

ANNUAL RESULTS 2020

Financial Highlights	2020	Restated* 2019	Increase
Turnover	£230.0m	£225.2m	2.1%
Profit before tax	£13.0m	£11.9m	9.6%
Proposed full year dividend	2.55p	0.69p	369.6%
Basic earnings per share	6.45p	6.09p	5.9%

* Restatement resulting in a reduction in Turnover and Profit before tax of £0.2m relating to backdated duty with details set out on pages 21 and 22.

Macfarlane Group PLC (“the Group”) has performed well in 2020, achieving a resilient performance, which despite the challenging market conditions due to the impact of Covid-19, is ahead of our previous expectations.

At the outset of the Covid-19 pandemic, we acted decisively and responsibly to ensure that we protected the interests of our employees as well as other key stakeholders and all our sites remained operational serving customers throughout the year. The Group performance in 2020 is a testament to the quality and commitment of our people, the diversity of our customer base and our strong added value proposition.

The Board wishes to thank all of our people for their exceptional hard work and dedication, which ensured that we effectively supported our customers throughout 2020 in the most difficult circumstances.

Trading

Macfarlane Group achieved a 2.1% increase in sales to £230.0m in 2020, (2019: Restated* £225.2m), with 2020 profit before tax increasing to £13.0m (2019: Restated* £11.9m), 9.6% ahead of 2019.

Packaging Distribution increased sales by 2.6% in 2020 to £201.7m (2019: £196.7m). Sales revenue from existing customers benefited from underlying strength in the e-commerce, household essentials and medical sectors partially offset by weaker demand from sectors most affected by Covid-19, namely automotive, aerospace, high street retail and hospitality. Sales also benefited from the 2019 acquisitions of Ecopac and Leyland Packaging, as well as the January 2020 acquisition of Armagrip. Gross margin in Packaging Distribution at 32.5% showed improvement on the prior year (2019: 31.1%) and reflected effective management of input price movements, customer mix changes and increased online activity. The growth in sales and margin was partially offset by an increase in bad debt and end of lease property provisions totalling £1.9m which resulted in Packaging Distribution achieving a 12.8% increase in operating profit to £14.0m (2019: £12.4m).

Sales in Manufacturing Operations at £28.3m (2019: Restated* £28.5m) showed a 0.9% decrease on the previous year. Strong demand from the food, medical and household essentials sectors in the Labels business was more than offset by weaker demand from the aerospace and automotive sectors in the Packaging Design and Manufacture business. Operating profit in 2020 decreased to £0.4m (2019: Restated* £1.1m).

After net finance costs of £1.4m (2019: £1.6m), Group profit before tax totalled £13.0m, £1.1m ahead of 2019. Basic and diluted earnings per share were 6.45p (2019: Restated* 6.09p) and 6.42p (2019: Restated* 6.07p) respectively.

Dividend

The Board is proposing a final dividend of 1.85 pence per share, amounting to a full year dividend of 2.55p pence per share, compared to the prior year dividend of 0.69 pence per share which was impacted by the cancellation of the proposed final dividend of 1.76 pence per share, as one of the key Covid-19 cash conservation measures. Subject to the approval of shareholders at the Annual General Meeting on Tuesday 11 May 2021, the final dividend will be paid on Thursday 3 June 2021 to those shareholders on the register at Friday 14 May 2021.

Net Bank Debt

The Group's net bank borrowing at 31 December 2020 reduced to £0.5m from £12.7m at the previous year-end. The improved cash position has been achieved primarily through effective management of working capital. The full benefit of all government support and deferral programmes totalling £5.4m was repaid during the year. Deferred considerations on the Ecopac and Leyland acquisitions in 2019 totalling £1.8m were paid during 2020.

The Group's bank facility of £30.0m with Lloyds Banking Group has been extended until December 2025 and accommodates normal working capital requirements as well as supporting acquisition funding.

Pension Scheme

The Group's pension deficit at 31 December 2020 reduced to £1.5m (2019: £6.5m). Although the discount rate decreased, increasing the value of pension liabilities, this was offset by increases in the value of the scheme's holding in liability-driven investments and other investments.

The triennial valuation of the pension scheme on 1 May 2020 has now been concluded and the Group has agreed with the Scheme's Trustees to reduce contributions from £3.1m to £1.3m per annum with effect from 1 May 2021. The recovery period for deficit contributions now runs until April 2024.

Outlook

2021 has started well despite the ongoing impact of Covid-19. There are still significant uncertainties about the duration of disruption caused by lockdowns and the consequential impact on demand levels which means that 2021 will be another challenging year. However the Board is confident that, given the resilience seen in 2020, the strength of our business model and the commitment of our people, Macfarlane Group will progress in 2021 and is well positioned to benefit when the UK economy begins to recover.

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Notes to Editors:

- Macfarlane Group PLC is listed on the London Stock Exchange (LSE: MACF) in the Industrials Sector
- The company is headquartered in Glasgow, Scotland and has more than 70 years' experience in the UK packaging industry. Macfarlane Group's businesses are:
 - **Packaging Distribution** is the leading UK distributor of a comprehensive range of protective packaging products;
 - **Manufacturing Operations** which includes **Labels**, which designs and print high quality self-adhesive and resealable labels, principally for FMCG companies, and **Packaging Design and Manufacture**, which designs and produce protective packaging for high value, fragile products.

- Macfarlane Group employs over 850 people at 31 sites, principally in the UK, but also in Ireland, Sweden and Holland.
- The company has 15,000+ customers in the UK, Europe and the USA providing 600,000+ lines to a wide range of industry sectors including: consumer goods; food manufacturing; logistics; internet retail; mail order; electronics; defence and aerospace.

MANAGING THE COVID-19 PANDEMIC (“Covid-19”)

Background

During March 2020 the UK Government issued guidance in response to Covid-19 which introduced a national lockdown and social distancing rules. Reduced activity in the UK economy and restrictions on personal behaviour continued during 2020 and still remain in place in February 2021.

The Group’s response to Covid-19 has focused on:

- The safety and wellbeing of our people;
- Protecting our financial position; and
- Maintaining service to our customers.

The measures taken throughout the period are detailed below together with a summary of the ongoing impact on Macfarlane Group, its employees, customers and other stakeholders.

Crisis Management

A Covid-19 project team (“Covid-19 team”) comprising senior managers from across the Group was established in February 2020 to review and lead the implementation of our business continuity plans. The Covid-19 team reported regularly to Executive Management and the Board.

The project team has managed the Group’s response to the pandemic, adapting actions to respond to changing government legislation and advice. The team has also consulted with experts to provide ongoing learning and has benchmarked its actions against other businesses.

In the first stages, the Covid-19 team focused on implementing safety protocols for those employees working on site, the application of the furlough scheme and ensuring employees were equipped to work from home, or where required shield or self-isolate. Employees on furlough were paid 80% of their full pay throughout the furlough period, although all employees were topped-up at the Group’s expense to ensure no member of staff was paid less than minimum wage.

Our Covid-19 team reviewed and implemented the Group’s procedures in response to local, regional and national lockdowns, ensuring that we complied with local guidelines and continued to provide safe working environments and protection for our employees’ wellbeing.

Specific initiatives included:

- (a) Mental Health Awareness training for senior managers;
- (b) Employee engagement activities; and
- (c) Care packages for employees and their families.

Financial Management

Financial modelling was completed in March 2020 which stress tested the Group’s ability to survive a range of scenarios both short-term and long-term focusing on levels of customer demand and the resultant finance requirements.

Following this stress testing actions were taken to preserve cash and control costs. These actions included

- (a) furloughing employees, utilising the Coronavirus Job Retention Scheme (“CJRS”);
- (b) deferring VAT and PAYE payments in accordance with Government pronouncements;
- (c) cancelling the 2019 final dividend of 1.76p per share;
- (d) deferring all acquisition activity;
- (e) eliminating non-essential capital and revenue spending;
- (f) cancelling 2020 incentive schemes;
- (g) Board members waiving 25% salary for six months; and
- (h) engaging with all suppliers, including landlords and pension trustees to explore the Group’s ability to defer payments.

Given the uncertainty throughout the economy, the Group withdrew profit guidance to the market in March 2020.

MANAGING THE COVID-19 PANDEMIC (“Covid-19”)

Financial Management (continued)

There was a strong focus by the finance teams on day to day management of working capital, including increased diligence over customer credit, the conversion of trade receivables and closely managing inventory levels in line with changing customer demand. It became clear during the second quarter of 2020 that reductions in activity would not be as severe as had been initially modelled and that there would be no requirement for the Group to seek additional finance from our bank, government supported loan schemes, suppliers or shareholders.

At the end of 2020 our committed bank borrowing facility of £30m was extended from June 2022 to December 2025 to provide greater financial certainty over a longer period.

Customer Impact

Customers we serve in the e-commerce retail, hygiene, household essentials, medical and food sectors demonstrated strong demand as they played a vital role in helping the country meet the challenge of Covid-19. However, customers in industrial sectors particularly aerospace and automotive were materially impacted by lockdown activity and demand levels reduced.

As the year progressed our strong customer sectors continued to perform well with recovery in some of the industrial sectors with businesses beginning to return to work as they implemented revised working protocols for their staff.

Customer Service

All our sites remained open and trading throughout 2020. Staffing levels were adjusted to service reduced demand, with social distancing and hygiene measures established to protect the health, safety and wellbeing of our staff and customers.

