

## Principal risks – Inherent to the sector

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### Nature of Risk

#### DESTINATION DISRUPTION

Providers of holiday and travel services are exposed to the inherent risk of incidents affecting some countries or destinations within their operations. This can include natural catastrophes such as hurricanes or tsunamis; outbreaks of disease such as Ebola; political volatility as has been seen in Egypt and Greece in recent years; the implications of war in countries close to our source markets and destinations; and terrorist events such as the tragic incident in Tunisia last year.

There is the risk that if such an event occurs which impacts on one or more of our destinations that we could potentially suffer significant operational disruption and costs in our businesses. We may possibly be required to repatriate our customers and/or the event could lead to a significant decline in demand for holidays to the affected destinations over an extended period of time.

### Mitigating Factors

- Whilst we are unable to prevent such events from occurring, we have well defined crisis management procedures and emergency response plans which are implemented when an event of this nature occurs, with the focus being on the welfare of our customers.
- Where the appropriate course of action is to bring customers home immediately, our significant fleet of aircraft allows us to do this smoothly and efficiently.
- Our policy is to follow foreign office advice in each of our source markets with regards to non-essential travel. This serves to minimise the exposure of our customers to turbulent regions.
- Due to our presence in all key holiday regions, when a specific destination has been impacted by an external event, we are able to offer alternative destinations to our customers and to remix our destination portfolio away from the affected area in future seasons if necessary.

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## Nature of Risk

### MACROECONOMIC RISKS

Spending on travel and tourism is discretionary and price sensitive. The economic outlook remains uncertain with different source markets at different points in the economic cycle. Furthermore, terrorist incidents in source markets can influence the overall demand for overseas travel in those markets. Consumers are also waiting longer to book their trips in order to assess their financial situation.

There is the risk that fluctuations in macroeconomic conditions in our source markets will impact on the spending power of our customers which could impact on our short-term growth rates and lead to margin erosion.

Furthermore, changes in macroeconomic conditions can have an impact on exchange rates which, particularly for the £/€ rate, has a direct impact on the translation of non-euro source market results into euros, the reporting currency of our Group.

### COMPETITION & CONSUMER PREFERENCES

The tourism industry is fast-paced and competitive with the emergence of new market participants operating new business models, combined with consumer tastes and preferences evolving all the time.

In recent years there has been an emergence of successful substitute business models such as web-based travel and hotel portals which allow end users to combine the individual elements of a holiday trip on their own and book them separately.

Consumer tastes and preferences have evolved in recent years as well, with more consumers booking their holidays online and via mobiles and tablets, and booking closer to the time of travel.

There is the risk that if we do not respond adequately to such business model disruption or if our products and services fail to meet changing customer demands and preferences, that our turnover, market share and profitability will suffer as a result.

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## Mitigating Factors

- We always assume some level of destination disruption each year when setting financial plans and targets, so that we are able to cope with a 'normal' level of disruption without it jeopardising achievement of our targets.

- Many consumers prioritise their spending on holidays above other discretionary items.
- Creating unique and differentiated holiday products which match the needs of our customers.
- Leveraging our scale to keep costs down and prices competitive.
- Having a range of source markets so that we are not over exposed to one particular economic cycle.
- Expressing our key profit growth target in constant currency terms so that short term performance can be assessed without the distortion caused by exchange rate fluctuations.
- Promoting the benefits of travelling with a recognised and leading tour operator to increase consumer confidence and peace of mind.

- Our outstanding market position as a leading tourism group, the strength of our brands and our integrated business model enables us to respond robustly to competitive threats.
- The TUI Group is characterised by the continuous development of unique and exclusive holidays, developing new concepts and services which match the needs and preferences of our customers.
- Our integrated business model offers end-to-end customer services, from consultation and booking of holidays via flights with the Group's own airlines through to Group-owned or operated hotels, resorts and cruise ships. Integration thus facilitates the development and marketing of individual, tailored holiday offerings for customers which it is difficult for competitors to replicate.
- Building strong and lasting relationships with our key hotel partners, which further reinforces our ability to develop new concepts exclusive to the TUI Group which competitors struggle to match.
- Focusing on being online throughout the whole of the customer journey – from inspiration, to booking, to the holiday itself, as well as returning and sharing experiences through social media.

