CASE STUDY

JULY 2021

ADVANCE INFORMATION

This material is issued prior to the examination session on 21 July 2021.

You MAY bring this material with you to the Exam. It will also be available on your ICAEW Bookshelf.

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HOUSE PRIDE LIMITED: ADVANCE INFORMATION

This Advance Information is issued prior to the examination session so as to allow you to familiarise yourself with the information provided and to undertake any other appropriate research and analysis. The Advance Information is also published on the website: www.icaew.com/students.

You MUST bring this Advance Information with you to the Examination Hall, annotated if you wish, together with any other notes of your preparatory work. You must carry out sufficient and appropriate analysis work **of your own** in order to have a detailed understanding of the Advance Information. You should also undertake any additional research and analysis you feel necessary to enhance your awareness of the industry and market context and to enable you to clarify any technical terms or other issues of vocabulary. You will need to be able to refer back quickly to the Advance Information and your notes during the exam; you are therefore unlikely to benefit from taking large quantities of additional material with you into the Examination Hall.

At the start of the examination you will receive some additional material which will complete the description of the case scenario and state the Case Study requirements. Your answer must be submitted on the CBE software provided by ICAEW in the Examination Hall.

Assessment of the Case Study

The marks in the Case Study are awarded for professional skills, allocated broadly as follows:

• Assimilating and using information	22.5%
• Structuring problems and solutions	22.5%
• Applying judgement	22.5%
• Drawing conclusions and making recommendations	15.0%
• Demonstrating integrative and multidisciplinary skills	17.5%

Of the total marks available, 15% are awarded for the executive summary and approximately 10% for the relevant discussion of ethical issues within your answer to the requirements. Ethical issues do not form a specific requirement but, within a requirement, may cover such topics as:

- Lack of professional independence or objectivity
- Conflicts of interest among stakeholders
- Doubtful accounting or commercial practice
- Inappropriate pressure to achieve a reported result.

You should be clear that marks are awarded for demonstrating your professional skills, not for reproducing facts from the case. In order to be successful, you will need to:

- Demonstrate your knowledge of the case material and make use of your preparatory work;
- Carry out relevant analysis of the problems and structure your proposed solutions;
- Apply your judgement on the basis of the analysis that you have carried out; and
- Draw conclusions from your analysis and judgement, and develop them into practical commercial recommendations.

Omitting any one of these elements will have a significantly detrimental effect on your chances of success.

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July 2021 Case Study: House Pride Limited

List of exhibits

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EXHIBIT 1

About you (Jules Wingate) and your employer (House Pride Limited)

You are Jules Wingate, a final-year trainee ICAEW Chartered Accountant, working in the business advisory unit at Quiller, a firm of ICAEW Chartered Accountants in the north-west of England. You are currently on secondment to House Pride Limited (HP), which is not otherwise a client of Quiller. HP supplies building materials and home improvement products to regional housebuilders, building contractors and tradespeople across the north-west of England. You report to HP's Finance Director, Amanda Ellis.

Your work at HP has included the following:

- Analysing HP's performance for variations and trends, especially by reference to its internal targets and industry norms, enabling the directors to identify items (both revenue and cost) requiring further attention
- Applying your numerical expertise to add value to your analysis of detailed financial and other data
- Using a range of information to advise HP on other financial and commercial aspects of its business
- Applying professional scepticism to financial and other data provided to you by third parties
- Preparing reports for management on strategic and operational proposals
- Evaluating the benefits and risks of new opportunities, including ethical and business trust concerns.

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EXHIBIT 2

The UK building supplies industry

Overview

The UK building supplies industry is both large and diverse. The companies that sell building supplies are called "builders' merchants", generally referred to below simply as "merchants". They range from small, single-unit entities, through medium-sized businesses that cover one or more regions of the UK, to the large chain Travis Perkins, which generates annual revenue in excess of £6 billion and has hundreds of branches. The industry is not a new one: some merchants proudly boast on their websites that they were set up over 100 years ago and have remained within the same family since then.

There have been numerous recent mergers and acquisitions, with more expected to follow in the short term. This activity has also been driven by the need for companies to focus on core strengths and customer requirements; to gain scale economies; and to meet the growing threat from online specialists. Some transactions have also come under the spotlight of the UK Competition and Markets Authority (CMA), which on occasion has forced merged enterprises to sell outlets so as to ensure proper competition in a particular region. It has also investigated anti-competitive pricing practices among companies in the construction sector (see **Exhibit 13**).

The role of the merchant

A typical merchant acts as an intermediary between manufacturers and users of products required for building or renovating properties, both domestic and commercial. Their customers may be either personal or trade. Some merchants serve both personal and trade customers; others, only trade customers. Most trade customers are regional housebuilders, property developers and small-to-medium-sized building contractors, as well as ancillary tradespeople, eg, plumbers, decorators, roofers, electricians, landscape gardeners. (Large national housebuilders, together with constructors of roads and railways, generally do not use merchants but instead buy direct from manufacturers.) Merchants also sell to small hardware shops and other retailers. Trade customers generally receive more favourable terms than personal customers because they buy more frequently and in bulk.

Many merchants seek to become the sole supplier, or one of several preferred suppliers, to regional housebuilders and property developers. Managing relationships with major trade customers – and giving them a high-quality service, efficient delivery and competitive prices – is paramount. With a typically large customer base, and with most sales being on credit, merchants must maintain good credit control. Many are poor at management of cash and working capital and have to take out (short-term and/or long-term) borrowings.

Products and suppliers

Sales are made both physically and (a continually growing trend) online. The products sold by merchants include:

- basic construction materials, eg, bricks, cement, sand, gravel, timber (wood) and roof tiles
- windows, doors and frames
- small tools (eg, screwdrivers, drills)
- flooring
- interior fittings and materials, eg, nails, screws, paints, varnishes, adhesives, tiles for kitchens and bathrooms.

Some merchants have specialist outlets selling for example:

- plumbing supplies such as radiators and other heating items
- garden equipment and other outdoor products (eg, fences, barbecues, paving stones)
- bathroom fixtures (sanitaryware)
- fitted kitchens
- lighting and other household fixtures.

Some merchants additionally operate DIY (‘do-it-yourself’) outlets, from which they may sell an even wider range of products, as well as offering services such as design, building and installation of kitchens and bathrooms.

It will be apparent that the range of products can be huge, often amounting to several thousand lines. At any one time, merchants may be holding inventory worth several million pounds. For its accurate presentation in the financial statements, an extensive end-of-period count and valuation exercise is therefore needed.

Inventory management is a key challenge for all merchants, both large and small. The availability of sophisticated technology is invaluable. Inventory control, pricing and ordering systems can ensure availability of the optimum breadth and depth of items. Storage and security are important to prevent goods from being damaged or stolen. Merchants located near their customer base can deliver goods quickly, minimising inventory holdings and storage costs, which can otherwise be substantial. Being situated close to road networks and having reasonable parking capacity are also advantages.

Selling many product lines also usually means having a large set of suppliers. Some may supply only a few lines. Just as with customers, the relationships and financial arrangements with suppliers need careful oversight. In addition, merchants undertake checks to ensure that suppliers meet the highest possible standards for working conditions, eco-friendliness and quality assurance.

Capital investment and technology

Merchants need substantial storage and distribution facilities, customer access areas and showrooms. The initial capital outlay for each new site can be significant. This includes the cost of fixtures and fittings, security systems and IT. Merchants that run their own distribution networks (see **Exhibit 3**) also need to invest in a sizable fleet of vehicles and then incur significant running costs.

Capital expenditure has been rising with more investment in technology. Technological innovation in the industry mainly involves advances that improve efficiency and cut costs, notably in supply chain management. Many merchants use Enterprise Resource Planning (ERP) – software packages that streamline business activities and processes. An ERP system collates structured data to aid the management of sales orders, finance, production, supply chain and customer relationships. This improves demand forecasting and inventory management, allows working capital to be used more productively and helps to avoid stockouts (caused by short-term demand fluctuations), which affect merchants’ reputation and revenue. There are some specialist providers of ERP systems, which merchants can buy and install rather than developing their own.

The other main technological development is in e-commerce. This serves several roles: it offers an alternative, accessible and user-friendly channel for customers (especially at times when they cannot easily visit and browse around merchant premises); it counters the threat from manufacturers selling direct to contractors; and it reduces the need for large branches (there is instead a move towards central warehouses to support increased online shopping). In recent years, some businesses have emerged that sell only online.

To compete effectively, traditional merchants must use the latest web design tools to create eye-catching graphics, along with clear product descriptions and reviews, and to add value with interactive features. They also need to keep their systems up-to-date and secure.

Many merchants have begun to operate ‘click-and-collect’, a service allowing customers to buy products online and then collect them from a local branch. This can help to reduce distribution costs, shorten lead times and improve inventory turnover.

EXHIBIT 3

The UK building supplies industry: Revenue and costs

Revenue and the market environment

The prosperity or otherwise of merchants depends directly on trends in construction and home improvement – sectors that are representative of the wider economy. These can benefit from short-term boosts, such as new legislation giving generous incentives to property buyers. The growing emphasis on sustainability and energy efficiency also creates additional demand. Weather is another factor that determines when building or renovation work occurs. For example, 2018 saw a downturn because of a cold March (usually a busy month), but the subsequent heatwave in June and July improved sales.

In recent years, the industry has been helped by UK government policy to increase the supply of homes and by growth in personal home improvement expenditure and in property sales, leading to higher levels of renovation work. This has continued in 2020, despite an economic downturn. In general, the UK construction industry has been relatively unaffected by the downturn, with both housebuilding and home improvements carrying on. In the latter case, many homeowners have chosen to carry out renovation work that they had previously delayed, spending money that would otherwise have been used for holidays and other leisure activities. Some parts of the UK (eg, the north-west of England) have fared better than others, with steady growth in construction activity.

Purchase of goods

The purchase of goods for sale is by far the largest expense for merchants, typically amounting to around 70% of revenue. A vital statistic is the set of data known as the construction materials price indices (CMPIs), which are recognised measures of inflation in the industry. When the CMPIs are high, rises in the prices that merchants pay for goods cannot always easily be passed on to customers, and this puts pressure on merchants' margins. Through most of the past five years, the CMPIs have risen; this is expected to continue in 2020-21. Some products may be more successful in one year than another, for a variety of reasons (eg, timber sells well if there is a demand for garden fencing replacements after a storm).