Our Covid-19 team reviewed and implemented the Group’s procedures to re-open sites to employees who had previously worked from home. They ensured that all our employees could work in a Covid-19 safe environment including the provision of clear signage and barriers to manage social distancing, protective equipment, hand sanitising stations, temperature checking, regular cleaning and ongoing education.

All sites were risk assessed by our Health and Safety team and all external visits and assessments from the Health and Safety Executive validated that the measures taken throughout the Group were appropriate.

Managing our People

Our front line employees including warehouse, production and delivery staff were encouraged and supported to operate as normal. At the start of the third quarter, payments of £250 were made to all operational staff who had worked on site throughout the second quarter of the year.

The majority of our office-based staff worked successfully from home in accordance with our home working protocols.

Our Human Resources team has enhanced the health and wellbeing support available to staff, particularly for those in vulnerable groups as well as those undertaking extended periods of home working. The team ensured that all employees whether working on site or at home received regular communications regarding the Group’s response to Covid-19, regular care packages including supplies of hand sanitisers and face-coverings for staff and their families and for all employees on long-term furlough, one-to-one calls to ensure their wellbeing.

All 2020 Bonus Programmes were cancelled and a new incentive programme was introduced enabling employees to participate in a Performance Award Scheme which would reward based on the profitability of their respective business.

MANAGING THE COVID-19 PANDEMIC (“Covid-19”)

Communication

The 2020 AGM was held virtually, in line with government guidelines, with only directors and Registrars attending on a virtual basis.

There has been regular dialogue with shareholders to keep them updated on key operational and financial issues.

Throughout 2020 ongoing updates were held by Executive Directors with the senior management and local management teams in order to communicate progress, the sharing of ideas and addressing any concerns about how the Group was responding to the pandemic.

All employees received frequent communications providing support and guidance throughout the year. In addition to our normal communication with customers, a regular letter gave them clarity on our service offering and key business developments.

A Covid-19 Hotline was established for any employee to have direct, confidential access if they had any concerns or required additional support regarding the impact of Covid-19.

A number of surveys were carried out with both customers and employees to ensure we were fully aware of issues concerns and their priorities.

We maintained close contact with our key suppliers particularly in the final quarter of the year when volatile demand patterns created some stress within supply chains.

Financial Performance

Group sales reduced by 2.0% in the first half of 2020 compared to the same period in 2019 and net bank borrowings reduced by £11.9m over the six month period to £0.8m. We saw an increase in our bad debt experience in the second quarter.

On announcing the interim results on 27 August 2020, market guidance was restored and dividends to shareholders recommenced, with the declaration of an interim dividend of 0.70p per share which was paid in October 2020.

Following better than expected trading levels in the second quarter, CJRS monies received of £1.3m were repaid in full and £4.1m of deferred taxes were brought up to date. In total amounts equating to £5.4m were repaid to HMRC by the end of August 2020.

During the third quarter Group sales increased by 4.7% compared to the same period in 2019 and Group bank debt was £1.0m after the repayment of all CJRS monies and tax deferrals totalling £5.4m. In the final quarter of 2020, Group sales increased by 6.9% compared to the same period in 2019 and Group debt was £0.5m. Given the strong performance in the final quarter of the year, we were able to:-

- (a) make an advance payment on account in respect of the Performance Award Scheme;
- (b) apply sums totalling £20k usually used for Christmas cards, calendars and diaries to charitable donations for Mind, Shelter and the Trussell Trust;
- (c) recommence discussions with acquisition targets which were put on hold in March 2020;
- (d) approve certain capital expenditure projects which will take effect in 2021; and
- (e) repay sums waived from salaries by the Executive as instructed by the Remuneration Committee.

The full year 2020 performance resulted in sales of £230.0m, a 2.1% increase compared to 2019 and PBT of £13.0m compared to £11.9m (Restated*) in 2019. Net bank debt at the end of 2020 was £0.5m (2019: £12.7m).

MANAGING THE COVID-19 PANDEMIC (“Covid-19”)

2021 and Beyond

Covid-19 continues to have a significant impact across the world constraining day-to-day life and having wide-ranging impacts on our operations.

The key impacts of Covid-19 on our business are:-

- (a) There continues to be uncertainty about the duration of disruption, potential for further outbreaks and the consequential impact on demand levels caused by public health measures necessary to control the spread of the disease, including periods of lockdowns;
- (b) The speed and extent to which the economy recovers will continue to create fluctuations in demand across our customer base. Some key market sectors may not fully recover for a significant period of time;
- (c) The increased move from traditional high street retailing to online retailing is likely to become a more permanent shift in consumer demand patterns. The Group has seen a significant increase in business in 2020 from online retailers which has helped mitigate the reductions experienced by manufacturing and industrial customers;
- (d) There has been an increase in customers placing their orders electronically both through our web-shop and our Simplicit-e electronic trading platform. We expect this trend to continue;
- (e) The moves to accommodate increased reliance on remote working by employees and increased online activity;
- (f) The health and wellbeing support available to staff has been enhanced, particularly for those in vulnerable groups;
- (g) The need for a strong and continued focus on day to day management of working capital, including increased diligence over customer credit, the conversion of trade receivables and managing inventory levels in line with changing customer demand; and
- (h) There may be delays and difficulties in sourcing inventory and raw materials due to the disruption of suppliers’ production, particularly given the overlay of new trading arrangements with the EU from 2021.

The Covid-19 pandemic has affected a number of our principal risks highlighted in the tables on pages 11 to 14. We have therefore treated Covid-19 as an event impacting many of our existing risks, rather than as a separately defined new risk.

Summary

The response by Macfarlane Group to the challenge of Covid-19 has been effective:-

- Our people have been operating in safe conditions both in their workplace and when working from home. We have worked hard to ensure their health and wellbeing;
- The 2020 financial results for the Macfarlane Group show a resilient performance despite challenging conditions. Sales in 2020 increased by 2.1%. PBT increased by £1.1m compared to 2019 (Restated*) and Group debt reduced by £12.2m to £0.5m; and
- All our sites remained operational and we have maintained our service to customers. Our Net Promoter Score (“NPS”) score in 2020 at 53 showed an improvement on 2019.

The impact of Covid-19 has been a real test for Macfarlane Group in 2020. The resilience in our performance reflects well on the strength of our business model, a well-diversified customer base operating across a wide range of industry sectors, a robust financial structure and the quality and commitment of our people.

BUSINESS REVIEW

The Covid-19 pandemic had a significant impact on Macfarlane Group in 2020. We had to quickly introduce new working practices to protect the health, safety and wellbeing of our employees, continue to provide high levels of service to our customers and ensure the financial stability of the Group.

Many of our customers depend on our packaging to supply their essential goods and services to consumers, critical businesses and the NHS. Our effectiveness in maintaining supply to our customers reflects favourably on the quality and commitment of our people and the strength of our business model.

Despite the significant challenges the Group has faced, the financial performance in 2020 has been resilient with sales growth of 2.1% and an operating profit performance 6.5% ahead of 2019.

Group performance	Revenue 2020 £000	Operating profit 2020 £000	Restated*	Restated*
			Revenue 2019 £000	Operating profit 2019 £000
Segment				
Packaging Distribution	201,739	13,988	196,706	12,406
Manufacturing Operations	28,290	381	28,540	1,081
Group Total	230,029	14,369	225,246	13,487
Operating profit		6.2%		6.0%

* Restatement resulting in a reduction in Turnover and Profit before tax of £0.2m relating to backdated duty with details set out on pages 21 and 22.

Macfarlane Packaging Distribution is the leading UK specialist distributor of protective packaging materials. Macfarlane operates a Stock and Serve supply model from 25 Regional Distribution Centres (RDCs) and 3 satellite sites, supplying industrial and retail customers with a comprehensive range of protective packaging materials on a local, regional and national basis.

Competition in the packaging distribution market is from local and regional protective packaging specialist companies as well as national/international distribution generalists who supply a range of products, including protective packaging materials. Macfarlane competes effectively on a local basis through its strong focus on and regular monitoring of customer service, its breadth and depth of product offer and through the recruitment and retention of high-quality staff with good local market knowledge. On a national basis Macfarlane has focus, expertise and a breadth of product and service knowledge, all of which enables it to compete effectively against non-specialist packaging distributors.

Macfarlane benefits its customers by enabling them to ensure their products are cost-effectively protected in transit and storage through the supply of a comprehensive product range, single source Stock and Serve supply, Just In Time delivery, tailored stock management programmes, electronic trading and independent advice on both packaging materials and the packing processes.

Packaging Distribution	2020 £000	2019 £000	2020 Growth
Revenue	201,739	196,706	2.6%
Cost of sales	(136,177)	(135,525)	
Gross margin	65,562	61,181	7.2%
Operating expenses	(51,574)	(48,775)	5.7%
Operating profit	13,988	12,406	12.8%

Packaging Distribution grew sales by 2.6% in 2020. Despite the challenges of Covid-19 existing business has remained resilient with strong demand in the e-commerce, household essentials and medical sectors

offsetting weaker demand from customers in the automotive, aerospace, hospitality and high street retail sectors. Sales to retail companies in 2020 represents 28% of sales (2019: 23%).

