



BIDWELLS

## **Company Strategy and Performance Report**

February 2010

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## 1 Introduction

DairyCo is a levy-funded, not-for-profit organisation working on behalf of Britain's dairy farmers. It is part of the Agricultural and Horticultural Development Board (AHDB); a Non-Departmental Public Body formed in 2008 bringing together the work of the previously separate bodies covering cereals and oilseeds, meat and livestock, horticulture, milk and potatoes.

DairyCo have instructed Bidwells Agribusiness to undertake an independent study aimed at gaining a deeper understanding of how the seven largest milk buyers in Britain currently operate and are planning to respond to ongoing changes in the sector.

The Brief is enclosed in Appendix A. Bidwells were invited to tender alongside others and were awarded the project in September 2009.

The study has comprised a mixture of desk based work and meetings with key people involved. At the core were meetings with senior representatives of each of the seven buyers to discuss issues of milk supply, future processing and marketing development, branding and innovation and strategy. In one case only, information was obtained through written correspondence supported by telephone discussions with relevant people.

From the outset, it must be emphasised that this study is not intended to be a report benchmarking performance or making tactical comparisons between the buyers. Its purpose is to increase understanding of the differing operations of these buyers and their future plans. Assessment of buyers is not a matter of looking at specific issues such as milk price but requires a much broader approach. This report seeks to facilitate this by providing better knowledge and understanding of the different buyer operations and strategies. Specifically, it aims to help DairyCo's levy payers understand:

- What is the potential for my milk buyer in terms of milk price and security of milk demand?
- What is the long-term strategy of my milk buyer and how can I best structure my dairy enterprise to fit in with that strategy?
- How is the company performing against this strategy?

For each business, the report includes a review of historic performance and current operations and indicates future trends or likely direction where possible, based upon data provided in terms of financial performance, strategy and sales performance. In the case of some businesses, some of this information is already available publically. In the other cases, we are grateful to the individual businesses for their provision of data.

Bidwells Agribusiness is an international provider of consultancy and management services to the farming, food, bio-energy and agri-investment sectors at all stages of the value chain. The wider team engaged in this study included expertise in agribusiness, food retail, food processing and marketing.

For each buyer the research has focused on:

- Current operation
  - Structure and ownership
  - Milk supply – quantity and distribution
  - Contract issues
  - Reviews
- Processing
  - Existing and planned infrastructure and utilisation
  - Efficiency metrics
  - Sustainability issues
- Marketing
  - Strategic partners
  - Product portfolio
  - Branding & markets
- Strategy
  - Strategic approach
  - Management structures
  - Cultural issues
  - Forward plans

In addition to the individual business sections, the report provides some observations on the global, retail and market context for milk and its products.

## **2 Executive Summary**

### **2.1 Global Market Context**

- The European Union is one of the world's most important bovine dairy producing regions, producing in aggregate about 134 million tonnes of milk per annum from about 24 million animals. The UK, France and Germany are the major EU producers.
- FAO forecasts indicate that, in absolute terms, world milk production will increase by 131 million tonnes between 2008 and 2018 to 814 million tonnes, representing growth of 16%. Europe will continue to be a major producer, although most growth in production and consumption will be in China and India.
- Global dairy prices rose strongly in 2007 as a result of supply failing to keep pace with demand increases. The rapid rise in prices triggered a supply response and a reduction in demand resulting from the effects of the economic downturn and a switch to alternatives in manufacturing. Prices fell substantially during the latter part of 2008 and into 2009. During 2009, the FAO dairy price index increased by over 80 percent from its low in February 2009, although prices had not yet returned to their 2007 levels.
- In the longer term, most forecasts suggest that international market prices will move towards a long term equilibrium determined to a large extent by the costs of milk production in the USA. As one of the largest exporters of dairy products, and the one with the most ability to react to changes in global commodity prices, production levels in the USA are key in determining international export supply and prices. Demand for dairy products is forecast to rise in the medium term as a result of income and population growth, but also due to changing diets and preferences.