A common phenomenon is that of buying groups: small and medium-sized merchants coming together to achieve economies of scale and to compete against the large national chains. Their increased purchasing power leads to bigger volume discounts and the ability to settle accounts with several suppliers using a single monthly payment. There are downsides of membership too, notably short credit periods and strict payment terms. The largest UK group, National Merchant Buying Society (NMBS), represents more than 1,000 merchants, between them having over 3,100 branches.

Staffing

The quality of the workforce is vital in an industry where repeat business, long-term relationships and loyalty are heavily reliant for on high-quality customer service and staff who are polite and knowledgeable (which is not easy with so many products on the market). Payroll costs for customer-facing staff typically represent around 15% of revenue. Most employees are engaged in manual tasks, some of which are gradually becoming redundant because of the growing automation of warehousing and other systems.

Transport and distribution

Another important cost is transport and distribution. Some merchants undertake these activities in-house, while others outsource them to specialist contractors. With the increase in online sales and a reduction in sales made by customers visiting merchants' premises, distribution has become even more critical. Builders and contractors need and expect fast delivery, and this will often be a key determinant when they are selecting a merchant.

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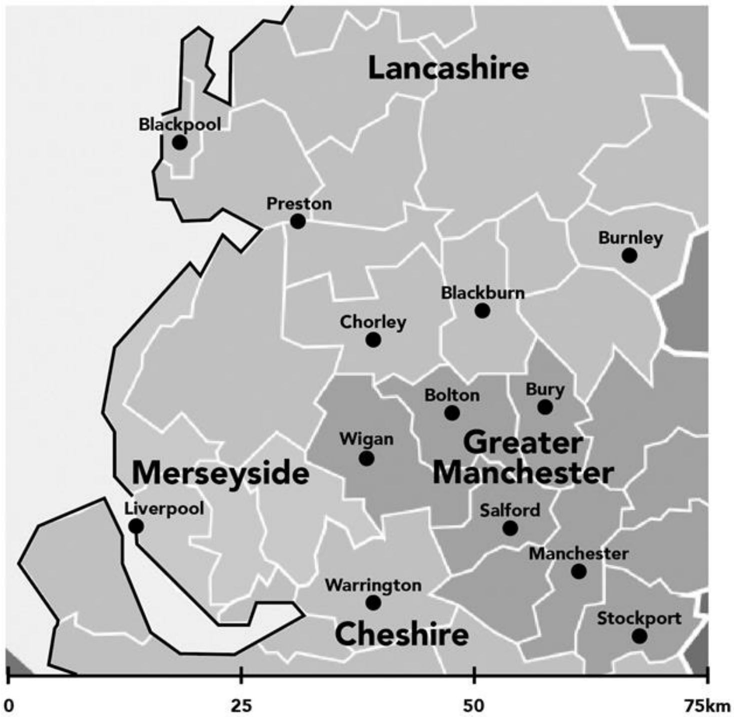
House Pride (HP): An introduction

Based in Warrington in the north-west of England, HP is one of the oldest and largest merchants in the region. It can trace its history back over 100 years, to the time when its founder Edward Brown began excavating sand for bricklaying from a sandpit close to Warrington. With the continued input from Edward's family, the business (Brown's, as it had become known) evolved over the following decades.

In 1997, Edward's great-grandson Philip decided that he did not want to retain the business and sold it to outside investors. They established a new company, House Pride, and as its founding directors they developed a plan to expand its geographical reach.

In the early days, the main trade of Brown's was in sand, bricks and other building materials. HP's product range today comprises thousands of separate product lines. At the outset, HP had a single branch, in Warrington. It now has eight, of roughly equal size, spread strategically across the four main areas of the north-west: Lancashire, Merseyside, Greater Manchester and Cheshire (see map below).



HP is a purely business-to-business (B2B) company, serving a wide range of trade customers in two divisions: (1) regional housebuilders (RH); and (2) building contractors and tradespeople (BCT). For management accounts purposes, the results are segmented into these two divisions. RH currently generates approximately 80% of revenue. HP does not sell direct to personal customers.

Sales in both divisions are made through two channels: online (which is growing fast) and at branches. Products are sold at the same prices (before any discounts) regardless of the sales channel. Some sales go through HP's click-and-collect facility, a relatively new service in which orders made online are left for collection at a nominated branch. For management accounts purposes, branch revenue represents simply physical sales made at the branches; click-and-collect is treated as part of online and not attributed to the individual branch from which the goods are collected, but it is intended that this will change once all branches have been adapted for click-and-collect facilities.

Online sales tend to be at a higher gross margin than branch sales because staffing requirements are lower. However, with some employees being involved in both branch and online (including click-and-collect) sales, it is not straightforward to allocate staffing costs across the two channels, and for that reason there is no analysis of cost of sales by channel in the management accounts.

Distribution costs also vary between the two channels. For branch transactions that are smaller in value and/or volume, the customer transports the goods; but for larger purchases, the customer arranges for delivery (see **Exhibit 7**). For standard online sales (ie, other than click-and-collect), the goods always have to be delivered to a specified location.

Branches

The branches, other than Warrington, are as follows (the head office, together with a large warehouse, is situated on the Warrington branch site).

Branch	**Opening date**
Preston	1 July 1999
Bury	1 January 2002
Blackburn	1 January 2006
Burnley	1 July 2010
Wigan	1 July 2014
Bolton	1 January 2016
Manchester	1 July 2017
Liverpool	1 January 2019

As can be seen, branch openings over the period have been gradual. One of the earliest branches, Bury, was closed on 31 December 2016 after a prolonged spell of poor trading. Its performance never fully recovered from a fire in 2013. At the time of closure, HP transferred inventory to other branches, as well as items of property, plant and equipment (PPE) that were movable and still usable. Where this was not possible, it disposed of the PPE for zero proceeds and sold the inventory for 50% of its normal sale price. Staff were redeployed to other branches or to head office. Net closure costs for the Bury branch, including a loss of £40,000 on the PPE, were £100,000.

HP had planned to open two new sites (Chorley and Blackpool) in the year to 30 June 2020, but these plans are currently on hold because of uncertainty about general trading conditions.

Revenue from each branch has been as follows:

Year ended 30 June	**2020 £000**	**2019 £000**	**2018 £000**	**2017 £000**
Warrington	2,970	3,021	2,855	2,831
Preston	2,457	2,491	2,336	2,259
Bury	-	-	-	653
Blackburn	3,168	3,399	3,179	2,937
Burnley	2,860	3,071	2,808	2,661
Wigan	2,101	2,249	2,026	2,073
Bolton	2,565	2,686	2,421	2,158
Manchester	2,513	2,594	2,072	-
Liverpool	1,845	973	-	-
	20,479	20,484	17,697	15,572

The board

The board comprises:

- Emily Hanwell – CEO
- Amanda Ellis – Finance Director
- Ross Connor – Sales and Marketing Director
- Wei Li – Purchasing and Inventory Director
- Hans Ritz – IT Director

EXHIBIT 5

HP: Review of management accounts for the three years ended 30 June 2020 (prepared by Amanda Ellis, July 2020)

I attach the management accounts for the three years ended 30 June 2020 (**Exhibit 6**). These are for our internal use to enable us to manage the business. Relevant notes set out the policies adopted in their preparation. The review below covers the key issues arising in each year as identified at the time.

In general, revenue and profits have been impacted by several significant issues over the period under review: branch openings and refurbishments; the growth of e-commerce; and, more recently, the effects of an economic downturn. Our key measure, average branch revenue per month, calculated as total branch revenue / (number of branches x total number of months open), has risen steadily over the period. The commentary below highlights, where relevant, key factors affecting the results of individual branches.

	2020	2019	2018	2017
Average branch revenue per month (£000)	238.1	232.8	210.7	199.6

Year ended 30 June 2018 (2018)

Total revenue was up by 21.4%, exceeding £20 million and well on the way to our target of £25 million by June 2019. Both divisions achieved strong revenue growth. We were especially pleased with BCT – revenue up by just over £1 million (24%) to almost £5.4 million. A significant part of this increase was due to the launch of our online platform for BCT customers after its successful set-up for RH customers. RH made excellent progress in both branch and online sales, also increasing revenue by more than 20%. It benefited from a major new customer, Elevant, a fast-growing housebuilder which selected HP as one of its of building product suppliers. This added over £1 million to our revenue, spread across several branches, with the promise of a steady stream of work from Elevant in the years ahead.

Another important contributor was the opening of our new Manchester branch on the first day of the financial year. The capital costs, all incurred by 30 June 2017, began to be depreciated on 1 July 2017. The Manchester branch achieved promising sales (just over £2 million) in its first 12 months, proving an excellent replacement for the Bury branch that had been closed in December 2016. With its better location and configuration (both of which were the result of extensive market research), the Manchester branch was much more user-friendly than the Bury branch. HP’s existing strong regional profile also provided us with free marketing. Benefiting from the new arrangement with Elevant, Bolton achieved the highest growth rate among the established branches.

The net effect of these developments was that average branch revenue per month rose by more than 5% to exceed £200,000 for the first time. However, gross margin fell slightly. There were three main causes:

- pricing strategies and promotions designed to enable HP to compete effectively;
- higher costs of purchases from some suppliers; and
- the large number of staff recruited to ensure a strong start at Manchester branch.

HP managed other costs effectively: the ratios of distribution costs and administrative expenses to revenue fell slightly, to 5.7% and 11.4% respectively, taking operating profit up by nearly 50% to £377,000. Our goal is to reduce both ratios as we strive to make our operations more efficient.

We also strengthened the central credit control function. It had become apparent towards the end of the previous financial year that the level of aged receivables was rising. We improved our computer systems by introducing red flags that showed when a receivable reached 60 or 90 days overdue. This led to the recovery of some large balances and a fall in trade receivables days.

We built up inventory across all branches to combat shortages of materials in the sector and to ensure that as far as possible we did not have to disappoint customers. We worked hard to identify the most popular lines and to anticipate changes in tastes and needs. We also began to replace older delivery vehicles with more environmentally friendly models.