Whilst new business growth has been more subdued due to limited engagement with potential customers through the Covid-19 lockdown period, new business generation of £11.3m (2019: £12.5m) was achieved. The impact of lockdowns meant a change in buying behaviour with increasing numbers of customers choosing to buy online through our shop.macfarlanepackaging.com website or through our Simplict-e electronic trading platform.

BUSINESS REVIEW

Packaging Distribution

The gross margin in Packaging Distribution improved to 32.5%, (2019: 31.1%) through our effectiveness in managing input price changes, a more favourable customer mix and the growth in customers transacting online.

We continued to deliver the benefit from acquiring high quality packaging distribution businesses and in January 2020 we completed the acquisition of the packaging trade and assets of Armagrip. During 2020 the earn-out programmes for the 2019 acquisitions of Ecopac and Leyland were concluded, with both achieving close to maximum payments.

During 2020 we made steady progress in extending our service into Europe to support a number of our pan-European customers. A Macfarlane subsidiary company, Macfarlane Group BV, was set up in Holland to service customers in the Benelux region and whilst still in the early stages, achieved sales of £1.1m in 2020.

Overhead increases were primarily due to the impact of acquisitions (£1.3m), bad debt charges (£0.8m), end of lease dilapidations (£1.1m) and some incremental Covid-19 costs.

Packaging Distribution's operating profit at £14.0m grew 12.8% vs 2019 reflecting a 6.9% (2019: 6.3%) return on sales.

Future Plans

2021 plans are focused on continuing to grow sales and improving profitability through the following actions:

- Prioritise engagement with potential new customers in stable and growing sectors such as e-commerce, medical and third party logistics ("3PL");
- Invest in new technology to allow our sales teams to demonstrate our ability to add value for customers through ongoing implementation of our "Significant Six" sales approach to optimise their "Total Cost of Packaging" in both face-to-face and virtual environments;
- Extend the penetration of our web-based solutions and technologies to enable customers improved on line access to our full range of products and services;
- Accelerate the good progress we have made in our "Follow the Customer" programme in Europe;
- Reduce operating costs through efficiency programmes in sales, logistics and administration;
- Maintain the focus on working capital management to facilitate future investment and manage effectively the bad debt risk which has increased in the current economic environment; and
- Supplement organic growth through progressing further suitable quality acquisitions.

Manufacturing Operations comprises our Packaging Design and Manufacture business and our Labels business.

The principal activity of the **Packaging Design and Manufacture** business is the design, manufacture and assembly of custom-designed packaging solutions for customers requiring cost-effective methods of protecting high value products in storage and transit. The primary raw materials are corrugate, timber and foam. The business operates from two manufacturing sites, in Grantham and Westbury, supplying both directly to customers and also through the national RDC network of the Packaging Distribution business.

Key market sectors are defence, aerospace, medical equipment, electronics and automotive. Our markets are highly fragmented with a range of locally based competitors. We differentiate our market offering through technical expertise, design capability, industry accreditations and national coverage through the Packaging Distribution business.

Our **Labels** business designs and prints self-adhesive labels for major Fast-moving Consumer Goods ("FMCG") customers in the UK and Europe and resealable labels for major customers in the UK, Europe and the USA. The business operates from production sites in Kilmarnock and Wicklow and a sales and design office in Sweden, which focuses on the development and growth of our resealable labels business, Reseal-it.

The Labels business has a high level of dependence on a small number of major customers. Management works closely with these key customers to ensure high levels of service and to introduce product and service development initiatives to achieve competitive differentiation.

BUSINESS REVIEW

Manufacturing Operations

	2020	Restated* 2019	2020 Growth
	£000	£000	
Sales	28,290	28,540	(0.9%)
Cost of sales	(17,306)	(17,731)	
Gross margin	10,984	10,809	1.6%
Operating expenses	(10,603)	(9,728)	9.0%
Operating profit	381	1,081	(64.8%)

* Restatement resulting in a reduction in Turnover and Profit before tax of £0.2m relating to backdated duty with details set out on pages 21 and 22.

Manufacturing Operations

2020 sales for Packaging Design and Manufacture were 20.2% below 2019 due to weak demand in the aerospace and automotive sectors. Given the weakness in sales, particularly in the aerospace sector, which is expected to continue for some time, actions were taken in the second half of 2020 to realign the cost base in order to return the business to profitability in 2021. As a result of the lower sales and the one-off impact of effecting these cost reductions, the business made a small loss in 2020.

Labels' sales increased by 10.6% in the year due to higher demand from existing customers in the food, household essentials and hygiene sectors. Overheads costs increased, due primarily to higher transportation costs servicing overseas customers in a Covid-19 environment. Profit in 2020 was marginally ahead of 2019.

Future Plans

Priorities for the Manufacturing Operations in 2021 are to:

- Re-focus the Design & Manufacture sales team on growth sectors, such as Medical and Defence;
- Prioritise new sales activity on our higher added-value bespoke composite pack product range;
- Continue to strengthen the relationship between our Design and Manufacture operations and our Packaging Distribution business to create both sales and cost synergies;
- Ensure the cost saving actions in 2020 return the Design and Manufacture business to profitability in 2021;
- Accelerate the Reseal-it growth momentum through improved geographic penetration, extending the product range and introducing Reseal-it to new product sectors; and
- Secure efficiency benefits from the additional labels printing capacity in our Kilmarnock site.

2021 Outlook

The impact of Covid-19 will remain for some time. However, Macfarlane Group has demonstrated its resilience in 2020 and is well positioned to benefit when the UK economy begins to recover. We have a strong financial position, a diverse customer base, added value customer propositions, a successful acquisition track record and experienced, high quality people.

In 2021 we will continue to add value for our protective packaging customers through our Significant Six sales approach and support them to reduce cost in their packaging operations and achieve their sustainability objectives. Our sales focus will be on sectors such as e-commerce, which have strong growth potential, and industrial sectors where we can add value through our sales approach and national network of RDCs. We will respond to customers looking to consolidate their purchasing through our European "Follow the Customer" strategy.

In 2021, we plan to acquire further good quality protective packaging businesses, improve penetration of new products introduced by recent acquisitions, continue to develop our partnerships with strategic suppliers and invest in new technology to improve operational efficiency and sales effectiveness.

Macfarlane Group's businesses all have strong market positions with differentiated product and service offerings. We have a flexible business model and a clear strategic plan incorporating a range of actions, which are being effectively implemented. This has been reflected in consistent profit growth in the ten years to 2019 and in the most difficult circumstances profits have increased again in 2020.

Our future performance is largely dependent on the successful execution of actions to grow sales, increase efficiencies and bring high-quality acquisitions into the Group. Despite the continuing challenges from the Covid-19 pandemic, our strategy and business model have proved resilient. We expect 2021 to be a year of progress for Macfarlane Group.

BUSINESS REVIEW

Principal Risks and Uncertainties

The principal risks and uncertainties faced by the Group and the factors mitigating these risks are detailed on the following pages.

Response to the Covid-19 pandemic (“Covid-19”)

The Group’s response to Covid-19 has focused on the safety and wellbeing of our people, protecting our financial position and limiting the interruption of service to our customers.

Whilst we have not classified Covid-19 as a separate principal risk due to its pervasive effect across all of the principal risks and uncertainties shown below, specific uncertainties arising from the pandemic include:

- Fluctuations in demand across our customer base. Some key markets may not fully recover for a significant period of time.
- Potential deterioration in cash flow of reduced demand from customers and recoverability of trade receivables.
- Uncertainty about the duration of disruption, the potential for further outbreaks and the consequential impact on demand levels caused by continued public health measures necessary to control the spread of the disease, including periods of lockdowns.
- Delay and difficulties in sourcing inventory and raw materials due to the disruption of suppliers’ production.
- Uncertainty regarding the speed and extent to which the economy and in particular the key market sectors relevant to the Group’s business and growth, recover.

Accordingly Covid-19 is built into our assessment of certain specific risks below.

Response to Brexit

A new trading arrangement was concluded between the UK and the EU in December 2020. Based on our earlier impact analysis, the Group’s view is that this trading arrangement should not have a significant impact on our supply costs. However, we shall continue to monitor and mitigate any disruption to our supply chain for EU sourced products.

The principal risks and uncertainties are detailed on the following pages. These risks are complemented by an overall governance framework including clear and delegated authorities, business performance monitoring and appropriate insurance cover for a wide range of potential risks. There is a dependence on good quality local management, which is supported by an investment in training and development and ongoing performance evaluation.

We continue to evolve our risk management processes to ensure they are robust, effective and integrated within our decision-making processes. Two additional risks have been highlighted in the current year partly as a consequence of the Covid-19 pandemic on strategic changes to the market generally and the increasing potential for cyber-security attacks. We have also included a brief description of how we assess that each risk level has changed during 2020. For risks shown as [← →] the risk level broadly similar between 2020 and 2019. If the risk is shown as [↑ ↓] the risk has increased or decreased respectively during 2020.

