CHIEF EXECUTIVE'S REVIEW

I start my review by echoing the thoughts of Richard Macdonald, our Acting Chairman, regarding Anthony Fry, our Chairman. Everyone in Dairy Crest wishes Anthony a successful recovery. His guidance and inspiration are missed.

Summary

The year ended 31 March 2014 was one of consolidation for Dairy Crest. Following the transformational sale of our French spreads business, St Hubert, last year we have completed our reorganisation into one business structure and are seeing the benefit of this project in the form of greater focus on consumers and a more integrated supply chain. This has also helped in our constant drive to reduce costs. Our largest brand, Cathedral City, continues to grow strongly.

The rationalisation of our butter and spreads manufacturing onto one well-invested site at Kirkby, Merseyside is nearing completion and our plan to close our factory in Crudgington is progressing.

In parallel to the continued strengthening of our existing operations we have initiated a major project to add value to the whey we produce as a by-product of cheese manufacturing. In total we are investing £45 million at our cheese creamery at Davidstow, Cornwall to allow us to manufacture demineralised whey powder which we expect to boost annual profits by around £5 million from 2015/16. We are in the process of agreeing a contract with an exclusive customer which is already well established in the appropriate markets. The customer will also provide technical advice as the project moves forward.

Adjusted Group profit before tax increased by 31% to £65.3 million (2013: £49.7 million). Adjusted basic earnings per share increased by 39% to 40.8 pence (2013: 29.4 pence). Key factors behind the increase in adjusted Group profit were higher profits from selling surplus properties, which increased by £10.5 million, and lower interest costs which reduced by £8.8 million.

Exceptional costs fell sharply in the year from £56.5 million in the year ended 31 March 2013 to £10.4 million in the year ended 31 March 2014 reflecting the reduced level of restructuring across the business.

Group net debt at 31 March 2014 was £142 million, up from £60 million at 31 March 2013, but significantly lower than at 31 March 2012, prior to the sale of St Hubert, when it was £336 million. Net debt fell significantly in the second half of the year. Significant factors in the increase from 31 March 2013 were one-off payments resulting from the sale of St Hubert to the pension scheme and bondholders which together totalled £49 million. As noted above, we also invested significantly at Kirkby and Davidstow.

Market background

The year has seen an on-going decline in food sales by the major retailers, our principal customers. They continue to be intensely competitive and liquid milk in particular remains a key product where they are seeking to offer value to consumers. In this environment it has been difficult to pass higher input costs onto our customers and this emphasises the importance of our own cost reduction initiatives.

Towards the end of the year most major retailers chose to reduce the price at which they sell milk to consumers. This had the effect of further increasing the gap between these prices and those which we charge our residential customers. We expect this to accelerate the downward trend in our residential sales.

The background on the supply side is very different. UK milk production is buoyant and dairy farmer confidence high. We remain committed to paying fair, market related prices to the dairy farmers who supply us with milk. The milk prices we pay our farmers increased by 8% over the year ended 31 March 2014 and we continue to work with our direct suppliers to offer them a choice of milk supply contracts. These include those with prices determined by formulas, which allow them to optimise their production. We have broadly maintained our milk purchase prices since the year end although market prices are now starting to fall.

Looking ahead, European milk supply is likely to increase after the abolition of production quotas from April 2015. UK production, which has been below the available quota for over a decade, is unlikely to be affected by this change. Consumer preferences and the economics of milk transportation make it unlikely that liquid milk will be imported into the UK. It is possible that some additional cheese produced in Ireland, for example, may be exported to the UK but other global markets may well be more attractive. If more cheese was to be imported into the UK it could put downward pressure on commodity cheese prices and farmgate milk prices. However, we anticipate that our market-leading Cathedral City brand, will continue to perform strongly.

Branded sales

We have continued to support our four key brands, Cathedral City, Clover, Country Life and FRijj. As the table shows, total sales of these brands have grown by 4% this year. Cathedral City continued its strong performance and again significantly outperformed the market. It is now Britain's 18th largest grocery brand (Source: The Grocer, March 2014).

Brand	Market	Dairy Crest sales growth*	Market statistics**	
			Brand growth	Market growth
Cathedral City	Cheese	+12%	+10%	unchanged
Clover	Butters, spreads, margarine	-6%	-6%	-4%
Country Life	Butters, spreads, margarine	-4%	-7%	-4%
FRijj	Ready to drink flavoured milk	-4%	unchanged	+16%
Total		+4%	+3%	

*Dairy Crest value sales 12 months to 31 March 2014 v 12 months to 31 March 2013 **IRI data 52 weeks to 29 March 2014

In the butters and spreads market, which is declining, Clover's market share reduced slightly. However, Country Life spreadable grew share and outperformed its major spreadable rivals. Country Life block butter sales fell as we reduced promotions due to higher cream input costs.

Over the year as a whole FRijj sales fell by 4%. However, FRijj sales rebounded strongly in the second half following the upgrade of our production facilities in the first half.

Innovation is key to the success of these brands. We have an ambitious target that 10% of our sales will come from products introduced in the last three years. This year around 4% of our total revenue and 7% of our key brand revenue has come from such sales. This is a key target as we continue to move our focus to a consumer driven, demand led business. To support this we are building a new innovation centre in partnership with Harper Adams University, Shropshire.

Cost cutting

Cost reduction remains an important part of our strategy. We have made good progress to improve efficiency across the business. Cost reduction projects initiated in the year have delivered annual benefits of £25 million, ahead of our £20 million target. We have also continued to benefit from work done in previous years. The greatest cost savings this year have arisen from the reorganisation of the business into 'One Dairy Crest'. Next year we expect to benefit from lower spreads manufacturing costs as a result of the consolidation of our spreads manufacturing into Kirkby as well as lower milk distribution costs.

Future prospects

The current trading environment is challenging. However, the strength of our key brands and our proven ability to cut costs and drive efficiencies mean that we remain confident that we can generate profit growth in all three of our product groups over the medium term. Additional profit growth will come from our project to add value to the whey stream at Davidstow, which is on track.

Our net debt is comfortably within our targeted range and we expect to be able to reduce it further in the future as capital expenditure on our existing business falls back towards depreciation and we continue to sell surplus properties. Debt reduction will also be supported by the reduction in our annual contributions to the Dairy Crest Group Pension Fund from £20 million to £13 million for the next two years.

Mark Allen Chief Executive
21 May 2014

4%
Sales growth of four key brands

31%
Increase in Adjusted Group profit before tax

8%
Increase in milk price paid to our farmers

39%
Increase in Adjusted basic earnings per share