Year ended 30 June 2019 (2019)

Overall revenue growth was again well into double digits (18.6%), considerably above industry norms, taking revenue up to £27.7 million. This led us to reset our target: we now aim to reach £30 million by 30 June 2020. The growth came in both RH and BCT and both branch and online. With Manchester doing particularly well in its second year, we were delighted to launch another new branch (Liverpool) to extend our footprint in the region. We registered a further strong increase in our 'average branch revenue per month' measure:

- Liverpool added almost £1 million to revenue in the six months after opening.
- We were particularly pleased with the performance of Wigan branch, which had experienced a slight decline in the previous year. The steps we took, to strengthen the management team and to enhance control of inventory, produced rapid results.

We gained some sizable new business in the BCT division, the indirect result of an expanded and widespread interest among local homeowners in carrying out refurbishments. We also reaped the rewards of recommendations from satisfied customers and a series of high-profile appearances in the north-west regional press (the editor of the main newspaper is a close friend of Emily Hanwell). Within RH, we continued to benefit from the growth in new housebuilding projects by Elevant – assisted by government subsidies – as well as some new projects by more established customers.

We were especially pleased to report a rise – by a whole percentage point – in our gross profit margin, taking it to 19.7%. With the significant revenue growth, absolute gross profit rose by more than £1 million to £5.5 million. The expansion in our online activity, across both divisions, has undoubtedly introduced greater efficiencies. The overall increase in scale has also helped us to secure better supplier terms.

Distribution costs rose by around £0.5 million to £1.8 million (6.6% of revenue). This was due to a larger number of smaller orders. We may need to review route planning so as to reduce distances travelled and maximise load sizes, as well as continuing our vehicle replacement programme.

During the year, we increased our spend on staff recruitment and training, product management and customer services. We initiated our Enterprise Resource Planning (ERP) project to upgrade our IT systems. We see this as essential for supporting the management and expected growth of the business.

Recognising that some of our branches were starting to look shabby, we began a rolling refurbishment programme at the two oldest: Warrington and Preston. Part of this involved setting up click-and-collect facilities. The combined capital cost of the upgrades was £150,000. The branches were closed for a brief period (one month), at a quiet time of year (January). We were able to give notice of closure, enabling us to redirect customers and transfer inventory temporarily to other branches and to rearrange deliveries as necessary to keep disruption and lost business to an absolute minimum.

These various areas of higher spending increased administrative expenses (including depreciation) to just over £3 million, but we still managed to achieve strong growth in operating profit.

Year ended 30 June 2020 (2020)

Although there was unseasonally poor weather in July and August 2019, this had only a minor impact on performance. In general, the nine months to 31 March 2020 were characterised by an influx of new customers for both RH and BCT, as well as strong revenue growth from some existing customers. We were especially pleased to be appointed sole supplier of building products to Wrights, an established local builder of serviced offices, following the bankruptcy of its previous sole supplier, Brickbuild. We were able to demonstrate our capability and reliability to Wrights' senior management. In the period from our appointment to 30 June, Wrights generated £800,000 of revenue.

With a full impact from last year's new opening (Liverpool) and upgrades (Warrington, Preston), and from the next two upgrades (Blackburn and Burnley) – which were both closed for the month of January 2020 at a total capital cost of £120,000, with little if any resulting loss of business to HP overall – we seemed well on course to achieve the £30 million revenue target. In particular, with collections from click-and-collect orders now available from four branches, online revenue was growing strongly.

However, the momentum in the final quarter of the year was affected by the economic downturn. To help us adapt and temporarily refocus the business, we closed all branches for the month of June, reopening them at the start of the new financial year. Customers continued to make online purchases during the closure. As a result, we experienced less of an overall decline than we might have expected, albeit with a much-altered operational model. We were fortunate that we had a pipeline of advance orders and that major construction projects continued while businesses in other sectors suffered very badly.

We kept most of our staff occupied during June. In many cases they had to be re-trained in different roles, notably e-commerce support, and had to work remotely – a situation that we expect to continue. Where necessary, we paid for them to have suitable IT facilities at home.

We reaped the benefits of our new inventory management system. We believe that with fewer stockouts, this added £450,000 to revenue, less than anticipated but still good. However, we became aware that our online sales systems were slower and less efficient than those of some competitors. We therefore made some small enhancements to ensure that we could cope with higher volumes of online trade, mindful that this was a temporary measure and that more investment would be needed in the future. We estimate that that we lost around £600,000 of revenue in the year through online systems issues.

The combined impact of these events was that branch revenue was virtually unchanged from 2019 but online sales grew by 25%, so total revenue was still impressive at £29.6 million. There was a marked disparity between the two divisions: RH actually managed almost a 10% year-on-year revenue increase but BCT's fell by 4.2%, partly reflecting a brief pause in small-scale refurbishment work by homeowners. With two branches open for 10 months and six for 11 months (a total of 86 months), average branch revenue per month was up only slightly for the year. We are conscious that this figure is flattening. In fact, all individual branches – other than Liverpool, which had been open for only half of the previous year – suffered an absolute drop in revenue, ranging from 1.4% (Preston) to 6.9% (Burnley).

The disruption involved in finding new ways to work, especially in June, affected GP%, which fell to 19.1% – still respectable. We had to put on hold our plans to open new branches. The shift towards online sales in 2020 also caused relative increases in distribution and administrative expenses, partly offset by savings from the new ERP system. At the start of the year, we launched an incentive scheme for branch, warehouse and e-commerce staff: the total payment under this scheme was £80,000.

As a result of our reduced capital expenditure in the year, and despite the challenges we faced, we reported a positive cash flow, enabling us to clear our overdraft. We are conscious that tight monitoring of working capital is important. We were pleased that there was only a slight deterioration in trade receivables days. This was partly the result of the declining revenue towards the end of the year, but we are acutely conscious that some customers are falling into difficulties and that we will need to keep on top of credit control. There was little change in inventory turnover but some product lines were beginning to move slowly: we will continue to monitor this closely.

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EXHIBIT 6

HP: Management accounts for the three years ended 30 June 2020

Statement of profit or loss for years ended 30 June

	Note	2020	2019	2018
		£000	£000	£000
Revenue	1	**29,554**	**27,744**	**23,394**
Cost of sales	1	(23,895)	(22,279)	(19,021)
Gross profit	1	**5,659**	**5,465**	**4,373**
Distribution costs		(2,070)	(1,825)	(1,337)
Administrative expenses	2	(3,326)	(3,016)	(2,659)
Operating profit		**263**	**624**	**377**
Net finance income/(expense)		6	(17)	(20)
Profit before taxation		**269**	**607**	**357**
Income tax		(51)	(115)	(68)
Profit for the year		**218**	**492**	**289**

Statement of financial position at 30 June

	Note	2020	2019	2018
		£000	£000	£000
Non-current assets				
Property, plant and equipment (PPE)	3	4,342	4,561	4,062
		4,342	**4,561**	**4,062**
Current assets				
Inventories	4	2,020	1,861	1,591
Trade and other receivables	5	3,343	3,047	2,645
Cash and cash equivalents		227	10	10
		5,590	**4,918**	**4,246**
TOTAL ASSETS		**9,932**	**9,479**	**8,308**
Equity				
Ordinary shares		90	90	90
Retained earnings		5,441	5,223	4,731
		5,531	**5,313**	**4,821**
Current liabilities				
Trade and other payables	6	4,350	4,051	3,419
Taxation		51	115	68
		4,401	**4,166**	**3,487**
TOTAL EQUITY AND LIABILITIES		**9,932**	**9,479**	**8,308**

Statement of cash flows for years ended 30 June

	2020 £000	2019 £000	2018 £000
Cash flows from operating activities			
Profit before taxation	269	607	357
Adjustments for:			
Depreciation	537	565	525
Loss on disposal of PPE	-	6	18
Finance (income)/expense	(6)	17	20
	800	1,195	920
Change in inventories	(159)	(270)	(238)
Change in trade and other receivables	(296)	(402)	(25)
Change in trade and other payables	565	664	291
	910	1,187	948
Income tax paid	(115)	(68)	(34)
Net cash generated from operating activities	**795**	**1,119**	**914**
Cash flows from investing activities			
Acquisition of PPE	(318)	(1,085)	(360)
Proceeds from disposal of PPE	-	15	10
Interest received/(paid)	6	(17)	(20)
Net cash generated from investing activities	**(312)**	**(1,087)**	**(370)**
Cash flows from financing activities	**-**	**-**	**-**
Net change in cash and cash equivalents	483	32	544
Cash and cash equivalents at start of period	(256)	(288)	(832)
Cash and cash equivalents at end of period	**227**	**(256)**	**(288)**

Notes to the management accounts

Note 1: Revenue, cost of sales and gross profit

	2020 £000	2019 £000	2018 £000
Revenue			
RH			
Branch	15,535	14,834	12,814
Online	7,633	6,241	5,222
	23,168	21,075	18,036
BCT			
Branch	4,944	5,650	4,883
Online	1,442	1,019	475
	6,386	6,669	5,358
Total			
Branch	20,479	20,484	17,697
Online	9,075	7,260	5,697
	29,554	**27,744**	**23,394**
Cost of sales			
RH	19,493	17,681	15,298
BCT	4,402	4,598	3,723
	23,895	**22,279**	**19,021**
Gross profit			
RH	3,675	3,394	2,738
BCT	1,984	2,071	1,635
	5,659	**5,465**	**4,373**

Cost of sales comprises:

	2020 £000	2019 £000	2018 £000
Goods and materials	19,762	18,575	15,672
Wages and salaries	4,133	3,704	3,349
	23,895	**22,279**	**19,021**

‘Goods and materials’ includes impairment allowances against inventories (see note 4). Wages and salaries relate to customer-facing staff, based in branches, the warehouse and e-commerce operations.

Note 2: Administrative expenses

	2020 £000	2019 £000	2018 £000
Personnel	1,418	1,208	925
IT, premises, depreciation and other	1,619	1,558	1,511
Marketing and advertising	289	250	223
	3,326	**3,016**	**2,659**

‘Personnel’ includes the directors’ salaries and related costs: 2018 – £446,000; 2019 – £601,000; 2020 – £694,000. ‘Other’ includes impairment allowances against trade receivables (see note 5).