Risk Description	Mitigating Factors	Change in Risk Level
<p>Strategic changes in the market</p> <p>(New Risk in 2020)</p> <p>Failure to respond to strategic shifts in the market, including the knock-on impact of weaknesses in the economy as well as disruptive behaviour from competitors and changing customer needs (e.g. the move towards online retail) could limit the Group's ability to continue to grow revenues.</p>	<p>The Group has a well-diversified customer base giving protection from changes in specific industry sectors as well as a flexible business model and strong value proposition enabling it to meet the changing needs of customers.</p> <p>The Group strives to maintain high service levels for customers ensuring that customer needs are met, despite the reduction in contact during 2020. The Group continues to invest in electronic trading platforms, to further enhance its service offering.</p> <p>The Group maintains strong partnerships with key suppliers, to ensure that a broad range of products is available to customers to respond to their requirements including any changes in their environmental and sustainability concerns.</p>	<p>Increased risk ↑</p> <p>The Group's supply chain in 2020 has proved resilient and robust despite the disruptive impact of Covid-19.</p> <p>In 2020 the Group experienced weaker demand from customers in aerospace, high street retail, automotive and a number of other industrial sectors. However, this has been offset by growth in the e-commerce and medical sectors.</p>
<p>Raw material prices</p> <p>The Group's businesses are impacted by commodity-based raw material prices and manufacturer energy costs, with profitability sensitive to input price changes including currency fluctuations.</p> <p>The principal components are corrugated paper, polythene films, timber and foam, with changes to paper and oil prices having a direct impact on the price we pay to our suppliers.</p>	<p>The Group works closely with its supplier and customer base to manage effectively the scale and timing of these price changes and any resultant impact on profit.</p> <p>Our IT systems monitor and measure effectiveness in these changes.</p> <p>Where possible, alternative supplier relationships are maintained to minimise supplier dependency.</p> <p>We work with customers to redesign packs and reduce packing cost to mitigate the impact of cost increases.</p>	<p>Increased risk ↑</p> <p>Whilst gross margins have remained strong in 2020, with increased demand from internet retail, recovery of some sectors that have experienced reduced demand during Covid-19 and Brexit stock building it is anticipated that the Group will experience inflationary pricing pressures in 2021, including increased administration costs and tariffs for products sourced from the EU.</p>
<p>Decentralised structure</p> <p>In Packaging Distribution, the business model reflects a decentralised approach with a dependency on effective local decision-making. There is a risk that the decentralised management control is less effective and local decisions may not always meet overall</p>	<p>The Group ensures that our staff have the right working environment, information and sales tools to enable them to meet corporate objectives.</p> <p>A comprehensive management information system is maintained with key performance indicators monitored and actions taken when required.</p>	<p>No change ↔</p> <p>The implementation of our Covid-19 mitigations resulted in a high proportion of our employees working remotely, further increasing pressure on local decision-making.</p> <p>Virtual conferencing technology has enabled the Group to improve the quality,</p>

Risk Description	Mitigating Factors	Change in Risk Level
corporate objectives	Significant investment has been made in 2020 and further investment is planned in 2021 to provide the technology to our employees to work remotely while enhancing the quality of communication with fellow employees, customers and supplier.	consistency and frequency of engagement with managers and employees. This has contributed to the speed and effectiveness of implementing key actions during 2020.
<p>Property</p> <p>Given the multi-site nature of its business, the Group has a property portfolio comprising 3 owned sites and 34 leased sites. This portfolio gives rise to risks in relation to ongoing lease costs, dilapidations and fluctuations in value.</p>	<p>The Group adopts a proactive approach to managing property costs and exposures.</p> <p>Where a site is non-operational the Group seeks to assign, sell or sub-lease the building to mitigate the financial impact.</p> <p>If this is not possible, rental voids are provided on vacant properties taking into consideration the likely period of vacancy and incentives to re-let.</p>	<p>Reduced risk ↓</p> <p>Our property consolidation strategy has continued during 2020 and work is ongoing to finalise exit costs on expiry for two long-term leases, which had been sub-let. Provisions have been established to cover the anticipated exit costs.</p> <p>The Group currently has no vacant or sub-let properties.</p>
<p>Cyber Security</p> <p>(New Risk in 2020)</p> <p>The increasing frequency and sophistication of cyber-attacks is a risk which potentially threatens the confidentiality, integrity and availability of the Group's data and IT systems. These attacks could also cause reputational damage and fines in the event of personal data being compromised.</p>	<p>The Group continually invests in its IT infrastructure to protect against cyber security threats. This includes regular testing of IT Disaster Recovery Plans.</p> <p>We also engage the services of a Cyber Security partner to perform regular penetration tests and assess potential vulnerabilities within our security arrangements.</p> <p>This is complemented by a program of cyber security awareness training to ensure that all staff are aware of the potential threats caused by deliberate and unauthorised attempts to gain access to our systems and data.</p>	<p>Increased risk ↑</p> <p>We have increased our reliance on remote working which increases the number of points from which attacks could originate.</p> <p>The frequency and sophistication of cyber-attacks generally has increased as a result of Covid-19.</p>
<p>Financial liquidity, debt covenants and interest rates</p> <p>The Group needs continuous access to funding to meet its trading obligations and to support organic growth and acquisitions. There is a risk that the Group may be unable to obtain funds and that such funds will only be available on unfavourable terms.</p>	<p>The Group's borrowing facility comprises a committed facility of £30 million with Lloyds Bank PLC, which finances our trading requirements and supports controlled expansion, providing a medium-term funding platform for growth.</p> <p>The Group regularly monitors net bank debt and forecast cash flows to ensure that it will be able to meet its financial obligations as</p>	<p>Reduced risk ↓</p> <p>The Group has proved to be strongly cash generative in 2020 and has operated well within its existing bank facilities throughout the year.</p> <p>At the start of 2021, the £30 million committed facility with Lloyds Banking Group PLC was extended until December 2025.</p>

Risk Description	Mitigating Factors	Change in Risk Level
<p>The Group's borrowing facility comprises a committed facility of up to £30 million. This includes requirements to comply with specified covenants, with a breach potentially resulting in Group borrowings being subject to onerous conditions.</p>	<p>they fall due.</p> <p>Compliance with covenants is monitored on a monthly basis and sensitivity analysis is applied to forecasts to assess the impact on covenant compliance.</p>	
<p>Working capital</p> <p>The Group has a significant investment in working capital in the form of trade receivables and inventories. There is a risk that this investment is not fully recovered.</p>	<p>Credit risk is controlled by applying rigour to the management of trade receivables by our Credit Manager and the credit control team and is subject to additional scrutiny from the Group Finance Director.</p> <p>Inventory levels and order patterns are regularly reviewed and risks arising from holding bespoke stocks are managed by obtaining order cover from customers.</p>	<p>Increased risk ↑</p> <p>The impact of Covid-19 resulted in increased bad debts write-offs in 2020 with some customers experiencing cash flow difficulties. The Expected Credit Loss allowance has been increased accordingly.</p> <p>Aged stock over 6 months old has increased reflecting the slower movement of older bespoke stocks particularly to customers experiencing reduced demand. Provisioning levels have been increased accordingly.</p>
<p>Acquisitions</p> <p>The Group's growth strategy includes acquisitions as demonstrated in recent years. There is a risk that such acquisitions may not be available on acceptable terms in the future.</p> <p>It is also possible that acquisitions will not succeed due to the loss of key people or customers following acquisition or the acquired business not performing at the level expected. This could potentially lead to an impairment in the carrying value of the related goodwill and other intangible assets.</p> <p>Execution risks around the failure to successfully integrate the acquired business following conclusion of the earn-out period also</p>	<p>The Group carefully reviews potential acquisition targets, ensuring that the focus is on high-quality businesses which complement the existing Group profile and provide opportunities for growth.</p> <p>Having completed a number of acquisitions in recent years, the Group has well-established due diligence and integration processes and procedures.</p> <p>The Group has a comprehensive management information system to enable effective monitoring of post-acquisition performance.</p> <p>Earn-out mechanisms also mitigate risk in the post-acquisition period.</p> <p>Goodwill and other intangible assets are tested annually for impairment with no impairment required in 2020.</p>	<p>No change ← →</p> <p>The Group has made 12 acquisitions since 2014, including one in 2020, all of which continue to perform well. The Group has well-established due diligence and integration processes while only acquiring well established quality businesses which will perform well in the Group.</p>

Risk Description	Mitigating Factors	Change in Risk Level
exist.		
<p>Defined benefit pension scheme</p> <p>The Group's defined benefit pension scheme is sensitive to a number of key factors including investment returns, the discount rates used to calculate the scheme's liabilities and mortality assumptions.</p> <p>Small changes in these assumptions could cause significant movements in the pension deficit.</p>	<p>The scheme was closed to new members in 2002. Benefits for active members were amended by freezing pensionable salaries at April 2009 levels.</p> <p>A Pension Increase Exchange option is available to offer flexibility to new pensioners in the current level of pension benefits and the rate of future increases.</p> <p>The Group makes Deficit Reduction Contributions each year.</p> <p>The investment profile is regularly reviewed to ensure continued matching of investments with the scheme's liability profile.</p>	<p>Reduced risk ↓</p> <p>The IAS 19 valuation of the Group's defined benefit pension scheme as at 31 December 2020 estimated the scheme deficit to be £1.5m, a decrease of £5.0m during 2020.</p> <p>Deficit repair contributions will decrease from £3.1 million in 2020 to £1.3 million from 1 May 2021 following the actuarial valuation at 1 May 2020. This reflects continued progress in reducing the deficit.</p>

There are a number of other risks that we manage which are not considered key risks. In addition, the Group is subject to the impact of general economic conditions including any economic uncertainty, the competitive environment, compliance with legislation and risks associated with business continuity. These are mitigated in ways common to all businesses and not specific to Macfarlane Group.