### **2.2 UK Milk Production and Supply Chain Structure**

- With the demise of the Milk Marketing Boards (MMB) in 1994, its role as the sole milk purchaser was taken by a wide range of licensed milk purchasers including member co-operatives, farmers who sold directly to milk processors, and milk groups.
- The largest co-operative Milk Marque was broken up in 2000. A subsequent re-organisation of the co-operatives left three by 2005; and the collapse of Dairy Farmers of Britain (DFOB) in 2009 resulted in the co-operatives First Milk and Milk Link remaining. The other major UK purchasers are Arla Foods UK, Dairy Crest, Meadow Foods, Müller and Robert Wiseman Dairies.

- According to the most recently available DHI<sup>1</sup> data, there are currently about 13,000 registered producers in GB producing just under 11 billion litres of milk, an average of 842,000 litres per annum per producer.
- The substantial change in milk supply chains over the past two decades has been the significant decline in the importance of milk doorstep deliveries – falling from 2.5 billion litres of milk in the mid 1990s to under 300 million litres today, and now accounting for less than 6% of liquid milk consumed in GB. At the same time, there has been considerable consolidation within the retail sector and significant competition between the big four which has led to considerable price pressure within supply chains.
- Retailer decisions on milk sourcing are to a large extent based on price, but also security of supply, provenance, traceability, service levels and sustainability. This offers significant opportunities for producers and processors to work together to take out costs and capitalise on other specific supply chain opportunities to create value for all links of the chain.
- The development of dedicated supply chains is a particular opportunity. The real aim must be functional and collaborative supply chains which look for efficiencies and consumer value up and down the chain and not just within individual businesses.

## 2.3 Arla Foods UK

### Overview

- Arla Foods amba is a Swedish and Danish farmer owned co-operative, with a subsidiary business based in the UK (Arla Foods UK).
- Arla Foods UK is run by an executive team with clearly defined responsibilities and a management style with an emphasis on developing staff linked to achieving optimum results.

### Financial

- Arla Foods amba can demonstrate good performance against its strategy to date, a sound financial position and a profit record sufficient to support continued investment in facilities and process.
- Overall Arla Foods amba is an ambitious and profitable business with significant growth in turnover in recent years and the ratio analysis does not highlight any real concerns.

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<sup>1</sup> Dairy Hygiene Inspectorate, June 2009 figures

### Milk Supply & Contracts

- Arla's plans indicate increasing internal demand for milk for a variety of uses. It will continue to seek supply from its national milk field from well invested dairy units who can deliver the quality and quantities required.
- Arla offer farmers long term contracts with the milk price set by Arla in relation to market conditions.

### Processing

- Arla has implemented policies of both rationalisation and targeted investment in its processing facilities to ensure maximum efficiency and effectiveness.
- The substantial facility planned for the edge of London may lead to further rationalisation in facilities and capacity easily sufficient for current production and to meet its significant growth plans.

### Brands & Markets

- Business plans are about achieving growth, developing existing markets and seeking to broaden range.
- It has some strong brands and Arla is bidding to be the major players in the UK Crème Fraiche and cottage cheese markets.

### Business Strategy

- Arla's UK expansion plans are coupled to growing a broader and bigger business. It seeks to achieve increasing quality in milk supply and improve its performance in low cost production methods, waste reduction and sustainability. Its past track record would indicate that there is no reason why this cannot be achieved.
- Its latest major investment plans will be an important part of its own success and the UK milk market generally.
- Arla anticipates playing a role in future industry consolidation.

## **2.4 Dairy Crest**

### Overview

- Dairy Crest is a public limited liability company with its ultimate responsibility being to its shareholders and maximising returns as well as enhancing share value.

- It has an executive structure typical of such an organisation with executive directors responsible for specific areas and responsibilities.

#### Financial

- Turnover has greatly increased over the last three years with a consistent profit level and relatively healthy balance sheet although with a not insignificant debt level. Recently, there has been variable performance between its markets with added value cheeses and spreads providing the greatest sources of profit.
- Current focus is on cost control, cash generation and investment in existing facilities whilst maintaining an appetite for mergers, acquisitions and joint ventures where it would make business sense.