Note 3: Property, plant and equipment (PPE)

	Land, buildings, plant, machinery, fixtures, fittings and equipment	Motor vehicles	**TOTAL**
Cost	£000	£000	**£000**
At 1 July 2017	3,646	1,892	**5,538**
Additions	74	286	**360**
Disposals	(30)	(137)	**(167)**
At 1 July 2018	3,690	2,041	**5,731**
Additions	806	279	**1,085**
Disposals	(46)	(115)	**(161)**
At 1 July 2019	4,450	2,205	**6,655**
Additions	217	101	**318**
Disposals	(18)	-	**(18)**
At 1 July 2020	4,649	2,306	**6,955**
Depreciation			
At 1 July 2017	646	637	**1,283**
Charge for the year	246	279	**525**
On disposals	(30)	(109)	**(139)**
At 1 July 2018	862	807	**1,669**
Charge for the year	262	303	**565**
On disposals	(25)	(115)	**(140)**
At 1 July 2019	1,099	995	**2,094**
Charge for the year	275	262	**537**
On disposals	(18)	-	**(18)**
At 1 July 2020	1,356	1,257	**2,613**
Carrying amount			
At 1 July 2017	3,000	1,255	**4,255**
At 1 July 2018	2,828	1,234	**4,062**
At 1 July 2019	3,351	1,210	**4,561**
At 1 July 2020	3,293	1,049	**4,342**

Note 4: Inventories

Inventory is carried at the lower of cost and net realisable value. Where necessary, an allowance is made for obsolescence and slow-moving items. Allowances have been recognised as part of goods and materials within cost of sales as follows: 2018 – £106,000; 2019 – £121,000; 2020 – £135,000.

Note 5: Trade and other receivables

	2020	2019	2018
	£000	**£000**	**£000**
Trade receivables	3,009	2,723	2,310
Other receivables and prepayments	334	324	335
	3,343	**3,047**	**2,645**

Trade receivables are stated after impairments for amounts considered irrecoverable. Impairment charges recognised in administrative expenses are: 2018 – £53,000; 2019 – £44,000; 2020 – £31,000.

Note 6: Trade and other payables

	2020	2019	2018
	£000	**£000**	**£000**
Bank overdraft	-	266	298
Trade payables	3,583	3,128	2,561
Other payables and accruals	767	657	560
	4,350	**4,051**	**3,419**

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HP: Business operations

Overview

HP prides itself on selling quality products at competitive prices, supported by experienced staff.

Although sales take place through the year, there are seasonal patterns. In a typical year, around half of all sales are made in the last four months of HP's financial year (March to June), the time when most housebuilding and refurbishments are started. However, other factors can also affect sales trends, such as weather; government announcements about new incentives; and the general economic situation.

Products

HP's product portfolio comprises a wide range of items, including: bricks, sand, cement, gravel, timber, roof tiles, windows, doors and frames, flooring, nails and screws, paints, adhesives, tiles for kitchens and bathrooms, and outdoor products such as fencing. HP does not sell sanitaryware or fitted kitchens, as it believes that it cannot compete effectively against those companies that have specialised outlets and divisions for such products.

At any one time, HP holds a significant amount of inventory, spread across its branches and its Warrington head office warehouse.

Wei Li, Purchasing and Inventory Director, oversees a small team – comprising buyers, analysts and administrators – who maintain records of all products sold, with details of sales by value and volume each month, as well as inventory levels. The buyers work closely together and with Wei Li to ensure that HP obtains the best possible prices from suppliers.

Customers

Customers are in two categories: (1) regional housebuilders (RH); and (2) building contractors and tradespeople (BCT). They are all located in the north-west of England. Some are regional sections of larger national companies.

Under the overall supervision of Ross Connor (Sales and Marketing Director), there is a small, dedicated team responsible for each division: Head of RH is Bill Travers and Head of BCT is Des O'Reilly. Each team consists of a group of account managers and administrators who work closely together in winning new business from both existing and new customers. They also liaise with Wei Li's team so that they are aware of the latest products available.

A key aim of Bill, Des and their teams is to form durable long-term relationships so that customers stay with HP over a long period. The company strives at all times to achieve excellent customer service, which it promotes to staff under the slogan Get It Right Now! (colloquially referred to as GIRN). Staff receive regular training, and there is an annual dinner every January at which awards are presented for outstanding examples of customer service. The new ERP system (see **Exhibit 9**) should enable further improvements.

All major customers (most of whom are in the RH division) have a named HP Account Manager, who is the point of contact for all aspects of trading. HP can provide monthly or quarterly updates on customer spend and breakdowns of spend by specific products or by product group.

HP's branch staff have expertise in many areas and are always available with technical advice on the use of products, whether at the branch, by phone or through the website. HP also runs monthly free workshops at three of its branches where customers can see new products being demonstrated. In recent months, these workshops have been held on a videoconferencing platform and have been well received, with no noticeable drop in the level of interest or subsequent purchase of the new products.

Branch operations

It is one of HP's internal requirements that all branches are situated in industrial parks, alongside other large enterprises such as Ridley Plumbing. (In one recent case – Liverpool – HP acquired the site jointly with Ridley.) This sometimes leads to cross-referrals, for example when HP is approached by property developers requiring specialist plumbing products that are not part of the range that HP supplies, or when a Ridley customer is looking for accessories and can be redirected to HP. Occasionally, HP buys products itself direct from Ridley, and in such cases it benefits from Ridley's trade discount. Similarly, if Ridley has to buy any products from HP, it receives HP's normal trade discount.

Each branch has a team of around 15 staff, led by a Branch Manager and Branch Assistant Manager. Other than the two accounting and administration staff at each branch, all staff are trained to work both on the shopfloor serving customers and at the back of the site, loading and unloading goods and ensuring that all items are checked in and stored securely and safely.

Online sales operations

HP has gradually developed its e-commerce systems over the past few years, but it is conscious that they will need upgrading to meet the continuing growth of online sales and to compete effectively. Around 50% of IT outages (see **Exhibit 9**) occurring in the year to 30 June 2020 (compared with 20% in the previous year) related to e-commerce, each potentially representing lost sales, disappointed customers and social media messages deterring other customers. HP estimates that it lost £600,000 revenue from e-commerce outages in the year. This is also the area where HP is most exposed to data breaches: much IT time is spent ensuring that all protocols are followed and that payment systems are secure.

The online platform was at first available only to RH customers, but after its initial success it was extended to BCT customers from 1 July 2017. Recently, click-and-collect facilities have been introduced at some branches: when ordering goods online, customers can arrange to collect them from a chosen branch for no charge. This has proved a popular initiative. For all online sales, including click-and-collect, the goods are taken from inventory at the Warrington warehouse rather than from storage at the branch from which they are being collected.

Distribution

Because of the nature of the products and the quantities in which they are bought, the vast majority are delivered to customers' own premises or direct to construction sites. However, with the rise in click-and-collect, a larger proportion of sales are now being physically transported by customers from branches.

HP needs to have a large, flexible and reliable fleet of vehicles for transportation and delivery, as well as a team of qualified drivers. Distribution costs in the management accounts comprise packaging plus the running costs of vehicles (primarily fuel), repairs and drivers' wages. Running costs are a function of the numbers, sizes and destinations of deliveries; and hence they vary according to the mix between branch and online sales and, within the latter, the level of click-and-collect sales.

HP's vans, lorries and other vehicles comprise a range of types and sizes of models to meet the different customer requirements and product types. HP is gradually replacing all its vehicles: where possible, it will introduce electric models, which should create future savings in fuel and other running costs.

HP offers free delivery for all orders of more than £100. Below this level, a delivery charge is applied. HP promises to deliver within 48 hours of any order and it notifies the customer with a 4-hour time-slot for delivery. HP measures the proportion of deliveries made on time in a year, and this has been on an upward trend: 2018 – 91%; 2019 – 92%; 2020 – 94%. The target is 95%. For late deliveries, any delivery charge is refunded together with 5% of the order value. HP is currently reviewing the free delivery threshold, believing that the attraction to customers is outweighed by the cost to the company. Some competitors have begun charging on a sliding scale for all deliveries.

HP offers a 30-day returns policy. Products must be returned unused. In practice, there are few returns. Where they do occur, the problem is usually found to be a production fault and the item (or batch) is returned to the manufacturer, which in turn gives HP a full refund. Sometimes the manufacturer announces a product recall, and HP works with it to track all such items that have been sold or which are in inventory.

Staff

Staff development and retention are key. Through a twice-yearly appraisal process, managers assess the needs of employees to identify training requirements and unrealised potential. HP offers a clear promotion structure rewarding exceptional performance. Most branch managers have been promoted internally, while others have moved from rivals where the pay and working conditions were inferior to those of HP. When seeking new staff, HP does not use recruitment agencies. It prefers to advertise vacancies on its website, social media and in popular trade magazines.

HP seeks to provide a happy work environment. Employees are encouraged to report immediately to their managers any instances of inappropriate behaviour, whether by colleagues, customers or others. HP also publishes on its website its Modern Slavery Policy and Equal Opportunities Policy.

Pricing and payment arrangements

As a result of the different discount arrangements (see below) for the two sets of customers, HP earns a significantly higher gross profit margin from BCT customers than it does from RH customers. Credit terms of 30 days are typically given to all customers in both divisions, whether buying at a branch or online, but these terms can be varied in exceptional cases.

<u>RH</u>

Although RH customers are relatively small in number, their annual spend with HP is high: between them they provide around 80% of HP's revenue. They pay 'trade prices' for all purchases, ie, they receive a 10% discount on all prices advertised at branches and on HP's website, regardless of the volume and value of transactions in a given period. RH customers must undergo a rigorous due diligence and acceptance procedure before they qualify for these terms.

<u>BCT</u>

HP operates a loyalty scheme for BCT customers. By holding a 'HP card', they are eligible to receive a 5% discount on all prices advertised at branches for all products when they spend a minimum amount each month, whether at a branch or online.

