CHIEF EXECUTIVE'S REVIEW

Summary

This has been another year of significant progress for Dairy Crest. We have grown combined Cheese and Spreads sales despite the deflationary market environment. We have also delivered an encouraging improvement in the combined margins of these businesses. Cathedral City has again outperformed and accounts for over 50% of retail sales of branded cheddar. Our focus on product development has underpinned these results and our investment in a new innovation centre will support this. We have again met our target to deliver annual cost savings of over £20 million. These include consolidating our butter and spreads production onto one site.

We have agreed to sell our Dairies operations. The conditional sale is a positive development for Dairy Crest and the wider UK dairy sector. Shareholders have approved the sale and the process to obtain regulatory approval is on track. Completion of the sale will result in Dairy Crest operating from five well-invested manufacturing sites. It will be a much simpler, more focused, predominantly branded business. It will also have exposure to the growing infant formula category and emerging markets.

Market background

This year has been a difficult one for the major food retailers, our principal customers. They have faced falling sales due to food price deflation and greater competition.

It has also been a very difficult year for dairy farmers. Global dairy commodity prices have fallen steeply since the first quarter and ended the year close to half the peak they reached as recently as the autumn of 2013. The collapse in these markets and high milk production around the world and in the UK have led to a significant reduction in the price UK farmers have received for their milk. Our purchase prices for milk fell by around 25% across the year, reversing the increases we have paid in recent years.

The long-awaited abolition of European milk production quotas took effect from 1 April 2015. This has been widely expected to lead to an increase in milk production across Europe, although not in the UK where production has been unconstrained by quotas. It is too early to say how the reduction in global dairy commodity prices and the removal of quotas will affect milk production and imports of dairy products, particularly cheddar cheese, into the UK, although cheddar imports into the UK decreased 9% in the year ended 31 December 2014 (Source: DairyCo). While we monitor this situation closely we anticipate that our market leading Cathedral City branded cheddar will not be affected significantly by these changes and will continue to perform strongly.

Against this market background we continue to position ourselves to deliver sustainable and profitable growth.

Transformational sale of Dairies operations

In November 2014 we agreed to sell the assets of our Dairies operations to Müller for a cash consideration of £80 million. The conditional sale of our Dairies operations will result in Dairy Crest becoming a stronger, predominantly branded business that can grow profitably and generate cash.

In December 2014 Dairy Crest's shareholders overwhelmingly approved the proposed sale, which remains conditional on the approval of the competition authorities. This process is on track. The European Commission referred it back to the UK for review by the Competition and Markets Authority ('CMA') which is currently expected to make a phase one decision in June 2015. Although this deadline may change and the review could move to a second phase we remain confident that a sale will ultimately be approved and proceed.

The conditional sale of our Dairies operations and their subsequent combination with Müller's dairies business will help create a more sustainable UK dairy sector by delivering economies of scale and cost efficiencies that will underpin investment and help the UK to compete more successfully in global markets. It is encouraging that we have received support for the sale from the independent organisation that represents our farmers, Dairy Crest Direct, and the wider farming community.

A successful outcome will benefit farmers, consumers, customers, employees and Dairy Crest's shareholders.

Cathedral City outperforms

In total, sales of our four key brands, Cathedral City, Clover, Country Life and FRijj were unchanged over the year. As the table on page 12 shows, both Cathedral City and FRijj performed strongly. However Clover and Country Life sales both fell in a butter and spreads market that continues to decline. Despite this we saw a welcome increase in margins in our Spreads and butters business.

Cathedral City again outperformed the market and grew sales by 5%. Its annual growth over the last five years has averaged over 7%. Cathedral City is now Britain's 16th largest grocery brand (Source: The Grocer 21 March 2015) up from 18th last year. Cathedral City now accounts for over 50% of total branded retail cheddar sales. Sales of competing cheddar brands have continued to decline. Taken together retail sales of the next three largest cheddar brands were down over 20% in the year and were just half those of Cathedral City.

The UK butter and spreads market remains difficult. Total market sales fell by 4%. Consumption is falling as consumers continue to turn away from making sandwiches in the home. Butter, where market sales are unchanged compared to last year, continues to gain share

Brand	Market	Dairy Crest sales growth*	Market statistics**	
			Brand growth	Market growth
Cathedral City	Cheese	+5%	+2%	unchanged
Clover	Spreads	-8%	-8%	-8%
Country Life	Butter	-9%	-7%	unchanged
FRijj	Ready to drink flavoured milk	+7%	unchanged	+4%
Total		unchanged		

*Dairy Crest value sales 12 months to 31 March 2015 v 12 months to 31 March 2014 **IRI data 52 weeks to 28 March 2015

from spreads where sales are down 8%. Against this background Clover and Country Life butter, our two key brands in this market, have delivered a satisfactory performance. Clover performed in line with the spreads market as a whole and was awarded Which magazine's 'Best Buy' in the spreads category (Source: Which February 2015). Country Life Spreadable, which accounts for nearly 60% of total Country Life butter and spreads sales outperformed the butter market and grew sales by 2%. We expect to use some of the savings we will achieve from the consolidation of our spreads and packet butter production to increase marketing expenditure in this high-margin category.