#### Milk Supply & Contracts

- Dairy Crest purchase 70% of its milk from its milk field with the price set by them based upon market conditions and cost of production changes. Its direct retailer supplier contracts provide potential for greater reward but equally require consistent supply and quality of milk based upon well invested and managed farm operations.
- It offers a secure market for farmers with a range of contracts on offer; even a decline in internal milk use could be balanced by a reduction in purchases from third party suppliers or brokers.

#### Processing

- Dairy Crest inherited a wide range of processing facilities and, in recent years, has engaged in rationalisation to improve efficiency coupled with targeted investment to modernise and improve both capacity and capability of production.
- It has also been involved in a series of acquisitions linked to its objective of achieving a fully integrated business. Future investment will be concentrated on liquid facilities following much recent investment in cheese.
- It has recently announced a £75m, three year programme of investments in its liquid facilities, aimed at improving the efficiency and infrastructure of its liquid milk dairies.

#### Brands & Markets

- Dairy Crest has strong brands which hold leading positions in their market segments. Retail sales growth has been achieved through innovation, advertising, retail promotions and discounting. It is less

exposed to commodity markets than some other milk buyers which should create conditions for more stability in its milk price.

- Doorstep delivery remains an important part of the business and, to counter the market downturn, it has developed an internet based service which is a significant element of their strategy.

#### Business Strategy

- Dairy Crest seeks to build market leading positions for existing brands and added value markets. This could lead to increases in its milk pool, and it also aims to increase the proportion of milk from direct suppliers to 85% from the current 70%. It is committed to its current farm suppliers of milk and work with them to develop supply chain efficiencies through Dairy Crest Direct.
- It has developed significantly in recent times and delivered to its plans in that time. Future success will be influenced both by external factors and its success in maintaining and growing current sales to major retailers and of doorstep deliveries.

## **2.5 First Milk**

#### Overview

- First Milk is a co-operative owned by its 2,600 farmer members with its principal activity being the marketing of milk for its members and the manufacture and sale of its dairy products.
- Its management structure is based upon an executive team which act under instruction from the Board of Directors.

#### Financial

- Whilst turnover has increased, the most recent accounting year showed a net loss linked to the use of member reserves to support the milk price and to a decline in external markets for whey, powder and cheese. Positive actions have been taken to address this through improved cost control, selective use of out sourcing and further rationalisation and investment in existing facilities.
- The balance sheet remains sound and ratio analysis demonstrates this. Recently there has been some financial re-structuring with a release of reserves and sale of shares to support investment and maintain farmer returns.

### Milk Supply & Contracts

- Returns to milk producers are through both price and return on investment with two contracts linked to either liquid or manufacturing use. Price is set by First Milk linked to market returns with one year notice periods.
- Whilst significant expansion in producer number is unlikely, current security of supply to existing sites is good. Future returns are dependent upon the outcome of review measures currently being undertaken and described.

### Processing

- It has adequate facilities to meet current requirements – the issue is one of continuing rationalisation and focusing of investment to improve capability and efficiency.
- It is making use of external funds, including funds from the Scottish Government, to support this investment.

### Brands & Markets

- Whilst 60% of its milk is sold on to other buyers such as Wisemans, the remainder is manufactured for cheese and the ingredients market. Emphasis is on boosting sales of their branded cheese through increasing market penetration.
- The business is dependent upon the returns from cheese and the conditions pertaining in the ingredients market.

### Business Strategy

- The emphasis is upon growing the business by adding value wherever appropriate, ensuring maximum efficiency in its operation and re-building financial reserves by enhanced profit levels.
- It does not seek to enter new markets but consolidate and build upon existing ones making use of targeted investment policies.

## 2.6 Meadow Foods

### Overview

- Meadow Foods (Holdings) Limited is a privately owned company with its principal activity being the supply of milk and dairy ingredients to major food manufacturers.
- It has an executive management structure based upon a board of directors and has grown considerably through mergers and acquisition.

### Financial

- Financial analysis indicates a consistent and stable business with a significant increase in turnover.
- It has a strong capital position and is well placed to meet future demands for investment as well as business opportunities.