BUSINESS REVIEW

Viability statement

The Board is required to formally assess that the Group has adequate resources to continue in operational existence for the foreseeable future and as such can continue to adopt the Going Concern basis of accounting. The Board is also required to state that it has a reasonable expectation that the Group will continue in operation and meet its longer-term liabilities as they fall due.

To support this statement, the Board is required to consider the Group's current financial position, its strategy, the market outlook and its principal risks. The Board's assessment of the principal risks facing the Group and how these risks affect the Group's prospects are set out on pages 10 to 14. The review also includes consideration of how these risks could prevent the Group from achieving its strategic plan and the potential impact these risks could have on the Group's business model, future performance, solvency and liquidity over the next three years.

The Board considers the Group's viability as part of its ongoing programme to manage risk. Each year the Board reviews the Group's strategic plan for the forthcoming three-year period and challenges the Executive team on the plan's risks. The plan reflects the Group's businesses, which have a broad spread of customers across a range of different sectors with some longer-term contracts in place. The assessment period of three years is consistent with the Board's review of the Group strategy, including assumptions around future growth rates for our business and acceptable levels of performance.

Financial modelling and scenarios

The Group's existing bank facilities comprise a £30 million committed facility with Lloyds Banking Group, which is available until December 2025. The Group has performed well during 2020 despite a number of local, regional and national lockdowns as a consequence of the Covid-19 pandemic, which gives confidence in the strength of the underlying business model. The Directors have also considered the longer-term economic outlook for the UK, including the potential impact of a prolonged recession, given the uncertain economic environment. Given the current uncertainty of the economic outlook due to the Covid-19 pandemic, we have modelled a 'severe but plausible downside' scenario as described below. In forming conclusions, the Directors have also considered potential mitigating actions that the Group could take to preserve liquidity and ensure compliance with its financial covenants.

A detailed financial model covering a three-year period is maintained and regularly updated. This model enables sensitivity analysis, which includes flexing the main assumptions, including future revenue growth, gross margins, operating costs, finance costs and working capital management. The results of flexing these assumptions, both individually and in aggregate, are used to determine whether additional bank facilities will be required during the three-year period and whether the Group will remain in compliance with the covenants relating to the current facility.

We have modelled a range of scenarios, including a central case, a downside scenario, a severe but plausible downside and a reverse stress test, over the three-year horizon. The 'severe but plausible downside' scenario is conservative in assuming, compared to the central case, revenue reductions of 5% and gross margin reductions at the rate of 2.0% in each of the three years, with no reduction in costs. Even under this scenario, and before reflecting any mitigating actions available to Group management, the Group would forecast compliance with all financial covenants not require any additional financing.

As a result of the uncertainties due to the Covid-19 pandemic, the Group has also modelled a reverse stress test scenario. This models the decline in sales that the Group would be able to absorb before breaching any financial covenants. Such a scenario, and the sequence of events that could lead to it, is considered to be remote, as it requires sales reductions of c.12.5% per annum between 2021 and 2023 compared to the central case, before there is a breach financial covenants in the period under review and is calculated before reflecting any mitigating actions.

Even in the severe but plausible scenario, Macfarlane Group is forecast to have sufficient liquidity to continue trading, comfortably meeting its financial covenants and operating within the level of its facilities for the foreseeable future. The reverse stress test modelling has shown that a c.24% reduction in sales in 2021 compared to 2020 could lead to a breach of covenants in the period under review. However, in this scenario, management would also be able to take mitigating actions similar to those outlined in our Covid-19 update on page 3.

Conclusions

For this reason, the Board considers it appropriate for the Group to adopt the going concern basis in preparing its financial statements. The Board also has a reasonable expectation that the Group will continue in operation and meet its longer-term liabilities as they fall due.

Cautionary Statement

The Chairman's Statement and the Business Review on pages 1 to 15 have been prepared to provide additional information to members of the Company to assess the Group's strategy and the potential for the strategy to succeed. It should not be relied on by any other party or for any other purpose.

This report and the financial statements contain certain forward-looking statements relating to operations, performance and financial status. By their nature, such statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future. There are a number of factors, including both economic and business risk factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements.

These statements are made by the Directors in good faith based on the information available to them up to the time of their approval of this report. Nothing in this Preliminary Announcement should be construed as a profit forecast or an invitation to deal in the securities of the Group.

Responsibility Statement of the Directors

The responsibility statement below has been prepared in connection with the company's full annual report for the year ending 31 December 2020. Certain parts of the full Annual Report are not included within this announcement.

The Directors of Macfarlane Group PLC are

S.R. Paterson	Chairman
P.D. Atkinson	Chief Executive
I. Gray	Finance Director
J. Love	Executive Director
R. McLellan	Non-Executive Director and Senior Independent Director
J.W.F. Baird	Non-Executive Director
A.M. Dunstan	Non-Executive Director

To the best of the knowledge of the Directors (whose names and functions are set out above), the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit for the Company and the undertakings included in the consolidation taken as a whole;

The Strategic Report, incorporated into the Directors' Report in the Annual Report, includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and

Pursuant to Disclosure and Transparency Rules, Chapter 4, the directors consider that the Company's annual report and financial statement, taken as a whole, are fair, balanced and understandable and provide information necessary for the shareholders to assess the Company's and the Group's position and performance, business model and strategy.

Peter Atkinson
Chief Executive

25 February 2021

Ivor Gray
Finance Director

25 February 2021

Macfarlane Group PLC
Consolidated income statement
For the year ended 31 December 2020

	Note	2020 £000	Restated* 2019 £000
Revenue	3	230,029	225,246
Cost of sales		(153,483)	(153,256)
Gross profit		76,546	71,990
Distribution costs		(8,429)	(8,441)
Administrative expenses		(53,748)	(50,062)
Operating profit	3	14,369	13,487
Finance costs	4	(1,367)	(1,625)
Profit before tax		13,002	11,862
Tax	5	(2,831)	(2,262)
Profit for the year	7	10,171	9,600
Earnings per share			
Basic	7	6.45p	6.09p
Diluted	7	6.42p	6.07p

Consolidated statement of comprehensive income
For the year ended 31 December 2020

	Note	2020 £000	Restated* 2019 £000
<i>Items that may be reclassified to profit or loss</i>			
Foreign currency translation differences - foreign operations		60	(62)
<i>Items that will not be reclassified to profit or loss</i>			
Remeasurement of pension scheme liability	10	2,112	537
Tax recognised in other comprehensive income			
Tax on remeasurement of pension scheme liability	11	(401)	(92)
Corporation tax rate change on deferred tax		129	-
Other comprehensive income for the year, net of tax		1,900	383
Profit for the year		10,171	9,600

Total comprehensive income for the year

12,071

9,983

* Details of the restatements are set out on pages 21 and 22.

Macfarlane Group PLC
Consolidated statement of changes in equity
For the year ended 31 December 2020

	Note	Share Capital £000	Share Premium £000	Revaluation Reserve £000	Translation Reserve £000	Restated* Retained Earnings £000	Restated* Total £000
At 1 January 2019		39,387	12,975	70	293	9,404	62,129
Comprehensive income							
Profit for the year		-	-	-	-	9,600	9,600
Foreign currency translation differences		-	-	-	(62)	-	(62)
Remeasurement of pension liability	10	-	-	-	-	537	537
Tax on remeasurement of pension liability	11	-	-	-	-	(92)	(92)
Total comprehensive income		-	-	-	(62)	10,045	9,983
Transactions with shareholders							
Dividends	6	-	-	-	-	(3,689)	(3,689)
Credit for share-based payments		-	-	-	-	75	75
Issue of share capital	12	66	173	-	-	-	239
Total transactions with shareholders		66	173	-	-	(3,614)	(3,375)
At 31 December 2019		39,453	13,148	70	231	15,835	68,737
Comprehensive income							
Profit for the year		-	-	-	-	10,171	10,171
Foreign currency translation differences		-	-	-	60	-	60
Remeasurement of pension liability	10	-	-	-	-	2,112	2,112
Tax on remeasurement of pension liability	11	-	-	-	-	(401)	(401)
Corporation tax rate change on deferred tax	11	-	-	-	-	129	129
Total comprehensive income		-	-	-	60	12,011	12,071
Transactions with shareholders							
Dividends	6	-	-	-	-	(1,105)	(1,105)
Credit for share-based payments		-	-	-	-	75	75

Total transactions with shareholders	-	-	-	-	(1,030)	(1,030)
At 31 December 2020	39,453	13,148	70	291	26,816	79,778

* Details of the restatements are set out on pages 21 and 22.

Macfarlane Group PLC
Consolidated balance sheet at 31 December 2020

	Note	2020 £000	Restated* 2019 £000
Non-current assets			
Goodwill and other intangible assets		60,598	62,663
Property, plant and equipment		8,640	9,621
Right of Use assets		28,584	25,855
Other receivables		35	35
Deferred tax assets	11	396	1,224
Total non-current assets		98,253	99,398
Current assets			
Inventories		15,858	15,813
Trade and other receivables		51,371	52,044
Cash and cash equivalents	9	7,228	5,579
Total current assets		74,457	73,436
Total assets	3	172,710	172,834
Current liabilities			
Trade and other payables		47,755	48,530
Provisions		1,834	660
Current tax payable		1,731	1,084
Lease liabilities	9	5,784	6,321
Bank borrowings	9	7,766	18,253
Total current liabilities		64,870	74,848
Net current assets/(liabilities)		9,587	(1,412)
Non-current liabilities			
Retirement benefit obligations	10	1,471	6,465
Deferred tax liabilities	11	3,072	3,116
Trade and other payables		19	22
Provisions		592	-
Lease liabilities	9	22,908	19,646
Total non-current liabilities		28,062	29,249
Total liabilities	3	92,932	104,097
Net assets		79,778	68,737

Equity			
Share capital	12	39,453	39,453
Share premium	12	13,148	13,148
Revaluation reserve		70	70
Translation reserve		291	231
Retained earnings		26,816	15,835
Total equity	3	79,778	68,737

* Details of the restatements are set out on pages 21 to 23.