Health and safety and the environment

The safety of its staff, customers and visitors is paramount. HP has a detailed Health and Safety Policy, which is published on its website. The policy also forms part of all new joiners' induction and top-up training throughout their employment. HP monitors its procedures closely, by reviewing the policy and its risk assessments at least annually, updating them as necessary to take account of recorded incidents. The Health & Safety Manager carries out regular branch inspections and reports to the board at its quarterly meetings.

HP also publishes and regularly updates its Environment and Sustainability Policy. It endeavours to comply with environmental regulations and best practice in all areas of the business, for example:

- Older vehicles are checked regularly to ensure that the level of emissions is satisfactory.
- Products considered potentially hazardous are stored safely. This includes items such as substances that could be used to make explosives or that could cause fires, as well as knives and sharp tools.

- Before HP acquires new premises for conversion to a branch, or when it upgrades any branch, it consults external specialists and representatives from the community about the impact on the local environment. This covers such issues as noise, parking and general disruption to other traffic.
- The company uses energy-saving lighting and other energy-efficient processes across its sites.

Marketing and advertising

HP uses social media, as well as local radio and television, together with trade publications, to promote itself and especially its branch network. HP also sponsors industry conferences and events, as well as a Manchester netball team and a Liverpool athletics club. Towards the end of the year to 30 June 2020, it began to benefit from reduced advertising rates being introduced by broadcasters.

Marketing costs also include HP's annual subscriptions to several trade bodies: the Builders Merchants Federation (BMF); the Construction Products Association (CPA); the British Home Enhancement Trade Association (BHETA); and the Institute of Builders' Merchants (IoBM). This enables HP to stay informed about industry developments, as well as presenting opportunities to lobby for changes in practice.

Accreditations and awards

HP has achieved a range of professional accreditations including ISO9001 (quality management); and FSC® and PEFC status, enabling all branches to supply Chain of Custody timber.

HP has also won several accolades from key customers for its work, including Supplier of The Year from Orko, a developer of retirement homes (see **Exhibit 8**).

Charity and community

As a trusted independent merchant with a long-standing presence in the region, HP believes in giving back to local people by supporting charitable and community ventures in the north-west. All staff are encouraged to spend two days each year assisting on community projects. Recent examples include decorating a hospital for sick children and planting a sensory garden in a public park. HP also helped a local Association for the Disabled, by donating materials for the construction of new stables.

EXHIBIT 8

HP: Customer profiles

Set out below are details of some of HP's customers and an overview of the work undertaken for them, together with testimonials.

Elevant (housebuilder)

Elevant has built several hundred new homes in the north-west of England since its formation in 2018. They range from small flats to large family houses. Elevant has a reputation for innovative, sustainable design of properties that make best use of the space, as well as high-quality construction.

Before it could start building properties, Elevant had to choose suppliers on which it could rely for quality products at competitive prices. Many of the properties that it planned to build were inexpensive homes (known as 'affordable housing') aimed at public sector employees (eg, teachers, nurses), for whom the UK government was offering financial incentives. Elevant undertook a long, careful review of companies in the area, visiting branches, exploring websites and talking to managers and branch staff. It selected HP as one of several suppliers for building products and materials. HP has so far earned over £1 million annually in revenue from Elevant.

Testimonial
"HP provides a fast, flexible and efficient service that is critical to the demands of the industry. Staff are friendly, helpful, experienced and knowledgeable. At the moment, HP is heavily involved with one of our flagship new developments, and we are proud to advertise the company as one of our partners in this prestigious project."

Wrights (builder and facilities manager for serviced offices)

At the end of September 2019, HP was appointed sole supplier of building products to Wrights, a builder and manager of serviced offices in the north-west of England, following the bankruptcy of its previous sole supplier, Brickbuild. (Serviced offices are offices that are fully equipped and run by a facilities management company, which then rents out individual offices or floors to other companies for short periods.) Wrights was in the middle of two projects and needed a new supplier quickly after Brickbuild's demise. Although HP had not previously supplied builders of commercial properties, Wrights was satisfied, from extensive discussions with HP management and other due diligence, that HP would be able to provide it with the service that it needed.

HP's RH division earned £0.8 million of revenue from Wrights in the nine months to June 2020. A general reduction throughout the UK in the number of people travelling to offices and a corresponding increase in those working from home (WFH) could reduce the future level of work from Wrights.

Testimonial
"When we needed a new supplier urgently, HP rose to the task. We remain delighted with our decision and look forward to many more collaborations in the future."

Orko (builder of care homes in the north-west)

Orko identified the need to design and build specialist care homes to meet the demand of the ageing population in the region. It has built a number of care homes in the north-west, and for each of these it has engaged HP as one of its main suppliers. HP has been responsible for supplying bricks, cement, wood and other construction materials, together with windows and doors. Orko has used other suppliers for other items such as sanitaryware and heating supplies (mainly from Ridley Plumbing), as well as bedroom, lounge and kitchen furniture and appliances.

The care homes are of roughly similar size: the average value of supplies to each from HP has been £400,000. Orko recently announced its plans to extend its presence in the 'care for the elderly' sector by acquiring Dolphino, a developer of retirement villages in the north-west of England.

Testimonial

"HP is ideally located to supply all of our sites, providing the various products we require and ensuring that we meet what are often demanding schedules. The staff go out of their way to assist, offering free advice and not being afraid to tell us if there is a better way of doing something. We also like the fact that some of their branches are close to Ridley Plumbing's branches, which can make our buying even more efficient."

Members of NWFT (North-West Federated Tradespeople)

HP counts among its customers a large number of independent building contractors and tradespeople. However, over half of its BCT business comes from members of the NWFT, a group of tradespeople in the region involved in renovating and refurbishing properties, both residential and commercial. NWFT provides its members with information and support, saving them time and money. Under the strapline 'Turn the North-West Green', the NWFT campaigns to encourage its members to lower carbon emissions and install energy-efficient heating systems.

Membership of NWFT also entitles tradespeople to a listing on a register of Trusted Local Traders (TLT) – a valuable marketing tool. Those listed are allowed to carry a TLT logo on their publicity material and other documents.

NWFT has set up a programme to advise homeowners on how to avoid being targeted by rogue contractors – people who fraudulently hold themselves out to have the necessary skills and qualifications to carry out building work. As well as being a criminal offence, this inevitably results in substandard work, potentially endangering the lives of occupants and passers-by.

Testimonial

"As a member of NWFT, and as a contractor who runs a team of part-time and full-time staff working on outdoor jobs, I need to have a reliable delivery service for products, so I am very grateful to be able to call on HP. No problem is ever too difficult to deal with. I frequently recommend HP to other NWFT members and they have never been disappointed."

EXHIBIT 9

HP: IT systems (March 2021)

HP relies heavily on IT across its business. It uses a range of systems and applications, some of which are becoming dated. This is apparent from the number of outages (faults causing a service breakdown) that HP has been experiencing, up from 77 in 2018 (year to 30 June) to 139 in 2019 and 273 in 2020. Most of these outages are minor, but the cumulative time taken to resolve them is an unnecessary drain on resources and the numbers are higher than those for other merchants of a similar size. HP has been investing significantly in technology, gradually replacing older systems as part of an ongoing commitment to more efficient working and enhanced customer service. This will also enable better integration of systems, to provide clearer insights into the relative profitability of its sales channels and customers.

In particular, in 2019 HP began a three-phase Enterprise Resource Planning (ERP) project, designed to transform its digital capability while saving time and cost. It will impact almost every area of the business. Instead of separate systems for sales, e-commerce, finance, production, suppliers and customers, there will be an integrated platform on which information can be shared and acted on quickly for the benefit of all interested departments. This project is being led by IT Director, Hans Ritz, who joined HP on 1 July 2018 after seven years working for a large national housebuilder. Each phase will be the subject of a separate bidding process: HP will not necessarily use the same supplier for every phase.

The main feature of Phase 1 has been a new inventory management system. This flags when a product is running low, reorders automatically or generates a purchase authorisation. It also provides data on which products are selling well at any one time and which are not; for the latter, HP follows up to identify the reasons (pricing, competition from other products, poor reviews, general downturn in demand, etc). There was a parallel run of one month before the new system went live. This allowed HP to be satisfied that it was working fully and to identify and resolve any initial problems with it.

Phase 1 has also introduced automated invoicing, QR (quick response) codes to delivery documents and a paperless document management system. These have all created substantial time savings and have enabled complete remote access to key information.

Phase 2 is scheduled to start after 30 June 2021 and to be completed by 30 June 2022 (the end of the three-year term for Phase 1). It will be followed by Phase 3, to be completed by 30 June 2023. The main part of Phase 2 will be a new website and e-commerce facility with enhanced functionality, building on the click-and-collect facility that HP has introduced at some branches – a vital addition that has boosted sales, with even greater benefits during the June 2020 closures. Phase 2 will significantly reduce the administration involved in fulfilling web orders, while remaining flexible. It should also give better management information and boost sales, especially by encouraging customers with 'People who bought product X also bought product Y' messages. Phases 2 and 3 will also incorporate:

- An account portal (optimised for mobile and tablet use) allowing customers to access key documents (eg, invoices, statements, quotes) and make payments. This will reduce administration time, phone calls and emails, also potentially lowering receivables days by making the payment process easier.
- A complete CRM (customer relationship management) system, accessible by all named HP sales and accounts staff. This will give detailed order history (indicating which products were bought and when), payment records, as well as a link to customers' website browsing history to show how frequently searches are converted to sales.
- An upgraded supplier platform, where suppliers can publish catalogues and provide delivery updates, invoices and statements, while HP can make payments and reconcile statements.
- A new accounting system, linked to the inventory management and CRM systems and the supplier platform, providing finance staff with up-to-the-minute information on performance by branch and by day, so that problems can be identified and solved as they occur.
- A new route management system to optimise delivery so that journeys are not wasted and orders are fulfilled more quickly than at present. This will be linked to the cabs of all delivery vehicles. A new off-the-shelf satellite navigation app will also be fitted in all vehicles, as well as speed control devices.