### Milk Supply & Contracts

- The nature of the buyer's business reflects in its contracts and there are incentives for producers delivering to forecast volumes matching company needs.
- With growth of its manufacturing customer base, Meadow Foods seek to increase the liquid milk supply from existing farms and there will be opportunity for new contracts depending upon the level of growth achieved.

### Processing

- It has facilities for processing which have benefitted from investment and are well resourced to meet current and future needs.
- The business continues to focus on its core markets and specialisms and the future plans are about growing the existing customer base as well as developing new ones.

### Brands & Markets

- The key markets are in fresh and sweetened dairy products as well as in milk supply and balancing with its customer base being manufacturing.
- It does not have any retailer branded products in its own right and seek to get better penetration and volume sales in its core market place.

## Business Strategy

- Meadow Foods have an excellent track record in achieving its stated strategies.
- Its future plans focus on continued growth, growing its current milk field and providing high levels of customer service.

## **2.7 Milk Link**

### Overview

- Milk Link is a farmer owned co-operative which currently has 2,100 direct suppliers.
- In recent times, it has created an executive management structure more in line with business needs but still with strong reporting lines to its members.

### Financial

- The business has delivered significant increases in turnover with similar levels of operating profits in the three years reviewed. Ratio analysis does not highlight any significant concerns.
- Recent half year results have produced some reduction in earnings linked to better milk prices offered to farmer members and external conditions in cheese markets but the business is strong and well structured going forward.

### Milk Supply & Contracts

- The last year saw a significant increase in new direct suppliers principally linked to transfer of former Dairy Farmer of Britain members. However, production continues to grow annually linked to growth in sales volumes.
- Returns to producers are a function of milk price and return on investment. Whilst the price for milk is set at board level, there are formal structures in place to consult with farmer members and discuss factors involved.

### Processing

- Milk Link has acquired and invested in upgrading eight processing facilities, and is well resourced to meet both current and planned future needs.

- Current investment is focused on technological advance and increasing capability as well as innovation. There is a clear strategy in place.

#### Brands & Markets

- Whilst having secured a significant foothold supplying dairy products to the retailer own label market, Milk Link has a significant range of branded products especially in relation to cheeses and long life & flavoured milks. They have also shown innovation in the use of licensed brands.
- They seek to be a price maker in an integrated market and have developed a significant income within the food service sector. They have a good range of products in the market place.

#### Business Strategy

- Milk Link have been involved in a series of strategic changes in the last two years and have re-aligned and refocused in terms of structures and processes to put their business in the very best position going forward.
- Whilst seeking growth, their emphasis going forward is on delivering security and business stability. They have strong emphasis on continuing to drive up customer service and efficiency of operation.

## **2.8 Müller**

### Overview

- Müller's UK operation is part of a multinational business with its primary base in Germany.
- It has an executive management structure with strong delegation to its UK arm and focus on business performance and results.

### Financial

- Account analysis is difficult given the multinational nature of the business and indeed some distortion in figures due to accountancy changes in the period.
- The balance sheet appears strong but carries no borrowing. It is believed that this is held under the main company. Profits have fallen recently but there is no cause for concern.

### Milk Supply & Contracts

- The emphasis is on local supply to the factory with producers generally no more than 30 miles from the factory. Milk prices are at premium levels but strongly depend on meeting quality requirements with penalties applying for under achievement and bonuses for the reverse position.
- Through investment, Müller is seeking to increase capacity and so there should be good prospects for increased milk supply contracts to existing suppliers and some potential for new suppliers who are located within their 30 mile radius limit.

### Processing

- Processing is concentrated on the site. The company is investing heavily to increase production capacity and drive up production so that 100% of the market requirement can be produced from the UK factory and not imported.

### Brands & Markets

- Core business is based on well established brands. The emphasis is both on increasing sales to existing customers and on increasing penetration into households not currently reached.
- They are not intending to enter the own label retail market but continue to focus on established own brands.

### Business Strategy

- The strategy is one of continued growth in its existing market place by selling more to existing households and increasing penetration.
- The business has invested to increase its capability to service its UK market from Shropshire which provides further opportunity for milk suppliers to grow their contracts.