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## Nature of Risk

### INPUT COST VOLATILITY

A significant proportion of operating expenses are in non-local currency and/or relate to aircraft fuel which therefore exposes the business to changes in both exchange rates and fuel prices.

There is the risk that if we do not manage adequately the volatility of exchange rates, fuel prices and other input costs, then this could result in increased costs and lead to margin erosion, impacting on our ability to achieve profit targets.

There is also the risk that if our hedging policy is too rigid, we may find ourselves unable to respond to competitive pricing pressures during the season without it having a direct detrimental impact on our market position and/or profitability.

### SEASONAL CASH FLOW PROFILE

Tourism is an inherently seasonal business with the majority of profits earned in the European summer months. Cash flows are similarly seasonal with the cash high occurring in the summer as advance payments and final balances are received from customers, with the cash low occurring in the winter as liabilities have to be settled with many suppliers after the end of the summer season.

There is the risk that if we do not adequately manage cash balances through the winter low period this could impact on the Group's liquidity and ability to settle liabilities as they fall due whilst ensuring that financial covenants are maintained.

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## Mitigating Factors

- Ensuring that the appropriate derivative financial instruments are used to provide hedging cover for the underlying transactions involving fuel and foreign currency.
  - Maintaining an appropriate hedging policy to ensure that this hedging cover is taken out ahead of source market customer booking profiles. This provides a degree of certainty over input costs when planning pricing and capacity, whilst also allowing some flexibility in prices so as to be able to respond to competitive pressures if necessary.
  - Tracking the foreign exchange and fuel markets to ensure the most up-to-date market intelligence and the ongoing appropriateness of our hedging policies.
  - Detailed information on currency and fuel hedges can be found in the Notes to the consolidated financial statements in section Financial instruments.
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- As our business is spread across a number of source markets within the Tourism division there are some counter-cyclical features e.g. winter is a more important season for the Nordic and Canadian source markets. Some brands, such as the UK ski brand Crystal, have a different seasonality profile which helps to temper the overall profile.
  - Our content-focussed strategy is also helping to reduce the seasonality risk, as hotels and cruises have a more evenly distributed profit and cash profile across the year. This is highlighted by the fact that in the current financial year, the Group made an underlying operating profit for the first time over the nine months to 30 June.
  - The business produces regularly both short term and long term cash forecasts during the year which the Treasury team use to manage cash resources effectively.
  - We have implemented a financial policy which has led to an improvement in our credit rating and makes it easier to maintain financing facilities at suitable levels.
  - Existing financing facilities are considered to be more than sufficient for our requirements and provide ample headroom.
  - We continue to maintain high-quality relationships with the Group's key financiers and monitor compliance with the covenants contained within our financing facilities.
  - Raising additional finance from the Capital Markets, should it be required, remains an option.

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## Nature of Risk

### LEGAL & REGULATORY COMPLIANCE

Most providers of holiday and travel services operate across a number of economies and jurisdictions which therefore exposes them to a range of legal, tax and other regulatory laws which must be complied with.

As the TUI Group is the world's leading tourism business operating from multiple source markets and providing holidays in more than 100 destinations, we are exposed to a range of laws and regulations with which we must comply or else risk incurring fines or other sanctions from regulatory bodies.

### HEALTH & SAFETY

For all providers of holiday and travel services, ensuring the health and safety of customers is of paramount importance. This is especially so for TUI as we are the world's leading tourism group selling holidays to over 20 million customers per annum.

There is the risk of accidents or incidents occurring causing illness, injury or death to customers or colleagues whilst on a TUI holiday. This could result in reputational damage to the business and/or financial liabilities through legal action being taken by the affected parties.

### SUPPLY CHAIN RISK

Providers of holiday and travel services are exposed to the inherent risk of failure in their key suppliers, particularly hotels. This is further heightened by the industry convention of paying in advance ('prepayment') to secure a level of room allocation for the season.

There is the risk that we do not adequately manage our financial exposure should demand drop either for individual hotels and/or for the destination in which the hotels are located and to which the tour operator still has a level of prepayment outstanding which could result in financial losses.