Macfarlane Group PLC
Consolidated cash flow statement
For the year ended 31 December 2020

	Note	2020 £000	Restated* 2019 £000
Profit before tax		13,002	11,862
Adjustments for:			
Amortisation of intangible assets		2,520	2,391
Depreciation of property, plant and equipment and ROU assets		8,459	7,816
Loss on disposal of property, plant and equipment		30	5
Share-based payments		75	75
Finance costs		1,342	1,606
Operating cash flows before movements in working capital		25,428	23,755
Decrease in inventories		161	2,006
Decrease in receivables		955	1,178
Increase/(decrease) in payables		965	(1,445)
Increase in provisions		1,766	660
Adjustment for pension scheme funding		(2,981)	(2,994)
Cash generated by operations		26,294	23,160
Income taxes paid		(1,728)	(2,288)
Interest paid		(1,243)	(1,375)
Cash inflow from operating activities		23,323	19,497
Investing activities			
Acquisitions, net of cash acquired	8	(2,661)	(6,162)
Proceeds on disposal of property, plant and equipment		102	185
Purchases of property, plant and equipment		(804)	(2,648)
Cash outflow from investing activities		(3,363)	(8,625)
Financing activities			
Dividends paid	6	(1,105)	(3,689)
Repayment on bank borrowing facility		(10,225)	(742)
Repayments of leases		(6,719)	(6,699)
Cash outflow from financing activities		(18,049)	(12,173)
Net increase/(decrease) in cash and cash equivalents		1,911	(1,301)
Cash and cash equivalents at beginning of year		3,310	4,611

Cash and cash equivalents at end of year	5,221	3,310
	<hr/> <hr/>	<hr/> <hr/>
* Details of the restatements are set out on pages 21 to 23.		
	2020	2019
	£000	£000
Reconciliation to consolidated cash flow statement		
Cash and cash equivalents per the consolidation balance sheet	7,228	5,579
Bank overdraft	(2,007)	(2,269)
	<hr/>	<hr/>
Balances per consolidated cash flow statement	5,221	3,310
	<hr/>	<hr/>

Bank overdrafts are included in cash and cash equivalents because they form an integral part of the Group's cash management.

Macfarlane Group PLC

Notes to the financial information

For the year ended 31 December 2020

1. General information

The financial information set out herein does not constitute the Company's statutory accounts as defined in Section 435 of the Companies Act 2006 and has been extracted from the full statutory accounts for the years for the years ended 31 December 2020 and 2019.

The financial statements for 2020 were approved by the Board of Directors on 25 February 2021. The auditor's report on the statutory financial statements for the year ended 31 December 2020 was unqualified pursuant to Section 498 of the Companies Act 2006 and did not contain a statement under sub-section 498 (2) or (3) of that Act.

The financial information for 2019 is derived from the statutory accounts for 2019 which have been delivered to the registrar of companies. The previous auditor has reported on the 2019 accounts; their report was (i) unqualified, (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

2. Basis of preparation

The Group's business activities, together with the factors likely to affect its future development, performance and financial position are set out on pages 1 to 15.

The Group's principal financial risks in the medium term relate to liquidity and credit risk. Liquidity risk is managed by ensuring that the Group's day-to-day working capital requirements are met by having access to committed banking facilities with suitable terms and conditions to accommodate the requirements of the Group's operations. Credit risk is managed by applying considerable rigour in managing the Group's trade receivables. The Directors believe that the Group is adequately placed to manage its financial risks effectively, despite any economic uncertainty.

The Group's has a committed borrowing facility of £30 million with Lloyds Banking Group PLC in place until December 2025. The facility bears interest at normal commercial rates and carries standard financial covenants in relation to interest cover and levels of headroom over certain trade receivables of the Group.

The Directors are of the opinion that the Group's cash forecasts and revenue projections, which they believe are based on prudent market data and past experience taking account of reasonably possible changes in trading performance given current market and economic conditions, show that the Group should be able to operate within the current facility and comply with its banking covenants. As a consequence of the Covid-19 pandemic, the Directors have modelled a range of scenarios, including a central case, a downside scenario, a severe but plausible downside and a reverse stress test, over the three-year horizon, as set out in the Viability statement on page 15.

After making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for at least the next twelve months. For this reason they continue to adopt the going concern basis in preparing the financial statements for the year ended 31 December 2020.

Restatement due to prior period adjustments

As part of the Group's preparations to mitigate Brexit-related risks, the Group undertook an exercise to review duty and tariff arrangements for all imports and exports to and from all countries, both within and outwith the EU. This review, which was completed in December 2020, uncovered one product area in the Manufacturing Operations segment where the Group, in conjunction with its customers, had applied an incorrect duty code on certain exported items. It was confirmed that this error had originated in prior years. Working with the customers concerned, the Group agreed that the error should be rectified forthwith and all arrears of duty including interest, should be paid.

In addition to rectifying the specific error identified, the Group undertook a further review of all imports and exports to confirm that there was no risk of any similar instances. This was concluded satisfactorily, and no other such errors were identified.

Macfarlane Group PLC
Notes to the financial information
For the year ended 31 December 2020

2. Basis of preparation (continued)

Restatement due to prior period adjustments (continued)

The Group's share of the estimated value of £697k after tax has been fully provided for at 31 December 2020, with £534k recognised as a prior period adjustment being £143k deducted from 2019 sales, £19k added to interest, £31k deducted from the 2019 tax charge and £403k relating to earlier years, recorded as a reduction in Retained earnings at 1 January 2019.

These adjustments have been recognised as prior year errors in accordance with IAS 8 'Accounting policies, changes in accounting estimates and errors' within these Financial Statements and restated accordingly. The impact of the restatements on the affected primary statement line items is shown in the tables below.

Restatement in prior periods to 31 December 2019	As previously reported £000	Adjustment to retained earnings £000	Adjusted (2019 impact) £000	As restated £000
Consolidated Income Statement				
Revenue	225,389		(143)	225,246
Gross Profit	72,133		(143)	71,990
Operating profit	13,630		(143)	13,487
Finance costs	(1,606)		(19)	(1,625)
Profit before tax	12,024		(162)	11,862
Tax	(2,293)		31	(2,262)
Profit for the year	9,731		(131)	9,600
Consolidated Statement of Other Comprehensive Income				
Profit for the year	9,731		(131)	9,600
Total comprehensive income for the year	10,114		(131)	9,983
Consolidated Balance Sheet				
Provisions	-	(498)	(162)	(660)
Deferred tax liabilities	(3,242)	95	31	(3,116)
Net Assets	69,271	(403)	(131)	68,737
Retained earnings	16,369	(403)	(131)	15,835
Total Equity	69,271	(403)	(131)	68,737
Consolidated Cash Flow				
Profit before tax	12,024		(162)	11,862
Operating cash flows before movements in working capital	23,917		(162)	23,755
Decrease in payables	(947)		162	(785)
Cash generated from operations	23,160		-	23,160
Consolidated Statement of Changes in Equity				
At 1 January 2019	9,807	(403)		9,404
Profit for the Year	9,731		(131)	9,600
At 31 December 2019	16,369	(403)	(131)	15,835

All headings and numbers throughout the Report and Financial Statements that are marked as "Restated" reflect the restatements for these prior period adjustments as set out above. All restatements relate to the Manufacturing Operations segment.

Macfarlane Group PLC

Notes to the financial information

For the year ended 31 December 2020

2. Basis of preparation (continued)

Restatement due to prior period adjustments (continued)

In addition the Group has previously offset certain cash balances against bank borrowings which, whilst in line with the Group's legal right of offset, did not reflect any short-term intention to offset the liabilities after the balance sheet dates as required by IAS 32. Accordingly, £2,269k has been added to cash balances and bank borrowings respectively in 2019. There has been no impact on the income statement or on net assets.

Key sources of estimation uncertainty

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities as at the balance sheet date and the amounts reported for revenues and expenses during the year. Due to the nature of estimation, the actual outcomes may well differ from these estimates. No significant judgements have been made in the current or prior year.

The key sources of estimation uncertainty that have a significant effect on the carrying amounts of assets and liabilities are discussed below:

Retirement benefit obligations

The determination of any defined benefit pension scheme liability is based on assumptions determined with independent actuarial advice. The key assumptions used include discount rate, inflation rate and mortality assumptions, for which a sensitivity analysis is provided in Note 10. The directors consider that those sensitivities represent reasonable sensitivities which could occur in the next financial year.