## **2.9 Robert Wiseman Dairies**

### Overview

- Wisemans is a public company developed from a successful family business and still principally managed by the family.

- The executive management structure is focused on reporting to a Board with ultimate responsibility to shareholders.

#### Financial

- There has been significant increase in volume sales and value gains in the period analysed with consistent profit levels.
- Ratio analysis shows a strong position with significant improvements in gearing and debt/equity ratios. They have had a strong cash flow position well able to service debt and create conditions to support further investment.

#### Milk Supply & Contracts

- The business model is based on securing supply from their own milk field and purchasing from the two UK co-operatives. They are solely concerned with liquid sales and have no processing facilities in other areas.
- Returns to farmer suppliers relate directly to market price for liquid milk and returns from the sales of bulk cream.
- Offers contracts with short notice periods to milk suppliers (3 months).

#### Processing

- Wisemans have built and located their facilities to meet market requirements. They are modern facilities and further investment is ongoing and includes development of distribution facilities to provide a better service to South East customers.
- They are well equipped to meet current and future requirements.

#### Brands & Markets

- The core business is in supplying liquid milk particularly to the major retailers. Although there is some branding in their liquid products, they are not premium brands and their business focus is on volume and throughput rather than brand value.
- They have no intention to enter non liquid markets nor grow internationally. They are focused on continuing to grow their UK market.

### Business Strategy

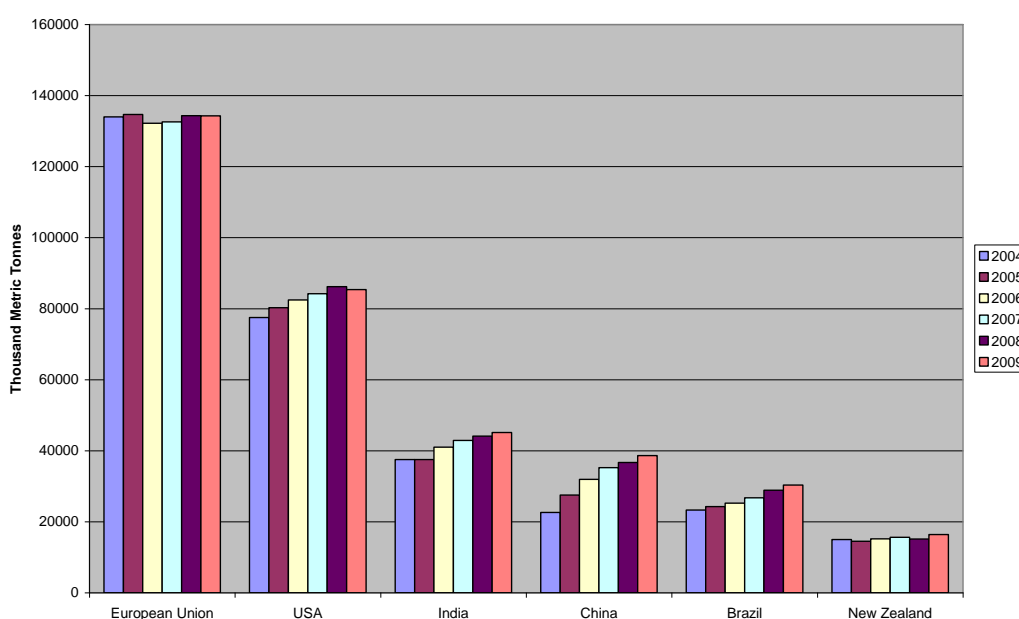
- The business has shown considerable success in delivering its plans and seeks to further increase its market share.
- Recognising that growth has been significant, the business recognises further growth is likely to be slower and will now focus on increasing profit levels and cash balances to meet future needs.

