Understanding and managing our principal risks and uncertainties

Risk management process

We recognise that effective risk management is critical to enable us to meet our strategic objectives and to achieve sustainable long-term growth. A four-step process has been adopted to identify, monitor and manage the risks to which the Group is exposed:

1 Identify risks

A top-down and bottom-up approach is used to identify principal risks across the business. Whilst the Board has overall responsibility for the effectiveness of internal control and risk management, the detailed work is delegated to the Operational Leadership Team ('OLT').

2 Assess and quantify risks

Risks and controls are analysed and evaluated to establish the root causes, financial impact and likelihood of occurrence. The Group categorises risks into six areas:

- economy, market and business environment;
- financial and compliance risk;
- asset risk;
- operational risk;
- competitive risk; and
- product specific risk.

3 Respond to, manage and mitigate risks

The effectiveness and adequacy of controls in place are assessed. If additional controls are required to mitigate identified risks then these are implemented and responsibilities assigned.

4 Monitor and review

The OLT is responsible for monitoring progress against principal risks in a continual process. They are assisted by the Group's internal audit programme run in conjunction with Deloitte.

The Board reviews the Group's risk register and assesses the adequacy of the principal risks identified and the mitigating controls and procedures adopted.

Our framework

Risks are reviewed on an ongoing basis and are captured in a risk register, identifying the risk area, the likelihood of the risk occurring, the impact if it does occur and the actions being taken to manage the risk to the desired level. The Board's role is to consider whether, given the risk appetite of the Group, the level of risk is acceptable within its strategy.

The roles and responsibilities of each level of this framework are as follows:

Risk governance and responsibilities

The Board's responsibilities
- Overall responsibility for risk management.

The Audit Committee's responsibilities
- Assess the scope and effectiveness of risk management processes and internal control systems.

Operational Leadership Team responsibilities
- identify, assess, monitor, manage and mitigate risks and exploit opportunities;
- ensure appropriate internal controls are in place;
- ensure the risk register is properly maintained; and
- embed risk management as business as usual.

Operational management and internal controls
- Embed and manage internal controls and risk management day to day as part of business as usual.

Oversight functions and internal audit
- Aid in setting appropriate policies, provide guidance, advice and direction on implementation of those policies and monitor the first line of defence.

Additional line of defence
- External auditor.

Viability statement

In accordance with Provision C.2.2 of the 2014 UK Corporate Governance Code, the Board has assessed the prospects and viability of the Group.

Assessment of prospects

Auto Trader is the UK's leading digital automotive marketplace and it is the Group's clear focus to maintain this position by relentlessly focusing on improving the process of buying and selling vehicles. During the year ended 31 March 2017 the Group generated a profit before tax of £193.4m and was highly cash generative with cash generated from operations of £212.9m. Taking into account the Group's current position and its principal risks and uncertainties as described on pages 33 to 35, the Directors have assessed the Group's prospects and viability.

The business model and strategy as set out on pages 10 and 13 are a core part of understanding its prospects. These factors provide a framework for the rolling three-year plan which is developed as part of the annual budget process and reviewed by the Board to assess the Group's prospects.

The Directors have adopted a three-year timeframe for assessing both prospects and viability, which is considered to be appropriate due to the following:

- it is consistent with the Group's rolling three-year strategic planning process;
- the Group operates within a digital online marketplace where the market can be fast moving, so looking out beyond this timeframe yields little benefit;
- it reflects reasonable expectations in terms of the reliability and accuracy of operational forecasting models; and
- it incorporates the period in which we expect to refinance our existing term loan and therefore includes an assessment on our ability to refinance.

The Group's prospects are assessed primarily through its strategic planning process. This process includes an annual review of the ongoing plan, led by the CEO through the Operational Leadership Team, and all relevant functions are involved. The Board participates fully in the annual process and has the task of considering whether the plan continues to take appropriate account of the external environment including technological, social and macroeconomic changes.

The output of the annual review process is a set of operational priorities, an analysis of the risks that could prevent the plan being delivered, and the annual financial budget.

Detailed financial forecasts that consider customer numbers, ARPR growth, revenue, profit, cash flow, funding arrangements and key financial ratios have been prepared for the three-year period to March 2020. The first year of the financial forecasts forms the basis for the Group's 2018 budget and is subject to a re-forecast process at the half-year. The second and third years are prepared in detail, and are flexed based on the actual results in year one.

Assessment of viability

The Board's assessment of the Group's prospects, as described above, has been made with reference to current market conditions and known risk factors. The principal risks and uncertainties facing the Group are outlined on pages 33 to 35.

Given the Group's financial performance in 2017 and over recent years, the Board continues to believe that the key factor which would prejudice the delivery of the Group's financial objectives is a severe weakening of Auto Trader's marketplace proposition and its leading market position. This could be caused by a loss of audience which results in a reduction in retailers and the level of stock listed on the marketplace or by a reduction in the number of retailers and stock which could then result in a loss of audience.

Using the current strategic plan as a base case, alternative forecasts have been produced to model the effect on the Group's liquidity and solvency of very severe combinations of the principal risks and uncertainties affecting the business.

The viability model assumed a rapid deterioration in stock and audience over a short period of time. The number of customer retailer forecourts and the ARPR generated were significantly degraded in the model, but expenditure in the areas of marketing, payroll and technology were held steady. Revenue and profitability are clearly affected in this scenario, but the business remains cash generative.

Given the Group's significant free cash flow, and the Board's ability to adjust the discretionary share buyback programme, there is long-term comfort around viability in the face of adverse economic or competitive conditions.

Based on their assessment of prospects and viability above, the Directors confirm that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period ending March 2020.

Going concern

The Directors also considered it appropriate to prepare the financial statements on the going concern basis, as explained in the Basis of preparation paragraph in note 1 to the financial statements.