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## Mitigating Factors

- Communication and strong tone from the top concerning compliance with laws and regulations.
- Legal Compliance Committee established to ensure appropriate oversight, monitoring and action plans and to further drive the compliance culture across the Group.
- Embedded legal and tax expertise in all major businesses responsible for maintaining high quality relationships with the relevant regulators and authorities.
- Ongoing review conducted by the Group Legal Compliance team to centrally monitor compliance with regulations and provide expert advice to local teams on specific areas.

- Health and safety functions are established in all businesses in order to ensure there is appropriate focus on health and safety processes as part of the normal course of business.
- Ongoing monitoring is conducted by the Group Security, Health & Safety function to ensure compliance with minimum standards.
- Appropriate insurance policies are in place for when incidents do occur.

- Owned and joint venture partner hotels form a substantial part of our programme which reduces our inherent risk in this area.
- Established and embedded a robust prepayment authorisation process to both limit the level of prepayments made and ensure that they are only paid to trusted, credit-worthy counterparties.
- Where prepayments are made to external hoteliers this is to secure access to unique and differentiated product for which demand is inherently higher and more resilient to external events than for commodity product.
- Prepayments are monitored on a timely and sufficiently granular basis to manage our financial exposure to justifiable levels.

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## Nature of Risk

### JOINT VENTURE PARTNERSHIPS

It is common for tourism groups to use joint venture partnerships in some of their operations in order to reduce the risk of new ventures or to gain access to additional expertise. TUI has three significant joint ventures – Riu, TUI Cruises and Sunwing.

There is the risk that if we do not maintain good relations with our key partners that the ventures' objectives may not remain consistent with that of the Group which could lead to operational difficulties and jeopardise the achievement of financial targets.

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## Mitigating Factors

- Good working relationships exist with all of our main joint venture partners and they are fully aligned with and committed to the growth strategy of TUI Group.

## Actively managed principal risks – Strategic and emerging and business change

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### IT DEVELOPMENT & STRATEGY

Our focus is on enhancing customer experience by providing engaging, intuitive, seamless and continuous customer service through delivery of leading digital solutions, core platform capabilities, underlying technical infrastructure and IT services required to support the Group's overall strategy for driving profitable top-line growth.

There is a risk that we fail to keep up with or outpace the market and evolving consumer preferences, we do not concentrate our activities on the correct areas for overall business success, do not address legacy inefficiencies and complexities of our existing infrastructure, do not ensure continuity of service for critical IT systems and/or do not execute our strategy and developments in line with expectations.

If we are ineffective in our strategy or technology development this could impact on our ability to provide leading technology solutions in our markets thereby impacting on our competitiveness, our ability to provide a superior customer experience and associated impact on quality and operational efficiency. This would ultimately impact on our customer numbers, revenue and profitability.

- Developed and communicated (in conjunction with Executives, Business & IT Leadership Teams) the Group's IT Strategy which is clearly aligned to our overall business objectives and considers external factors such as the pace of technology change and internal factors such as the underlying quality required throughout IT.
- Continuing to implement our online platform in order to enhance customer experience and drive higher conversion rates.
- Implementing a SAP-based central customer platform to collate all information on our customers across their journey to provide a single view of the customer alongside an eCRM platform which will support strategic marketing.
- Placing increased focus on ensuring continuity plans for critical IT systems are in place and regularly tested.
- Cascaded clear technology standards and associated delivery roadmaps which are linked to Group wide and source market objectives
- Adopting API, Big Data and Cloud architecture to drive improved speed, productivity and efficiency.
- Experimenting with Blockchain technology to be ahead of the competition.

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## Nature of Risk

### BRAND CHANGE

Our strategy is to migrate our many local tour operating brands in to one global brand, with the aim of strengthening and enhancing our competitive position, particularly in the online world. We are aiming to capitalise on the strength of the TUI brand on a global scale whilst ensuring we maintain local roots.

There is an inherent risk when executing such a large scale global brand strategy that we may not be able to maintain the benefits of local brand equity throughout the process and we recognise that such a large programme should take place with respect for the interests of all our stakeholders and existing contractual obligations.

If we do not successfully deliver against our strategy this could result in a decline in brand awareness and loyalty with associated decline in customer demand or it could impact on our ability to maximise on the opportunities facilitated by having one brand on a global scale.