### 3 Global Market Context

#### 3.1 Production

A large number of different species (not just bovine animals) are milked globally, but milk and dairy products from cattle are the most important. The European Union is one of the world's most important bovine dairy producing regions, producing in aggregate about 134 million tonnes of liquid milk per annum from about 24 million animals<sup>2</sup>. This represents about 20% of global production. The largest three producers within the EU are Germany, France and the UK. China and India are also substantial producers, but this is principally for their own domestic markets. The USA is another major producer accounting for approximately 13% of global production. While a large proportion of their milk production is directed towards their domestic market, they are increasingly exporting processed dairy products. New Zealand is the world's largest dairy exporter and Japan is the world's largest importer of dairy products. Internal consumption is often in the form of liquid milk, while the bulk of international trade is in processed dairy products such as milk powder and butter. Figure 1 below shows the largest producers in 2007.

*Figure 1 – Largest Producers of Fresh Liquid Cow's Milk*



*Source: USDA data re-analysed by Bidwells*

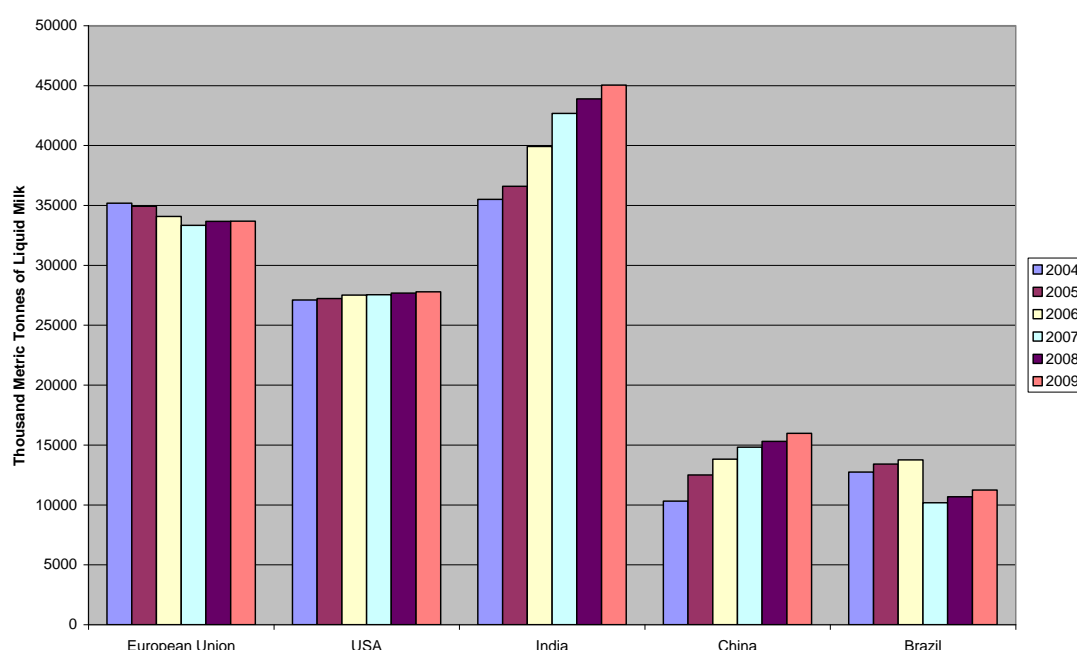
<sup>2</sup> United States Department of Agriculture (USDA) – Dairy: World Markets and Trade, August 2009

FAO forecasts indicate that, in absolute terms, world milk production will increase by 131 million tonnes between 2008 and 2018<sup>3</sup>. The majority of this extra milk is likely to be produced in Asia and Latin America, although Europe remains an important producer. Herd expansion will be increasingly limited by environmental and water constraints in many regions around the world, so additional milk production is anticipated to be increasingly coming from growth in per cow yields over the next decade.

### 3.2 Consumption

Consumption is relatively static in developed markets but increasing significantly in the major emerging markets, especially China and India. According to Tetrapak<sup>4</sup>, India is the largest consumer of all milk and dairy products – consuming some 51.5 billion litres in 2008, with a compound annual growth rate of 2.7% over the last four years.