Decision-making and post-implementation review

Before carrying out a major IT investment, HP follows a series of steps, as agreed by the board:

1. Set up internal project team from a range of commercial, operational and support functions
2. Consider scope and timetable for development and implementation, including testing (with pilots on a small sample of accounts where applicable) and parallel running
3. Determine budget (both initial capital investment and ongoing annual expenditure)
4. Agree specification for presenting to suppliers
5. Seek potential suppliers (two or, preferably, three quotes), ensuring that they can offer round-the-clock maintenance and can make any required post-implementation changes at an agreed price
6. Review quotes and make selection using a blend of financial and non-financial criteria
7. Communicate launch date to relevant staff and other stakeholders and carry out hands-on training
8. Undertake ongoing post-implementation reviews, seeking feedback from users and making changes as and when required.

Step 6 initially comprises an assessment of the expected incremental profits, which are then considered in conjunction with other relevant factors. When HP undertook Phase 1 of the new ERP system, Hans Ritz researched the market carefully. He looked at a range of IT suppliers (vendors). He knew some from his previous jobs and identified others from reading reviews in trade publications or speaking to counterparts at other merchants. He narrowed the choice and obtained three quotes. The planned launch date in all three cases was 1 July 2019, with the opportunity to renew on 1 July 2022. Albion proposed a parallel run of two months; Grossmark, one month; and Zenith, three months.

	Albion £000	**Grossmark £000**	**Zenith £000**
• Supplier quote: capital costs (hardware and software)	240	225	180
• Supplier quote: annual maintenance and IT support costs (each of Years 1-3)	30	45	60
• HP estimate: additional annual revenue			
o Year 1 (to 30 June 2020)	550	600	500
o Year 2 (to 30 June 2021)	800	900	750
o Year 3 (to 30 June 2022)	1,000	1,200	900
• HP estimate: saving in other annual operating costs (each of Years 1-3)	80	60	120

The additional revenue and annual operating cost savings were by reference to expected results for the year ended 30 June 2019. The capital costs were to be written off over the three-year term to renewal.

On the figures provided, and using 20% as an approximation to gross profit margin (as the June 2019 management accounts had not yet been finalised) and 6% of revenue as an approximation to delivery costs, the expected incremental operating profits were:

	Albion £000	**Grossmark £000**	**Zenith £000**
Year 1	47	24	70
Year 2	82	66	105
Year 3	110	108	126
TOTAL	239	198	301

Hans chose Grossmark because, although it was expected to generate the lowest profits, it best met HP's requirements and overall it offered more certainty. The key factors considered were:

- Hans did not feel that Albion had the requisite expertise for HP's needs. The combination of a high capital cost and low running costs suggested that (consistent with media reports that it was in financial difficulties) Albion was mainly interested in generating cash quickly – it asked for 90% of the capital cost to be paid upfront – and that it might not offer the necessary day-to-day support after installation. The capital cost also included items that had not been in HP's specification and which HP did not require. While these could be removed, thus reducing the cost, their inclusion was a sign that Albion might not be responsive to HP's demands as the project progressed.

- Hans had no previous experience with Grossmark, but he was impressed with the knowledge of the staff that he met and with their flexibility to change the design if needed. Their knowledge also gave him the reassurance that a one-month parallel run would be sufficient and would minimise disruption. The system was also more intuitive and would involve less staff training. The estimate of additional revenue was higher than for the other two bidders because he believed that the system design was more conducive to improved performance. This was offset by the fact that there would be no change in the level of administrative support, so the annual cost saving was less than for Albion and Zenith. If the trend of additional revenue were maintained, the benefit would continue after the initial period.

- Although Zenith's capital bid was the cheapest, the ongoing costs were higher, so the net financial benefit was reduced. The profit advantage was not felt to be significant enough, and there were also uncertainties about whether the quote included all relevant items. From conversations with industry colleagues during the evaluation process, Hans had heard that Zenith installations often involved 'hidden' costs. The proposed three-month parallel run also signalled that Zenith was not confident about the smooth running of its installation. The saving in annual costs was based on Zenith's assertion that the headcount could be reduced: it was not clear how this would be achieved, and in any case HP was reluctant to lose staff.

This process was felt to be very helpful, ensuring the smooth running of Phase 1 since launch. Actual cost of implementation was exactly as set out in the successful quote, as was the annual maintenance invoice, and costs of changes made since launch have all been as stated in the signed agreement. However, there have been problems with maintenance: Grossmark has not always been able to attend to requests within the specified two-hour window, giving 'staffing issues' as an excuse several times. Also, the additional revenue has not been as high as was estimated: Hans estimates the figure as £450,000 for the year to 30 June 2020 but he recognises that this is not an exact science as revenue increases result from a combination of factors that cannot always be easily distinguished. However, cost savings have been higher than expected, with a fall in the amount of paid overtime and in phone calls.

Security

Data protection and systems security are vital elements of the IT strategy. With the growth in online sales, together with the expansion and increased complexity of HP's systems, they have become even more critical. Procedures in place include the following:

- There is a daily cloud-based back-up of all systems.
- Experts from the company TopTech carry out regular checks on computer usage and immediately alert HP if they identify any unauthorised access.
- All staff must sign the Privacy Policy on joining HP. They are trained in password management and encryption processes, such as in relation to electronic payments from customers or to suppliers, as well as protection of customer and supplier data.
- HP's customers are warned to be on the lookout for emails that contain a change of payment information and to notify HP straightaway if they receive one.
- Clauses setting out clearly HP's policy on IT security are included in all agreements with third parties.
- All new IT providers must demonstrate that their systems can comply fully with HP's procedures.

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EXHIBIT 10

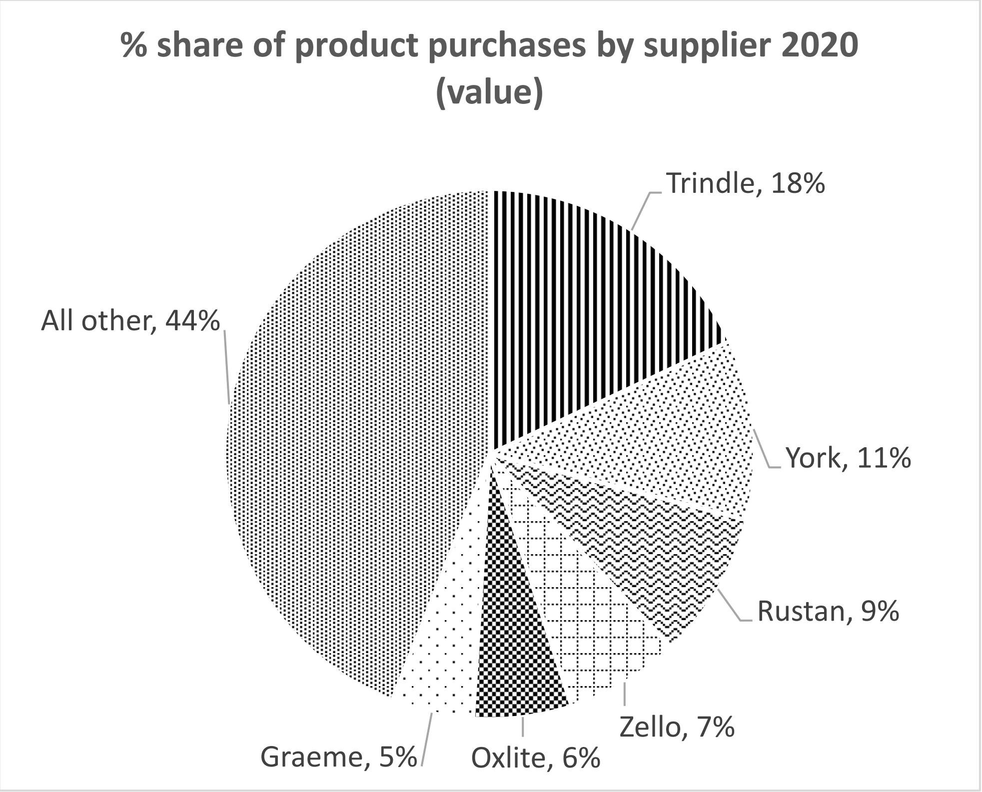
HP: Suppliers

The main items that HP buys are the products that it sells to its customers.

Product suppliers

HP sources its building supplies from a wide range of suppliers. They are all located in the UK though not necessarily in the north-west: some are based several hundred kilometres away. HP has dealt with many of them for a number of years; some are more recent trading partners; and others have been used on an occasional basis when a specialised product has been required at short notice to meet a customer's specific demand. The number of suppliers partly reflects the number of product lines sold by HP: for some products, such as bricks and cement, it has only two or three suppliers.

Some suppliers provide over £1 million of goods to HP in a year. Before taking on any larger suppliers, HP's head office team carry out due diligence to ensure that they are financially stable, treat their employees fairly and can supply the goods required by HP on the agreed terms, and that the goods meet the most rigorous quality and safety standards. The due diligence also covers sustainability, in relation to: products supplied; energy efficiency in the production process; and method of delivery to HP.



Once a company has become an established large supplier, HP repeats the due diligence. It has increased the frequency, from yearly to twice-yearly, combined with a more general monitoring of supplier performance. This has been a challenging and time-consuming exercise – but a valuable one as it has revealed several issues:

- HP stopped using one supplier when it found that, to save costs, the supplier had been altering the packaging of its cement, creating a potential fire hazard. HP returned all inventory to the supplier.
- One supplier of tiles and roofing products halved its payment terms at short notice. HP, sensing that the supplier was in financial difficulties, settled its account and switched to another supplier. It later emerged that the original supplier had deliberately sold substandard goods to a major property developer.

- One supplier was repeatedly delivering late to HP's branches. HP discovered that the supplier had reduced the number of its delivery vehicles and drivers in anticipation of an economic downturn. It ceased using this supplier.

Customers often make very big orders and ask for a delivery to be made direct to their own premises or to a construction site. Procedures are in place to ensure that the goods are delivered intact and that they can be safely secured and stored.

HP enjoys the freedom that comes from dealing direct with suppliers, in terms of ordering, pricing and payment arrangements. It is conscious that some of its competitors are members of buying groups; and that, although this may involve receiving generous bulk discounts from some suppliers, it can also be a constraint on its business activities. However, HP would not rule out joining such a group.

