouring Spokes.
Relationships with third parties		
Relationship with Waitrose	Ocado's reputation and brand is based, at least in part, on its relationship with Waitrose. If the Sourcing Agreement with Waitrose were to end or if Waitrose were unable to source products for the Group, Ocado would need to engage additional personnel to: (i) find or create replacement own-label products; and (ii) find appropriate suppliers and negotiate equivalent prices itself.	The Group has a successful relationship with Waitrose which is now in its twelfth year. The Sourcing Agreement with Waitrose will continue this relationship until at least 2017. The Group is not particularly dependent on the Waitrose supply chain as about 84% of products are delivered directly to CFC1 by the relevant supplier or manufacturer.
	Other than with regard to non-grocery products, the Sourcing Agreement with Waitrose contains provisions which restrict the extent to which Ocado can source products other than from Waitrose, and the extent to which Ocado's range of Ocado own-label products may be expanded.	Ocado has about 620 Ocado own-label products and will further extend this range. The sales of Ocado own-label products is closely monitored to ensure that the limits in the Sourcing Agreement are not exceeded. The Directors do not believe that the restrictions on Ocado own-label products will have a significant impact on the growth of the business or their intended expansion of the range of products stocked by Ocado.
	The Group is reliant on Waitrose for its sourcing and pricing of much of the Group's product range including accurately estimating and passing on the Group's share of supplier bonus and overrider payments.	The Group has reviewed the most significant of Waitrose's supplier arrangements to give it oversight of the supplier support payments and their allocation between Waitrose and Ocado for the period.
	If the parties terminate the Sourcing Agreement after certain competitors of Waitrose or John Lewis gain control of the Company, Ocado is obliged to pay Waitrose a maximum fee of £40 million.	

Principal risks and uncertainties continued

Risk area	Potential impact	Mitigation
IT systems and security and intellectual property		
IT systems	The Group relies to a very significant degree on the efficient and uninterrupted operation of the internet and its IT and communications systems. The Group's business model relies on the complex integration of the Group's Webshop, mobile apps, the highly automated CFC1, material handling equipment and the order fulfilment and delivery operations. Operational problems in the Group's core systems and technologies (such as computer server or system failures, network outages, software performance problems or power failures) can result in customer orders being unable to be captured on the Group's website or processed through CFC1, or errors and delays in their delivery.	The Group has an IT strategy that is aimed at ensuring plans are in place to have information systems and new technology that provide the capabilities necessary for the Group to maintain the integrity and reliability of its business. The Group has disaster recovery plans to maintain the integrity of its IT infrastructure. The Group's IT systems are housed in a purpose-built data centre and it has a separate disaster recovery location which houses standby servers for all of the critical systems and live replica data storage systems. All critical communication links between CFC1 and the disaster recovery location are provided via two diversely routed fibre optic cables and the Group is provided with internet connectivity simultaneously by two major internet service providers.
IT security and fraud	If any compromise in the Group's IT security measures or payment processing systems were to occur, the Group's reputation may be harmed and it could lose its customers. The Group relies on third parties to provide payment processing services and is exposed to typical fraud risk in relation to card payments. The Group is also subject to IT regulations and compliance requirements.	The Group uses encryption and authentication technology to provide the security necessary to effect the secure transmission of information from its customers, such as card payments and to reduce possible fraud. The Group's customers' confidential data is protected by both physical and systems controls. The Group's Webshop is regularly tested for vulnerability by third parties from inside and outside the Ocado network. Relevant accounting, IT and other procedures and controls at all levels are clearly set out and some of which are audited across the business to reduce the risk of fraud. Ocado took significant steps in 2011 in its Payment Card Industry Data Security Standards ("PCI") compliance plan by moving all credit and debit card processing to a PCI compliant external payment service provider.
Intellectual property rights	The business, IT systems, bespoke software and intellectual property are not protected by patents or registered design rights which means that the Group cannot inhibit competitors from entering the same market if they develop similar technology independently. In addition, third parties may independently discover Ocado's trade secrets and proprietary information or systems.	In order to minimise the disclosure of intellectual property outside the organisation, the Group chooses to rely on copyright, confidentiality and licence agreements with its employees, customers, suppliers, consultants and others to protect its intellectual property rights, rather than take other protective measures.

Risk area	Potential impact	Mitigation
Financing		
Funding for capital expenditure	The Group's £100 million credit facility may be terminated by the lenders if the Sourcing Agreement with Waitrose is terminated for any reason.	The Group is able to manage whether any such termination rights will arise under the Sourcing Agreement and hence any potential impact on the debt facility (with the exception of the change of control termination right described above).
Liquidity	To manage the working capital needs of the business and to finance the Group's expansion plans, the Group is reliant on being able to arrange and maintain sufficient financing and to comply with their conditions once established. The most material of the Group's facilities is its £100 million credit facility. A material reduction in forecast EBITDA could lead to a breach of covenants under this facility which would put the Group in default of this facility and would allow the lenders to terminate the facility. This would jeopardise the Group's expansion plans and would threaten the Group's ability to continue as a going concern.	The Group maintains a mixture of short and medium-term debt and lease finance arrangements that are designed to ensure that it has sufficient available funds to finance its operations. The Board monitors rolling forecasts of the Group's liquidity requirements based on a range of conservative growth scenarios to ensure it has sufficient cash to meet operational needs while maintaining sufficient headroom on its committed borrowing facilities at all times so that the Group does not breach borrowing limits or covenants (where applicable) on any of its borrowing facilities. As part of this the Board continues to monitor the timing and amounts of uncommitted expenditure on capital projects. Expenditure on these capital projects and other discretionary expenditure can be delayed if the Group is performing at the lower end of the range of these scenarios. Under all the above scenarios the Directors have a reasonable expectation that the existing facilities provide sufficient funding for the Group to operate as a going concern and to continue with many of its plans to expand the business. The Group regularly reports to and meets with its key lenders to ensure that they are fully informed of the current business performance and future financing requirements of the Group.
Exchange rate, interest rate and commodity fluctuations	Any depreciation of sterling in relation to the euro could increase the sterling equivalent of the price paid for the machinery used in CFC2 and to expand the capacity of CFC1 (which is mostly purchased from suppliers located in countries that have adopted the euro). Fluctuations in the cost of commodities affect the prices that the Group pays for its grocery products and (in the case of diesel) to deliver to customers, and often these cost increases are absorbed by the Group. Fluctuations in interest rates will impact the finance costs to the business.	The Group has a policy, controlled by the treasury committee (and monitored by the Board), to hedge certain foreign currency and interest rate exposures through the use of derivative financial instruments and fixed and floating instruments. There are approval parameters for hedging arrangements and a policy to monitor and review hedging arrangements including short and long-term foreign exchange rates, interest rates and counterparty risk.