Valuation of trade receivables

The provision held against trade receivables is based on applying an expected credit loss model and related estimates of recoverable amounts. Whilst every attempt is made to ensure that the provision held against doubtful trade receivables is as accurate as possible, there remains a risk that the provision may not match the level of debt, which ultimately proves uncollectable. For illustration only an increase in the average default rate of overdue trade receivables from 0.97% to 2.35% above the historic loss rates observed would lead to an increase of £650,000 in the provision required.

3. Segmental information

The Group's principal business segment is **Packaging Distribution**, comprising the distribution of packaging materials and supply of storage and warehousing services in the UK. This comprises over 88% of Group revenue and 97% of Group profit. The Group's **Manufacturing Operations** segment comprises the design, manufacture and assembly of timber, corrugated and foam-based packaging materials in the UK, the design, manufacture and supply of self-adhesive labels to a variety of FMCG customers in the UK & Europe and the design, manufacture and supply of resealable labels to a variety of FMCG customers in the UK, Europe and the USA. None of the individual business segments within Manufacturing Operations represents more than 10% of Group revenue or profit.

	2020 £000	Restated* 2019 £000
Group segment – total revenue		
Packaging Distribution	201,739	196,706
Manufacturing Operations	33,543	33,873
Inter-segment revenue Manufacturing Operations	(5,253)	(5,333)
External revenue	230,029	225,246

Macfarlane Group PLC
Notes to the financial information
For the year ended 31 December 2020

3. Segmental information (continued)

	2020	Restated*
	£000	2019
		£000
Operating profit		
Packaging Distribution	13,988	12,406
Manufacturing Operations	381	1,081
	<hr/>	<hr/>
Operating profit	14,369	13,487
Finance costs	(1,367)	(1,625)
	<hr/>	<hr/>
Profit before tax	13,002	11,862
Tax	(2,831)	(2,262)
	<hr/>	<hr/>
Profit for the year	10,171	9,600
	<hr/> <hr/>	<hr/> <hr/>
	Assets	Liabilities
	£000	£000
Group segments		Net assets
Packaging Distribution	152,272	(80,476)
Manufacturing Operations	20,438	(12,456)
	<hr/>	<hr/>
Net assets 2020	172,710	(92,932)
	<hr/> <hr/>	<hr/> <hr/>
	Assets	Liabilities
	£000	£000
Packaging Distribution	153,384	(92,777)
Manufacturing Operations	19,450	(11,320)
	<hr/>	<hr/>
Net assets 2019	172,834	(104,097)
	<hr/> <hr/>	<hr/> <hr/>
	2020	2019
	£000	£000
<u>Packaging Distribution</u>		
Revenue	201,739	196,706
Cost of sales	(136,177)	(135,525)
	<hr/>	<hr/>
Gross profit	65,562	61,181
Net operating expenses	(51,574)	(48,775)
	<hr/>	<hr/>
Operating profit	13,988	12,406

Manufacturing Operations

	2020	Restated*
	£000	2019
		£000
Revenue	33,543	33,873
Cost of sales	(22,559)	(23,064)
Gross profit	10,984	10,809
Net operating expenses	(10,603)	(9,728)
Operating profit	381	1,081

Macfarlane Group PLC
Notes to the financial information
For the year ended 31 December 2020

4. Finance costs	2020	Restated*
	£000	2019
		£000
Interest on bank borrowings	482	573
Interest on leases	761	802
Net interest expense on retirement benefit obligation (see note 10)	99	231
Other interest	25	19
	<hr/>	<hr/>
Total finance costs	1,367	1,625
	<hr/> <hr/>	<hr/> <hr/>
5. Tax	2020	Restated*
	£000	2019
		£000
Current tax		
United Kingdom corporation tax at 19.0%	2,343	2,057
Foreign tax	121	104
Adjustments in respect of prior years	(90)	(53)
	<hr/>	<hr/>
Total current tax	2,374	2,108
	<hr/>	<hr/>
Deferred tax		
Current year	457	154
	<hr/>	<hr/>
Total deferred tax (see note 11)	457	154
	<hr/>	<hr/>
Total tax charge	2,831	2,262
	<hr/> <hr/>	<hr/> <hr/>

The standard rate of tax based on the UK average rate of corporation tax is 19.0%. Taxation for other jurisdictions is calculated at the rates prevailing in these jurisdictions.

The actual tax charge for the current and previous year varies from the standard rate of tax on the results in the consolidated income statement for the reasons set out in the following reconciliation:-

	2020	Restated*
	£000	2019
		£000
Profit before tax	13,002	11,862
	<hr/>	<hr/>
Tax on profit at 19.0%	2,470	2,254
Factors affecting tax charge for the year:-		
Change in rate for deferred tax from 17% to 19%	367	-
Non-deductible expenses	107	47
Difference on overseas tax rates	(18)	14
Utilisation of tax losses not previously recognised	(58)	-
Changes in estimates related to prior years	(37)	(53)

Tax charge for the year

2,831

2,262

Effective rate of tax for the year

21.8%

19.1%

Macfarlane Group PLC
Notes to the financial information
For the year ended 31 December 2020

6. Dividends	2020	2019
	£000	£000
Amounts recognised as distributions to equity holders in the year:		
Final dividend for the year ended 31 December 2019 of Nil per share (2018 – 1.65p per share)	-	2,600
Interim dividend for the year ended 31 December 2020 of 0.70p per share (2019 – 0.69p per share)	1,105	1,089
	<u>1,105</u>	<u>3,689</u>

A proposed dividend of 1.85p per share will be paid on 3 June 2021 to those shareholders on the register at 14 May 2021. This is subject to approval by shareholders at the Annual General Meeting on 11 May 2021 and therefore has not been included as a liability in these financial statements.

7. Earnings per share

The calculation of the basic and diluted earnings per share is based on the following data:

	2020	Restated*
	£000	2019 £000
Earnings for the purposes of earnings per share		
Profit for the year	10,171	9,600
	<u>10,171</u>	<u>9,600</u>
Number of shares in issue for the purposes of calculating basic and diluted earnings per share	2020	2019
	No. of	No. of
	shares	shares
	'000	'000
Weighted average number of shares in issue for the purposes of basic earnings per share		
Weighted average number of shares in issue	157,812	157,636
Effect of Long-Term Incentive Plan awards in issue	703	393
	<u>158,515</u>	<u>158,029</u>
Weighted average number of shares in issue for the purposes of calculating diluted earnings per share	158,515	158,029
	<u>158,515</u>	<u>158,029</u>
Basic Earnings per share	6.45p	6.09p
	<u>6.45p</u>	<u>6.09p</u>
Diluted Earnings per share	6.42p	6.07p
	<u>6.42p</u>	<u>6.07p</u>

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For the year ended 31 December 2020

8. Acquisitions

On 6 January 2020, the Group's subsidiary, MGUK acquired the business trade and assets of Armagrip, a packaging distributor based in Co. Durham, for a consideration of approximately £0.9 million, paid in cash on acquisition. The business achieved sales of £1.2 million and a profit of £0.1 million in 2020.

In 2019, MGUK acquired 100% of Carnweather Limited, the parent company of Ecopac, for a maximum consideration of £3.9 million. £3.1 million was paid in cash on acquisition, with the deferred consideration of £0.8 million paid in 2020, as trading targets following acquisition were met in full.

In 2019 the Group also acquired 100% of Leyland, for a maximum consideration of £3.25 million. £2.00 million was paid in cash on acquisition with shares to the value of £0.25 million issued to the Vendors on acquisition. Deferred consideration of £0.97 million was paid in 2020, reflecting the results in the trading period after acquisition.

All the businesses detailed above are part of the Packaging Distribution segment. Goodwill arising on the acquisitions is attributable to the anticipated future profitability of the distribution of Group product ranges and anticipated operating synergies from future combinations of activities in the Packaging Distribution network.

Fair values assigned to net assets acquired and consideration paid and payable are set out below.

	Armagrip £000	Previous years' acquisitions £000	2020 £000	2019 £000
Net assets acquired				
Other intangible assets	291	-	291	3,313
Property, plant and equipment	-	-	-	1,194
Inventories	206	-	206	879
Trade and other receivables	282	-	282	1,797
Cash and bank balances	-	-	-	100
Trade and other payables	-	-	-	(1,658)
Current tax liabilities	-	-	-	(235)
Lease liabilities	-	-	-	(979)
Deferred tax liabilities (see note 11)	(55)	-	(55)	(599)
	<hr/>	<hr/>	<hr/>	<hr/>
Net assets acquired	724	-	724	3,812
Goodwill arising on acquisition	164	-	164	3,093
	<hr/>	<hr/>	<hr/>	<hr/>
Total consideration	888	-	888	6,905
Contingent consideration on acquisitions				
Current year	-	-	-	(1,600)
Prior years	-	1,773	1,773	1,207
Shares issued	-	-	-	(250)
	<hr/>	<hr/>	<hr/>	<hr/>
Cash consideration	888	1,773	2,661	6,262
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
Net cash outflow arising on acquisition				
Cash consideration	(888)	(1,773)	(2,661)	(6,262)

Cash and bank balances acquired	-	-	-	100
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net cash outflow	(888)	(1,773)	(2,661)	(6,162)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Macfarlane Group PLC
Notes to the financial information
For the year ended 31 December 2020

9. Analysis of changes in net debt

	Restated* Cash & cash equivalents £000	Restated* Bank borrowing £000	Lease Liabilities £000	Total Debt £000
At 1 January 2020 (as previously stated)	3,310	(15,984)	(25,967)	(38,641)
Restatement (see page 23)	2,269	(2,269)	-	-
At 1 January 2020 (restated)	5,579	(18,253)	(25,967)	(38,641)
Cash movements	1,649	10,487	6,719	18,855
Non-cash movements				
New leases	-	-	(1,959)	(1,959)
Lease Modifications	-	-	(7,485)	(7,485)
At 31 December 2020	7,228	(7,766)	(28,692)	(29,230)
Net bank debt 2020	<u>7,228</u>	<u>(7,766)</u>		<u>(538)</u>
Net bank debt 2019	<u>5,579</u>	<u>(18,253)</u>		<u>(12,674)</u>

Cash and cash equivalents (which are presented as a single class of asset on the face of the balance sheet) comprise cash at bank and other short-term highly liquid investments with maturity of three months or less.