*Figure 2 – Major Global Milk Consumption Trends*



*Source: USDA data re-analysed by Bidwells*

### 3.3 Pricing

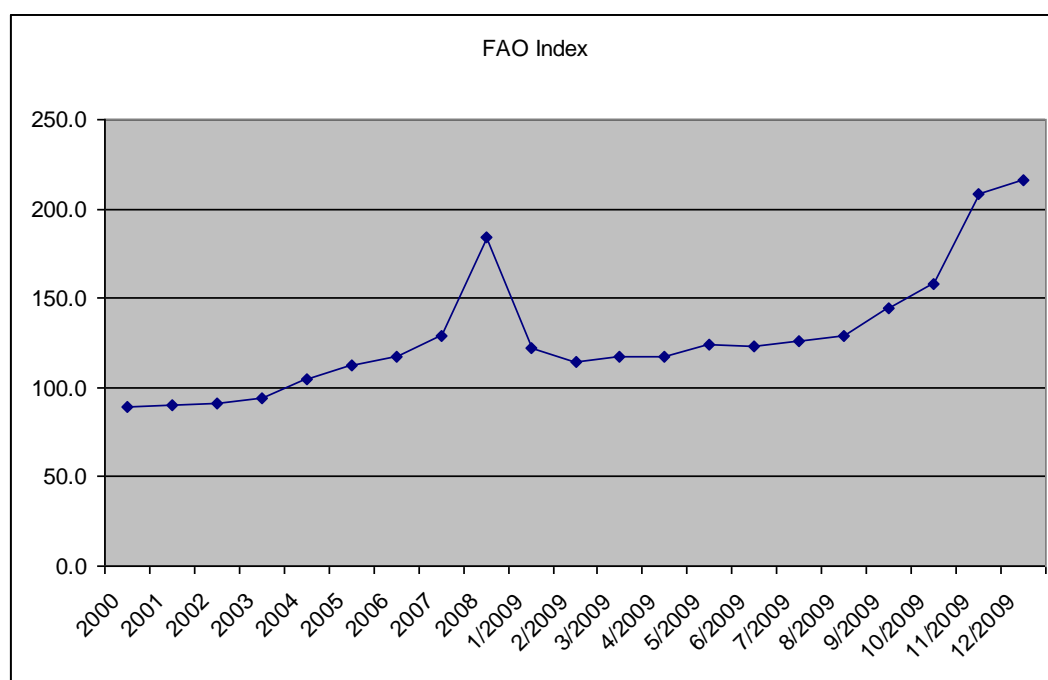
Global dairy prices, along with most agricultural commodities, rose strongly in 2007 as a result of an expansion in demand and a squeeze on supply. The rise in prices triggered both a supply response and a

<sup>3</sup> FAO-OECD Agricultural Outlook to 2018

<sup>4</sup> Tetra Pak Dairy Index, June 2009, "Focus on Emerging Markets"

reduction in demand as dairy ingredients were quickly replaced by cheaper substitutes in food manufacturing, such as oilseed based products. Prices fell substantially during the latter part of 2008 and into 2009. During 2009, the FAO dairy price index increased by over 80 percent from its low in February 2009.

*Figure 3 – FAO Dairy Price Index*



*Source: FAO data re-analysed by Bidwells*

In the longer term, most forecasts suggest that international market prices will congregate towards a long term equilibrium determined to a large extent by the marginal costs of milk production of key exporters such as the USA, where production and utilisation can adjust to global market conditions in a relatively short period of time. Demand for dairy products is forecast to rise in the medium term as a result of income and population growth, but also due to changing diets and preferences. Westernisation of diets, continuing urbanisation trends, and the increasing range and sophistication of dairy products available to consumers as ready forms of protein and energy, are causing structural shifts in demand. This trend is a key driver in the future growth of the dairy sector in developed and especially developing countries.

Table 1 below shows that the income and price elasticity of demand for dairy products varies substantially around the world. The income elasticity is a measure of how responsive consumer demand is to changes in income. A positive income elasticity indicates that as income rises, demand increases while negative elasticities mean that demand decreases with rising incomes. The price elasticity measures the change in demand from a change in the price of the product. As can be seen from the table, the demand for dairy

products is relatively insensitive to price changes. In the UK, a 1% increase in the price of dairy products reduces demand by 0.304%, a relatively smaller amount.