### GROWTH STRATEGY

We have set ourselves a medium-term target of achieving at least 10% growth in underlying EBITA at constant currency rates (see page 48). This will be driven by growth in own hotel and cruises content, and top line and efficiency improvements.

Additionally we have broadened our offering to customers by introducing extra flexibility into our packages, and expanded our long-haul offering by taking advantage of the capabilities of the 787s which we have and are due to receive via our order book. Note that availability of aircraft finance is a key assumption of our business model.

Whilst managing this expansion, we must continue to adapt to changes in consumer tastes and booking profiles, and we must continue to match our capacity to consumer demand. Asset utilisation – of aircraft, cruise ships and hotels – is critical to our financial success particularly when in a growth phase.

There is a risk that we could be unsuccessful in maximising opportunities to execute our expansion strategy. This could mean that we fail to achieve some of the initiatives we have embarked upon, which could result in us falling short against the overall growth targets we have set for the business.

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## Mitigating Factors

- Undertaken detailed market research in each source market to assess current brand positioning and likely impact of the brand change.
- Approved incremental marketing spend to raise the profile of the TUI brand locally in order to promote the benefits and to manage the expectations of our customers in relation to the future of our enhanced products and services.
- Established a 'One Brand' programme team responsible for coordinating and monitoring the brand change activity across all source markets, with KPIs identified and tracked on a regular basis by both local and group colleagues and prompt corrective action taken to address issues as they arise.
- Taking a phased and focussed approach to the brand change by implementing in one source market at a time. This minimises the risk at a given point in time and allows us to gain learnings from the source markets undergoing transition and implement those learnings in the next source market. Our first brand transition successfully occurred in the Netherlands in the prior financial year 2016, with Nordics and Belgium source markets successfully transitioned in financial year 2017. The major brand transition in the UK&I of Thomson to TUI is now well underway in financial year 2018.
- Communicating both internally and externally across multiple media channels to drive brand awareness, with increased awareness through consistent marketing in key destination airports and changing of the livery on our aircraft in order to support greater awareness of the TUI Brand.

- The Executive Board is very focussed on the strategy and mindful of the risks, so there is strong direction and commitment from the top.
- The Group Tourism Board plays an important role in coordinating, executing and monitoring the various growth initiatives.
- There are a number of initiatives underway to achieve growth which reduces the risk through diversification.
- Each of the business teams tasked with achieving an element of the growth strategy are still required to maintain sound financial discipline. The Group's investment criteria and authorisation processes must still be adhered to as we are not prepared to be reckless in the pursuit of growth.
- We continue to maintain strong relationships with the providers of aircraft finance.
- Monitoring of overall market conditions continues to occur so that plans can be adapted or contingency plans invoked if required.

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## Nature of Risk

### INTEGRATION & RESTRUCTURING OPPORTUNITIES

Our key strategic rationale for TUI Group is to act 'as one' wherever it makes sense to do so, whilst maintaining local differences where the benefit of that differentiation is greater than that of harmonisation.

There are a number of restructuring projects underway across the Group as a result to enable us to achieve these opportunities. Furthermore our continuous review of our own businesses and competitors means that we do have an active programme of business disposals (e.g. Travelopia in financial year 2017) and acquisitions with associated integration projects.

There is an inherent risk with any large restructuring or integration programme that we face challenges in managing the complexities associated with further integrating our business, and reducing overlapping activities in order to develop a more lean and streamlined operating model.

If we are not successful in leveraging and optimising the identified opportunities this could have a significant impact on our ability to deliver the identified benefits in line with expectations and enhance shareholder value.

### CORPORATE & SOCIAL RESPONSIBILITY

For TUI Group, economic, environmental and social sustainability is a fundamental management principle and a cornerstone of our strategy for continually enhancing the value of our Company. This is the way we create the conditions for long-term economic success and assume responsibility for sustainable development in the tourism sector.

Our focus is to reduce the environmental impact of our holidays and promote responsible social policies and outcomes both directly through our own business and indirectly via our influence over our supply chain partners, thereby creating positive change for people and communities and being a pioneer of sustainable tourism across the world.

There is a risk that we are not successful in driving forecast social and environmental improvements across our operations, that our suppliers do not uphold our corporate and social responsibility standards and we fail to influence destinations to manage tourism more sustainably.