10. Pension scheme

Macfarlane Group PLC sponsors a defined benefit pension scheme for certain active and former UK employees – the Macfarlane Group PLC Pension & Life Assurance Scheme (1974) (“the scheme”).

The scheme is administered by a separate Board of Trustees composed of employer nominated representatives and member nominated Trustees and is legally separate from the Group. The assets of the scheme are held separately from those of the Group in managed funds under the supervision of the Trustees. The Trustees are required by law to act in the interest of all classes of beneficiary in the scheme and are responsible for investment policy and the day-to-day administration of benefits. The scheme was closed to new entrants during 2002.

The scheme provides qualifying employees with an annual pension of 1/60 of pensionable salary for each completed year’s service on attainment of a normal retirement age of 65. Pensionable salaries were frozen for the remaining active members at the levels current at 30 April 2009 with the change taking effect from 30 April 2010 and as a result no further salary inflation applies for active members who remained in the scheme. Active members’ benefits also include life assurance cover, albeit the payment of these benefits is at the discretion of the scheme’s Trustees.

On withdrawing from active service a deferred member’s pension is revalued from the time of withdrawal until the pension is drawn. Revaluation in deferment is statutory and since 2010 has been revalued on the Consumer Price Index (“CPI”) measure of inflation. Revaluation of pensions in payment is a blend of fixed increases and inflationary increases depending on the relevant periods of accrual of benefit. For pensions in payment, the inflationary increase is currently based on the Retail Price Index (“RPI”) measure of inflation or based on Limited Price Indexation (“LPI”) for certain defined periods of service.

Macfarlane Group PLC
Notes to the financial information
For the year ended 31 December 2020

10. Pension scheme (continued)

During 2012, Macfarlane Group PLC agreed with the Board of Trustees to amend benefits for pensioner, deferred and active members in the defined benefit pension scheme by offering a Pension Increase Exchange ("PIE") option for deferred and active members at retirement after 1 May 2012.

Balance sheet disclosures

The fair value of scheme investments, the present value of scheme liabilities and expected rates of return are based on the provisional results of the actuarial valuation as at 1 May 2020, updated to the year-end.

	2020	2019
	£000	£000
Investment class		
Equities	22,936	22,139
Multi-asset diversified funds	31,559	25,382
Liability-driven investment funds	31,463	27,688
Secured property income fund	6,254	6,192
European loan fund	6,493	6,379
Other (cash and similar assets)	725	281
Fair value of scheme investments	99,430	88,061
Present value of scheme liabilities	(100,901)	(94,526)
Scheme deficit	(1,471)	(6,465)

The Trustees review the investments of the scheme on a regular basis and consult with the Company regarding any proposed changes to the investment profile. Liability-Driven Investment Funds are intended to provide a match of 100% against the impact of movements in inflation on pension liabilities and a match of 85% against the impact of movements in interest-rates on pension liabilities. During 2020 adjustments were made between investments to bring the overall allocations into line with the Trustees' strategic asset allocation.

The ability to realise the Scheme's investments at, or close to, fair value was considered when setting the investment strategy. 87% (2019: 86%) of the Scheme's investments can be realised at fair value on a daily or weekly basis. The remaining assets have monthly or quarterly liquidity, however, whilst the income from these helps to meet the Scheme's cash flow needs, they are not expected to require to be realised at short notice.

The present value of the scheme liabilities is derived from cash flow projections over a long period of time and is thus inherently uncertain.

Macfarlane Group PLC
Notes to the financial information
For the year ended 31 December 2020

10. Pension scheme (continued)

The scheme's liabilities were calculated on the following bases as required under IAS 19:

Assumptions	2020	2019
Discount rate	1.35%	2.00%
Rate of increase in salaries	0.00%	0.00%
Inflation assumption (RPI)	3.00%	3.00%
Inflation assumption (CPI)	2.50%	2.10%
Life expectancy beyond normal retirement age of 65		
Male currently aged 55 (years)	22.6	22.6
Female currently aged 55 (years)	24.3	24.7
Male currently aged 65 (years)	22.2	22.0
Female currently aged 65 (years)	23.5	24.0

Following the Lloyds Banking Group plc court case in December 2020, schemes are required to retrospectively adjust certain transfer values between 1990 and 2020 for GMP equalisation. The estimated cost of this adjustment in £87,000 and has been charge against the results for the year.

Movement in scheme deficit	2020	2019
	£000	£000
At 1 January	(6,465)	(9,765)
Current service costs	(143)	(112)
Past service costs for GMP equalisation	(87)	-
Employer contributions	3,211	3,106
Net finance cost (see note 4)	(99)	(231)
Remeasurement of pension scheme liability	2,112	537
	<hr/>	<hr/>
At 31 December	(1,471)	(6,465)
	<hr/> <hr/>	<hr/> <hr/>

Funding

UK pension legislation requires that pension schemes are funded prudently. Following the triennial actuarial valuation of the scheme at 1 May 2020, the Company agreed a new schedule of contributions with the Pension Scheme Trustees, which assumed a recovery plan period of 4 years. The next triennial actuarial valuation is due at 1 May 2023.

Sensitivity to key assumptions

The key assumptions used for IAS 19 are discount rate, inflation and mortality. If different assumptions were used, then this could have a material effect on the results disclosed. Assuming all other assumptions are held static then a movement in the following key assumptions would affect the level of the deficit as shown below:-

Assumptions	2020	2019
	£000	£000
Discount rate movement of +0.6%	9,684	9,072
Inflation rate movement of +0.1%	(515)	(482)
Mortality movement of +0.1 year in age rating	303	284

Positive figures reflect a reduction in the scheme liabilities and therefore a reduction in the scheme deficit. The sensitivity information has been prepared using the same method as adopted when adjusting the results of the latest funding valuation to the balance sheet date and is consistent with the approach adopted in previous years.

The sensitivities shown reflect average movements in the assumptions in the last three years. All information assumes that the average duration of Scheme liabilities is seventeen years.

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11. Deferred tax	2020	Restated*
	£000	2019 £000
At 1 January	(1,892)	(1,047)
Acquisitions	(55)	(599)
Charged in income statement (see note 5)	(457)	(154)
(Charged)/credited in other comprehensive income		
Remeasurement of pension scheme liability	(401)	(92)
Corporation tax rate change	129	-
	<hr/>	<hr/>
At 31 December	(2,676)	(1,892)
	<hr/> <hr/>	<hr/> <hr/>
Deferred tax assets		
On retirement benefit obligations	279	1,099
Corporation tax losses	117	125
	<hr/>	<hr/>
Disclosed as deferred tax assets	396	1,224
	<hr/>	<hr/>
Deferred tax liabilities		
On accelerated capital allowances/timing differences	(196)	(165)
On other intangible assets	(2,876)	(2,951)
	<hr/>	<hr/>
Disclosed as deferred tax liabilities	(3,072)	(3,116)
	<hr/>	<hr/>
	<hr/>	<hr/>
At 31 December	(2,676)	(1,892)
	<hr/> <hr/>	<hr/> <hr/>

*Details of the restatements are set out on pages 21 and 22.

12. Share capital	2020	2019
	£000	£000
Allotted, issued and fully paid:		
At 1 January	39,453	39,387
Issued during the year	-	66
	<hr/>	<hr/>
At 31 December	39,453	39,453
	<hr/> <hr/>	<hr/> <hr/>
Share premium		
At 1 January	13,148	12,975
Issue of new shares during the year	-	184
Expenses of share issue	-	(11)
	<hr/>	<hr/>

At 31 December

13,148

13,148

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The Company has one class of ordinary shares of 25p each, which carry no right to fixed income. Each ordinary share carries one vote in any General Meeting of the Company.

On 5 September 2019, the Company issued 264,382 ordinary shares of 25p each at a value of 94.56p per share as non-cash consideration to the Vendors of Leyland Packaging Company (Lancs) Limited, an effective value of £250,000. The shares were admitted to the Official List of the London Stock Exchange on 5 September 2019.

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13. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed.

Details of individual and collective remuneration of the Company's Directors and dividends received by the Directors for calendar year 2020 will be disclosed in the Group's 2020 Annual Report and Accounts.

The directors are satisfied that there are no other related party transactions occurring during the year which require disclosure.

14. Post balance sheet events

There are no post balance sheet events to be disclosed.

15. Posting to shareholders and Annual General Meeting

The Annual Report and Accounts will be sent to shareholders on Friday 2 April 2021 and will be available to members of the public at the Company's Registered Office from Friday 23 April 2021.

The Annual General Meeting will take place at 12 noon on Tuesday 11 May 2021.