Many of the goods supplied by HP are derived from natural substances such as minerals, chemicals, oil, metals and timber. The prices of these commodities fluctuate and, as a result, the prices that HP pays for its goods can sometimes increase without warning. It is often not possible for HP to pass on such increases to customers, and this inevitably reduces profit margins. HP recognises that if it joined a buying group, it could potentially limit the impact of such price variations because of the buying group's stronger negotiating power with its suppliers.

Other suppliers

HP has significant relationships with a wide range of other suppliers for goods and services, relating to both capital and revenue expenditure. The main ones are listed below.

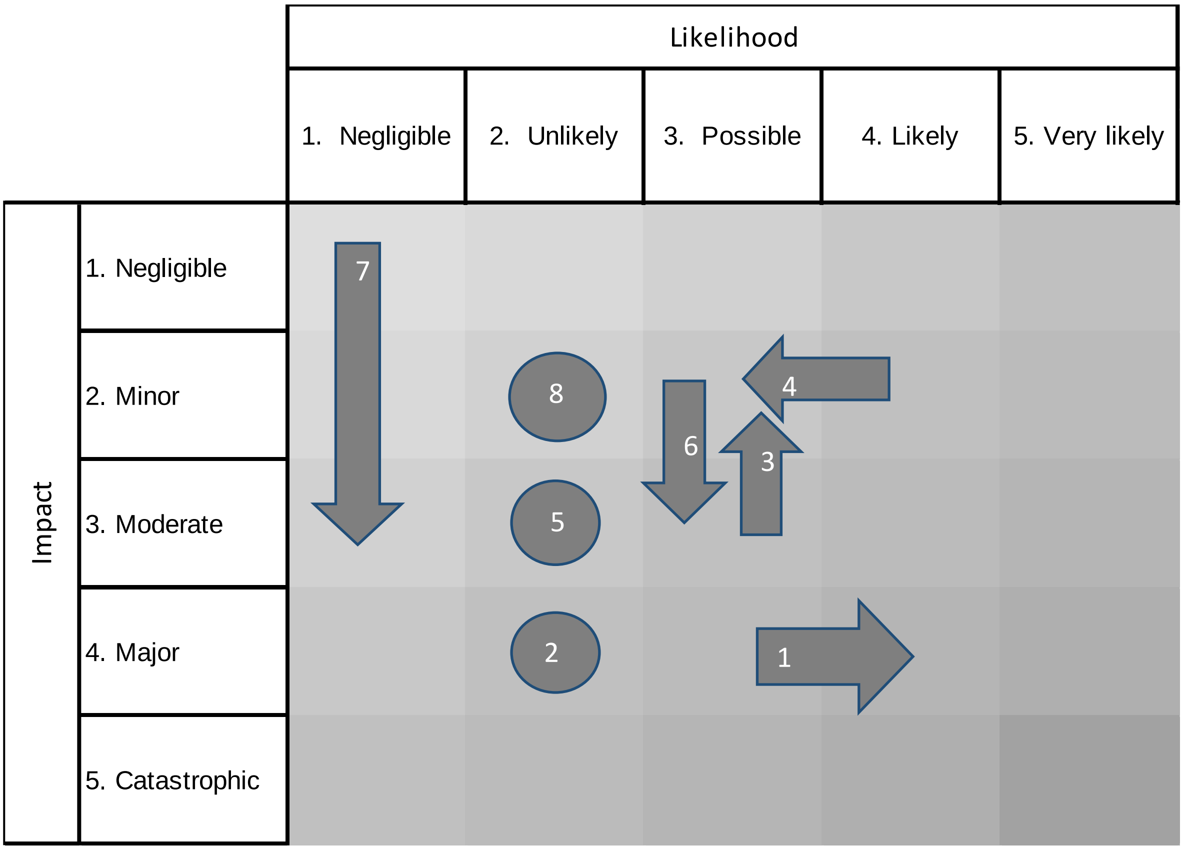
Category	Supplier(s)
Vehicle purchases, servicing, repairs and maintenance	Panthus; Zigzag Motors
IT systems, equipment, repairs and maintenance, back-up	Grossmark: TopTech
Fixtures and fittings (eg, shelving)	Harris; Thistle; Taylors of Warrington
Utilities (water, electricity, gas)	North West Energy

Other suppliers also include a range of professional services firms (eg, lawyers, accountants and payroll processors).

EXHIBIT 11

HP: Risk tracker (prepared by the HP board, reviewed July 2020)

HP operates in an industry which, by its nature, faces numerous risks. These risks – and their severity – inevitably change over time. Twice each year, the board evaluates them and then plots them on a risk tracker diagram. The version below reflects the updated ratings assigned in July 2020. The eight identified risks, numbered according to the grid that follows, are shown in arrows or circles: arrows indicate the change in assessment since the previous review (January 2020); circles indicate no change.



Risk	Description / implication(s)	Mitigation / contingency
Risk 1: **Adverse market conditions**	HP's financial performance is affected by factors such as house price inflation; activity in construction, renovation and home-buying; consumer confidence; and variations in weather. There are at present several UK government schemes designed to incentivise demand for housebuilding. If these do not continue, there could be a reduced demand for housebuilding and, in turn, the products supplied by HP.	Depending on the extent of any changes in market conditions, HP has shown that it can adapt through (eg) cost reduction, varying its channels to market, lower capital investment. Its risk is also limited by its wide ranges of customer and products. HP keeps a close watch on developments and strives to diversify customer types, for example by engaging with more tradespeople.
Risk 2: **Competition**	Market trends (manufacturers opting to deal directly with end-users; customers buying through a range of channels; the emergence of online-only merchants) could adversely affect HP's results. Market challenges by the CMA could have positive or negative consequences.	HP's varied customer base and competitive pricing (with trade discounts) reduce risk. HP monitors trends so that it can adapt its strategy, eg, by expanding its online offering. HP believes that it prices fairly and acts honestly at all times and that it is not at risk of a CMA challenge.

Risk	Description / implication(s)	Mitigation / contingency
Risk 3: **Negative liquidity and cash flow**	If revenue declines, customers struggle to pay, supplier terms tighten, inventory becomes unsaleable or major capital investment is required, HP could find that it does not have the funds available unless it takes out expensive finance.	To maintain liquidity for ongoing operations and future developments, HP monitors day-to-day needs and has a flexible overdraft. It has a good relationship with its bank, which would allow it to extend funding in the case of an emergency. The overdraft cleared by June 2020.
Risk 4: **Loss of major customer**	If HP lost one or more large customers, for any reason, this would have a direct impact on earnings potential. It would be hard to replace them quickly: it takes time to build enduring relationships with major customers. HP has suffered no major significant customer losses in recent years.	HP's customer base is well diversified, with no single customer contributing more than 5% of revenue. Relationships with all major customers are strong. HP maintains close contact at board level, enabling early identification of any issues. HP regularly monitors the credit status of key customers and endeavours to ensure that payment terms are agreed and adhered to. There are no large overdue receivables.
Risk 5: **Loss of major supplier**	HP's business is crucially dependent on the regular availability of certain product lines. Any shortages would be hard to rectify.	These products are sourced from several high-volume suppliers, giving flexibility and reducing exposure. HP monitors the financial status of all major suppliers.
Risk 6: **Cybersecurity and data protection (DP)**	A cyber-attack could impact day-to-day operations, HP's profits, reputation and customer relationships. Similarly, failure to ensure confidentiality and compliance with DP law could have serious consequences. A large number of small-scale outages could collectively create disruption or the loss of credibility among customers.	HP has rigorous back-up procedures and password policies. Staff are trained in data management best practice. IT providers monitor systems access and report immediately to HP any unauthorised attempts to access systems. Under the terms of their maintenance contracts, they are also on hand to resolve any problems within specified timeframes. Outages are monitored. The ongoing ERP project is designed to eliminate them as far as possible.
Risk 7: **Health and safety (H&S)**	HP's large machinery, moving vehicles, heavy materials and hazardous substances could endanger staff, customers and others. Any failure to maintain safe work sites could expose HP to major financial losses and/or legal liabilities, with a material adverse effect on prospects and reputation.	HP manages this risk and monitors potential changes in the law and regulations through a named Health and Safety Manager, who liaises as necessary with lawyers / other professionals and oversees training in and compliance with its published H&S Policy.
Risk 8: **Slow-moving, damaged or obsolete inventory**	Certain products may cease to be in demand among HP's customers. Impairment charges may be needed in the accounts, affecting financial performance.	By focused research, astute selection and effective use of its inventory management system, HP aims to: sell products relevant to its target markets; maintain suitable inventory levels; and store products safely. It also monitors competitor activity.

HP: Strategic plan (prepared by the HP board, July 2020)

Context

At the start of July 2020, following a month in which they were shut, all eight branches were reopened. Further temporary closures could be required in the future.

In the meantime, we have witnessed impressive growth in online sales. The small enhancements we have made to our systems have brought in a number of new customers, some of whom seem likely to generate significant repeat business in the months and years ahead.

We expect the housebuilding and home renovation market in the north-west – the main driver of the industry generally and HP specifically – to remain strong. This is helped by the continued availability of UK government incentives for home-buyers and also by growth in niche sectors, notably properties for the elderly (care homes, retirement villages). There has been a decline in activity across non-residential building sectors (offices, retail and education), but the vast majority of our customers are not involved in these and so we are not significantly affected by this decline.

Opportunities, challenges and responses

We believe that in the above context – coupled with our policy of reinvesting profits in the business, controlling working capital and generally good financial management – we are in a stable financial position. We set out below our key opportunities and challenges, with some suggested responses:

1. There are signs that over the coming year the industry will experience sizable price rises for some products (eg, roofing) because of shortages in underlying components. We cannot easily absorb these price rises and must find other ways to protect our margins. In addition, long lead times have started to occur in a number of key product lines: this is likely to continue in future and it is not always easy to source alternative suppliers. Joining a buying group could help to limit the impact of these issues by giving greater flexibility.
2. We must ensure that our IT systems continue to be reliable and up to date, notably including those which support e-commerce – an area in which we can quickly gain or lose competitive advantage. We must also maintain strong relationships with customers and find creative new ways to engage with them (and increase sales), especially online-only customers. Our ERP project will be key.
3. We must retain high staff morale. Here too, we need to be innovative, for example through flexible home working, regular conference calls and by setting up a dedicated support network to help staff facing mental health challenges.
4. We must continue to monitor costs and inventory levels at branches and our warehouse. We will take steps to rationalise our product portfolio, aware that some items are not profitable and that the storage space they occupy is out of proportion to the sales that they generate.
5. In the current environment, we have no plans to open any new branches. We will continue our upgrade programme, but we may also need to reduce the size of some branches if the trend towards a higher proportion of sales being made online continues. This might also mean expanding click-and-collect locations and/or building additional storage facilities, with online sales now being made throughout the region.