If we do not maximise our positive impact on destinations and minimise the negative impact to the extent that our stakeholders expect, this could result in a decline in stakeholder confidence, reputational damage, reduction in demand for our products and services and loss of competitive advantage.

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## Mitigating Factors

- Strong project management structures exist for all of the major restructuring and disposal programmes which are underway to ensure that they are managed effectively.
- Project reporting tool ensures enhanced visibility of the progress of major projects as a matter of routine.
- Regular reporting by the major projects to the Executive Board to ensure swift resolution of any issues or to enhance coordination across the Group where required.

- Early adoption of EU Directive 2014/95/EU requiring increased disclosure of Corporate and Social Responsibility initiatives.
- Developed and launched in 2015 the 'Better Holidays, Better World' 2020 sustainability strategy framework which includes specific targets for key sustainability indicators.
- Established a dedicated sustainability team to work closely with the business and other stakeholders to implement the sustainability strategy.
- Operating the most carbon efficient airlines in Europe with continued investment in new, more efficient aircraft (e.g. Boeing 787 Dreamliner & 737 MAX) and cruise ships (e.g. the new Mein Schiff 1 & 2).
- Implemented an environmental management system with five of our airlines having achieved ISO 14001 certification.
- Increased measures to influence accommodation suppliers to achieve third party sustainability certification recognised by the Global Sustainable Tourism Council (GSTC).
- TUI Care Foundation expanded to focus on the achievement of 2020 target for charitable donations and sustainability projects, with particular emphasis on sustainable tourism, environmental protection and the welfare of children.

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## Nature of Risk

Furthermore, if TUI Group falls short of achieving its sustainable development targets and at the same time the objectives of the UN Paris Climate Change Agreement (December 2015) are not met, this could lead to sustained long-term damage to certain of the TUI Group's current and future destinations, which could also have a material adverse effect on demand for our products and services.

### INFORMATION SECURITY

Our responsibility is to protect the confidentiality, integrity and availability of the data we have and the services we provide to our customers, our employees, our suppliers and service delivery teams.

This is a dynamic risk due to increased global cyber-crime activity and new regulations. At the same time our consolidation under the TUI brand and our increasing dependence on online sales and customer care channels (web/mobile) increases our exposure and susceptibility to cyber-attacks and hacks.

If we do not ensure we have the appropriate level of security controls in place across the Group, this could have a significant negative impact on our key stakeholders, associated reputational damage and potential for financial implications.

### BREXIT

With the UK government formally triggering Article 50 of the Treaty on European Union of Lisbon on 29th March 2017, Brexit has become an active principal risk facing TUI Group. Brexit has an impact both on existing principal risks (e.g. Macroeconomic risks and Input Cost Volatility, through the uncertainty it has introduced to prospects for future growth rates in the UK economy and the sustained depreciation of sterling since the referendum result in 2016) as well as introducing a new class of principal risk due to the direct potential impact it could have on specific areas of our business model.

Our main concern is whether or not all of our airlines would continue to have access to EU airspace as now. If we were unable to continue to fly intra-EU routes, such as from Germany to Spain, this would have a significant operational and financial impact on TUI Group. Other areas of uncertainty include the status of our UK employees working in the EU and vice versa, and the potential for customer visa requirements for holidays from the UK to the EU.

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## Mitigating Factors

- Continued commitment from the Executive Board in support of key initiatives to ensure all existing and future IT systems are secure by design, that exposure to vulnerability is managed effectively, user access is sufficiently controlled and colleagues are made aware of information security risks through appropriate training.
  - Launch of a company-wide Information Security awareness campaign to promote secure behaviours amongst our colleagues. Overall goal is to make information security part of everyone's job.
  - Continuous review and testing of all external devices and ongoing monitoring of logs in order to identify any potential threats as and when they arise.
  - Continuous improvement through lessons learned from real or simulated cyber incidents.
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- The Group has established a Brexit Steering Committee to monitor developments as the political negotiations take place, assess any impacts on TUI Group's business model and devise suitable mitigation strategies.
  - In addition we continue to lobby relevant UK and EU ministers, officials and regulators to stress the continued importance of a liberalised and deregulated aviation market across Europe to protect consumer choice in both regions.