Principal risks and uncertainties continued

Risk area	Potential impact	Mitigation
Staff		
Staff retention and recruitment	The Group is reliant on its key management in particular, and staff for the operation of its business and expansion of the business, notably CFC2. The Group's ability to recruit, retain and motivate suitably qualified and experienced staff is important for the Group's success. The relationship between the Group and its workforce will be influenced by the Union of Shop, Distributive and Allied Workers ("USDAW"). USDAW participates in the Group's employee representative body, the Ocado Council, since being formally recognised by the Group in November 2011 in respect of the Group's hourly paid staff in relation to pay, working hours and holidays.	The Directors continue to keep management and staff remuneration and incentivisation under review to ensure it remains competitive and motivating. The Group has a written management succession plan for all key roles and made development plans for management. The business has had good relations with its workforce to date. The Ocado Council provides the forum to discuss the terms and conditions of employment for the workforce and provide for further engagement with staff.
Risks relating to the industry		
Competition and the online grocery market	The trend in UK food retailing of moving from the traditional grocery market to the online grocery market may not continue in part because of changing economic conditions. The Group may be adversely affected (via loss of market share or by diminution of its gross margin through price competition) by the entrance of new competitors in the online grocery market or if the traditional grocery retailers, including Waitrose, invest heavily in their online operations.	The Directors believe that the online grocery market will continue to grow rapidly in the UK, particularly as the number of people shopping online has continued to increase. Ocado has a business model which is predicated on offering our customers a superior service in terms of product quality and convenience, reliability and accuracy of delivery, as well as environmental efficiency. The Directors believe that continuing to improve the Group's proprietary intellectual property and bespoke IT systems (including the Group's Webshop and mobile apps, the stock management systems, the customer delivery system and the van routing system) means that the Group is able to maintain its market leading online grocery offer.
UK and global economic conditions	The Group's performance may depend on factors outside the control of the Group which impact on UK consumer spending and demand, including economic and financial conditions. The difficult economic environment in the UK is likely to result in increased retail price competition in the UK grocery market and lower product margins because of increased promotional activity which will mean that maintaining the Group's gross margins will be very challenging. In addition, current economic conditions may lead to a reduction in the Group's sales or sales growth rate.	The Group regularly reviews its approach to pricing, marketing and product range for appropriateness to market conditions and to adapt to customer feedback and pricing initiatives of its competitors. The Group intends to significantly expand its product range (including non-grocery and Ocado own-label ranges) and is trialling various customer retention and pricing initiatives in order to help meet its gross margin expectations.

Risk area	Potential impact	Mitigation
Regulation and safety		
Health and safety law	A violation of health and safety laws relating to the Group's operations or construction of CFC2 or expansion of CFC1 could lead to injury to employees, negative publicity and reputational damage, fines, costly compliance procedures and in very serious circumstances, a temporary shutdown of all or part of the business, or a delay in construction of CFC2.	The Group's health and safety department maintains and monitors procedures, which are aligned with the relevant regulations and industry standards. The Group's staff are trained in safe workplace practices. The Group has safety procedures and reporting structures for the CFC2 construction project.
Product safety	The Group is subject to a wide variety of regulatory requirements including those in relation to the manner in which it sources, stores, handles and sells products (such as meat and fish) to customers and relating to the operating of its physical facilities. Any regulatory investigation or belief that the products (including Ocado own-label products) supplied by the Group caused illness or injury to customers or others could adversely affect the Group's reputation with existing and potential customers and its financial performance.	There is an established legal and regulatory team in place to monitor developments and to ensure that all existing regulations are complied with. The Group has a food technology department which monitors the Group's facilities, its vans and its procedures to ensure quality standards and compliance with applicable food law and which liaises with the Waitrose food technology department.
Government regulation	A change in regulations relating to the internet and online retail operations, consumer protection laws, the processing of customer data, the environment (such as carrier bags), or the sale, licensing or storage of products could adversely affect the manner in which the Group currently conducts its business or the Group's operational costs. Regulations govern the weight limits of the loads that each delivery van and LGV can take and the number of hours that drivers can work on consecutive days, which constrain the potential delivery efficiency of the business.	The Group has an established governance process in place to monitor regulatory developments and to ensure that all existing regulations are complied with. The Group's delivery routing software and customised vans (which are specifically designed to improve load-carrying capacity) help maximise the operational efficiency of the Group's delivery infrastructure within the scope of the existing regulatory requirements.