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The UK competition and markets environment

The Competition and Markets Authority (CMA) works to promote competition for the benefit of consumers, both within and outside the UK. It ensures that consumers obtain a good deal when buying goods and services, and that businesses operate within the law. It does this by:

- investigating mergers, to make sure that they do not reduce competition
- investigating entire markets if it believes that there are competition or consumer problems
- taking action against businesses and individuals that participate in cartels or anti-competitive behaviour
- protecting consumers from unfair trading practices
- encouraging government and other regulators to use competition effectively on behalf of consumers.

In recent years, the CMA has carried out several investigations in the wider construction sector, especially in relation to anti-competitive practices, leading in some cases to substantial fines. These have covered the supply of groundworks (Example 1 below) and of pre-cast concrete drainage products (Example 2). It has stated: "The CMA will not hesitate to issue appropriately large fines in these cases and we will continue to crack down on cartels in the construction sector and in other industries." A number of other investigations remain ongoing.

Example 1 (2017-2020)

Two UK-based companies supplying groundworks (products used to protect excavations – such as those made for laying pipes – from collapse) to some of the nation's largest construction firms were fined a total of £15 million. The companies supply these products for a range of major housing and road developments, railway line works and water pipe upgrades. The CMA found that they colluded illegally for periods totalling nearly two years to reduce competition and maintain or increase prices by sharing confidential information on future pricing and commercial strategy. They also co-ordinated their commercial activities to reduce uncertainty, including monitoring each other's prices and challenging quotes that they deemed to be too low. A third company took part for a single period of five months but was not fined as it brought the illegal activity to the CMA's attention and fully co-operated with the investigation, under the CMA's Leniency Programme.

Example 2 (2016-2020)

Three suppliers of pre-cast concrete drainage products were found to have infringed competition law in relation to the supply of certain items. The CMA found that they broke competition law by agreeing to fix or co-ordinate their prices, share the market by allocating customers and regularly exchanging competitively sensitive information. Fines totalling more than £36 million were levied on the companies. The original decision (2019) was upheld on appeal in 2020.

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Recent media coverage

EXHIBIT 14a

The building software revolution (IT Bulletin, June 2021)

Builders' merchants are finding that the customers who traditionally made their purchases in person are now increasingly doing so online, through a multitude of electronic devices.

While this has in many ways removed the appeal of merchants (some of whom have been trading for over a century from their original premises), it has also enabled them to continue operating and indeed to reach new customers with whom they might otherwise never have made any contact.

Perhaps unsurprisingly, those merchants that already had established internet capability have been the ones to benefit the most, closely followed by those that have realised the importance of investing in state-of-the-art technology to keep them competitive. (At the other end of the scale, some larger merchants do not even have an online presence.)

In the first group, pride of place goes to cementonline.com (COL), which was set up in 2019 specifically to offer an online-only service to tradespeople – perhaps a fortunate example of being in the right place at the right time. With relatively few overheads, COL has been able to offer its goods at very competitive prices – even with a delivery charge, they are cheaper than many rival offerings.

In the second group, long-standing family firm Greg & Sons had the foresight in early 2019 to recognise the challenges being faced by the traditional merchant's business model. It engaged IT consultants to advise it on how best to develop an internet-based sales function – together with powerful software systems and robust hardware – and by April the system, developed by Transit (a firm of website specialists) was in place. Backed by a focused marketing campaign and attractive opening discounts, Greg & Sons saw sales grow sharply. It estimates that the new sales function has added around 10% to annual revenue.

Both companies have had to adapt other aspects of their operations to meet the increased demand that they have faced, notably in relation to storage. Cementonline has built two brand-new warehouses, a strategic distance apart from each other so as to maximise coverage. Both are close to motorways and other main roads. Greg & Sons has taken a different approach. Rather than build a new warehouse, it decided to close its worst-performing branch and converted it into a warehouse. While this seemed at the outset to be a cheaper option, it has in fact proved expensive – and disruptive – because of unforeseen costs together with lost and damaged inventory, reducing the financial benefit of the new website. Also, the location, while suitable for a branch, is not ideal for a warehouse because of different access requirements for vehicles.

As well as serving as e-commerce platforms, merchants' websites are often used by tradespeople and other customers to compare prices and gauge quality, so pricing claims will be fact-checked. Although over half of customers regularly review their preferred product suppliers, this rarely results in a change. For online orders, merchants need to provide specific and relevant digital advice tailored to users' needs. Online chat facilities or comprehensive "frequently asked questions" (FAQ) pages can also add a lot of value.

Despite the shift towards online, half of all orders are still placed at stores, by phone or email, so branch staff continue to play an important part in forming and maintaining personal relationships and giving advice.

EXHIBIT 14b

The world of retirement villages (Young at Heart magazine, January 2021)

Retirement villages are large developments designed and built specially for older people, mainly – but not exclusively – those who have retired from work. They are growing in popularity with people seeking retirement housing in the UK. The demand reflects a continuing steady increase in the average age of the UK population. The UK census being held this March is expected to provide a detailed confirmation of this trend.

Retirement villages usually comprise at least 100 properties of different types and are often located in beautiful rural settings. Most promote a luxury lifestyle, offering a variety of leisure facilities, plus a range of social activities. Properties in retirement villages are generally designed for independent living, but some villages offer support for those who need it, such as home help or personal care services. Some have on-site care homes too. Many villages have apartments available for friends or family to rent when they visit. Below, we focus on one company specialising in this field, Antoine.

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Antoine currently has four villages, all in the south of England.

Antoine was one of the earliest companies to build retirement villages. Each has around 150 homes – a mixture of houses, bungalows (single-storey houses) and flats – with attractive gardens, plentiful leisure activities such as swimming pools, spas, restaurants and bars, plus a small parade of shops.

Villages are built only after Antoine has carefully gauged local demand, through a combination of market research and demographic analysis. It advertises enticing opening offers for the first properties in each village and, once these have been bought, the remaining ones generally prove easy to sell. There is also a waiting list so that if a property has to be vacated for any reason, it does not stay empty for long. All four villages are currently 100% occupied.

A key factor in Antoine's success is the close, flexible working relationships that it has developed with a range of builders' merchants and specialist suppliers. Antoine was anxious not to rely on a single supplier: other than the very large merchants (which it felt would not offer the necessary level of service), there were no companies that could provide the full range of products that it required, some of which were specific to properties of this type (eg, stairlifts and bathroom equipment for people with limited mobility). The relationships with its merchants and other suppliers have enabled Antoine to access the right products and materials when needed, both for the original development of its sites and for ongoing repairs and maintenance. Products are needed not just for the buildings and their foundations, but also for the roads and paths around the site.

The overall purchase cost of building products used in each village is about 25% of the total building cost, but this can vary according to a number of factors, including geology; the extent of any leisure facilities (swimming pools are notoriously expensive); and whether houses are detached (separate from one another) or semi-detached (connected to another house on one side). For projects of this scale, a 15% trade discount from merchants and other suppliers is typical.

Antoine has a project manager responsible for each village. This role begins at the earliest stage, when the village is being designed, and continues through the whole building phase and beyond. The project manager retains close contact with all suppliers.

For its first village, Antoine underestimated both the time and cost involved. There were numerous problems with the ground on which it was being built and this was compounded by several spells of poor weather during which no work could be undertaken. The village finally opened six months later than scheduled and cost nearly £15 million, around 50% more than budget. Antoine had to keep going back to its bank to request increased funding, and this in turn created extra finance costs. The bank also put pressure on Antoine to delay payments to its suppliers. Antoine has improved its processes and risk management for the three subsequent villages and, as a result, although these have also opened late, the delays have been less than three months.

EXHIBIT 14c

Buying group in the spotlight (Materials Monthly, March 2021)

MiNW is a buying group comprising 20 independent builders' merchants – of similar size and located across the north-west of England – committed to enhancing business opportunities and profit margins through joint purchasing while giving suppliers an efficient route to market. Member companies have collective control over strategy and decision-making.

MiNW's six Product Teams each comprise representatives from member companies with relevant product knowledge and spend. This means that they can negotiate and manage high-value deals competitively and fairly, benefiting both members and suppliers. MiNW is always one of the first groups to implement the latest best practice, and to lobby government on issues affecting members.

MiNW has recently adapted some of its activities to benefit from new technology. One example is new product launches. Traditionally, when a product is launched, a representative from MiNW visits all member companies to demonstrate it and explain its pricing structure and benefits face-to-face. The most recent launch (for a new roofing product) took place by a videoconference attended by members. This comprised a presentation followed by a question-and-answer session. Feedback from members was excellent and there were several orders of the product in the week after the event. There were also other advantages: attendees, all with busy schedules, did not have to travel; and they also had a chance to network with one another – albeit remotely.

EXHIBIT 14d

Look before you leap (Customer Focus, May 2021)

Well-known clothing retailer Yorath & Co recently learnt an expensive lesson. Yorath was upgrading its e-commerce platform and, rather than follow the normal practice of seeking three quotes, it opted to award the £1m contract directly to Quipp, a company run by the sister of Yorath's MD, Bob Cox. Eager to be ready for the busy spring sales period, it launched the new system on 1 March 2021 without proper testing or parallel running with the old system, which was discontinued at midnight on 28 February. The result? First, a site that did not communicate with existing systems, leading to inaccurate accounting information and bad business decisions. Second, a series of security breaches. Third, the sacking of Bob Cox. Fourth, severe damage to Yorath's reputation and the loss of several major long-standing customers.