FRijj performed well. In a ready to drink flavoured milk market that is still growing, but at a much slower pace than last year, FRijj sales grew by 7%. Some of this growth came from sales to the food service and convenience sectors and is therefore not reflected in the IRI market data which just covers major multiples. The FRijj brand is included in the conditional sale of our Dairies operations to Müller.

We have also seen strong growth from Frylight one calorie cooking spray, which we purchased in 2011. This brand has responded well to the increased investment in marketing that we have made consistently since then and has the potential to grow further. In future we expect to report it as one of our key brands alongside Cathedral City, Clover and Country Life butter and spreads.

Dairy is one of the UK's largest food retail categories and during the year Dairy Crest carried out a comprehensive category strategy project. 'Dairy for Life' is a framework to make people look differently at the dairy category. It forms the foundation for future innovation, marketing and category merchandising for our key brands. We will work with our major customers to implement the Dairy for Life findings and drive growth across the dairy category. Some ideas generated by Dairy for Life, such as cross-sector promotions and additional store positionings, have already been implemented.

Innovation remains key to the success of our brands. During the year we have launched several brand extensions including Cathedral City Spreadable, Clover Lighter than Light, and reduced sugar FRijj. Since the year end we have started to produce and sell Clover cooking oil which combines Frylight spray technology and the strength of the Clover brand.

In the year ended 31 March 2015 around 7% of our combined Cheese and whey and Spreads and butter revenue came from products introduced in the last 3 years. This compares to our ongoing ambitious target of 10% and last year's performance of 4% across the business as a whole and 7% for our branded business.

To further increase our focus on innovation we have entered into a new partnership with Harper Adams University. Our innovation team has moved to Harper Adams and we are building a £4 million innovation centre on the university campus. We expect this to be fully operational by the end of 2015. The partnership will give us access to food and farming research that will help us continue to develop new products and ways of working.

Building from strength

We have continued to make good progress with projects that enhance the future prospects of our Cheese and Spreads operations, including consolidating butter and spreads production onto one site and investing in demineralised whey and galacto-oligosaccharide, a lactose based prebiotic.

We are nearing completion of the project to make demineralised whey powder and GOS at our Davidstow creamery in Cornwall. These products will give us access to new sales channels in growing global markets. Both products are used in the manufacture of infant formula for which there is growing demand across the world. We expect commercial manufacture of both products to start later this year. During the year we entered into a strategic partnership with Fonterra, the world's leading dairy exporter. Fonterra will market and sell our products on our behalf and is also providing valuable technical and engineering support.

Cost cutting

We have again achieved our target of making cost savings in excess of £20 million in the year.

The consolidation of our spreads and packet butter manufacturing into one site at Kirkby, Merseyside and the closure of Crudgington will give us a lower fixed cost base that will benefit future years.

We continue to work with non-milk suppliers to drive efficiencies and lower our purchase costs. During the year we have increased our use of lighter weight polybottles; reduced packaging costs and made our distribution network more efficient.

Cost reduction is essential in our residential milk delivery business, where sales fell by 11% compared to the year ended 31 March 2014. We have continued with our programme of depot closures. In addition we announced that we would further rationalise our Dairies operations and consult with employees regarding the closure of our glass bottling dairy in Hanworth, West London and our specialist cream potting facility in Chard, Somerset. We anticipate that Chard will close later in 2015 and Hanworth in 2016.

Completion of the sale of our Dairies operations will significantly reduce the complexity of the business and will allow us to streamline our future overhead structure and systems.

Financial performance

The financial performance of the business as a whole starkly demonstrates the differing financial performances of the operations we are retaining and those we are selling. Taken together our Cheese and whey and Spreads and butter businesses (which we will retain) delivered marginally higher sales compared to the year ended 31 March 2014 and significantly higher product group profits, up by 19% to £66.9 million. However excluding property profits our Dairies business (which we are selling) recorded a product group loss of £15.8 million against a profit of £0.6 million in the previous year. Property profits were broadly in line with last year at £17.6 million (2014: £18.2 million).

For the business as a whole, adjusted group profit before tax decreased by 7% to £60.6 million (2014: £65.3 million). Adjusted basic earnings per share also decreased by 7% to 38.0 pence (2014: 40.8 pence). Pre-tax exceptional charges in the year were £36.3 million (2014: £10.4 million). These mainly related to the closure and future closure of manufacturing sites. Reported profit before tax, which reflects these exceptional charges, amortisation of acquired intangibles and pension interest, was £22.1 million (2014: £54.2 million).

Group net debt at 31 March 2015 was £199 million up from £142 million at 31 March 2014, as we invested a high level of capital expenditure in the whey and galacto-oligosaccharide project at Davidstow and the completion of the Kirkby spreads and butter manufacturing facility.

Future prospects

Completion of the sale of our Dairies operations will result in Dairy Crest operating from five well-invested manufacturing sites and be a much simpler, more focused, predominantly branded business. It will also have exposure to the growing infant formula category and emerging markets.

Looking ahead, Dairy Crest is well positioned for sustainable, profitable growth. Over the coming year as a whole we expect results to benefit from the continued growth of Cathedral City, ongoing cost savings and the completion of our project at Davidstow where we will add value to our whey stream by producing ingredients for infant formula. This growth will be second half weighted.

We expect that our net debt, which at the year end remains within our target range, will fall once we have completed our major investment projects. The receipt of the proceeds from the sale of our Dairies operations will accelerate this reduction.

Mark Allen Chief Executive
20 May 2015

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