In developed countries such as the USA and UK, the demand for dairy products is income and price inelastic, meaning they are **relatively insensitive** to changes in price and income. In emerging economies such as Brazil and Ukraine, demand is more sensitive as small increases in income allow consumers to purchase more 'luxury' products. According to research by Tetra Pak, global dairy consumption reached an all time high of 258 billion litres in 2008 and is forecast to reach 282 billion litres by 2012 (Figure 4), with growth recovering following the economic downturn.

*Table 1 – Income and Price Elasticities of Dairy Products in Different Countries<sup>5</sup>*

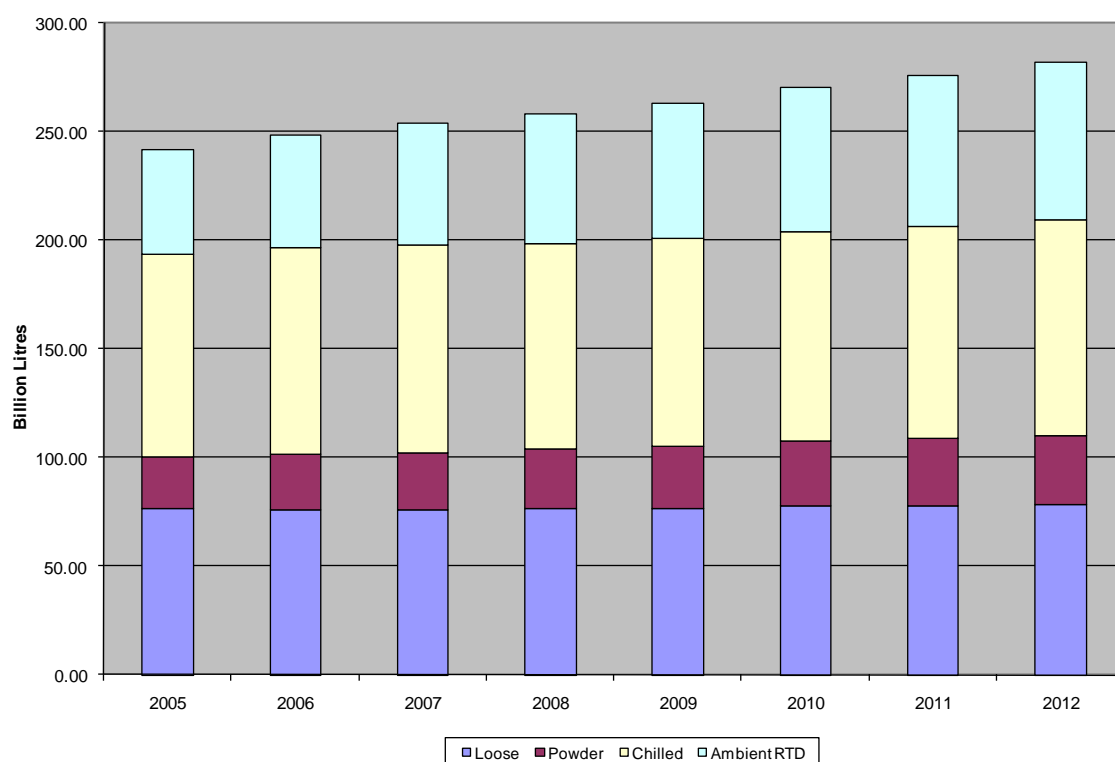
Income Elasticities		Price Elasticities	
Albania	0.792	Albania	-0.641
Argentina	0.587	Argentina	-0.474
Australia	0.340	Australia	-0.275
Bangladesh	0.859	Bangladesh	-0.695
Brazil	0.718	Brazil	-0.581
Canada	0.324	Canada	-0.262
Germany	0.351	Germany	-0.284
Greece	0.519	Greece	-0.420
Kazakhstan	0.727	Kazakhstan	-0.588
Kenya	0.906	Kenya	-0.733
Korea	0.510	Korea	-0.412
New Zealand	0.450	New Zealand	-0.364
Pakistan	0.843	Pakistan	-0.682
Romania	0.689	Romania	-0.557
Ukraine	0.775	Ukraine	-0.626
United Kingdom	0.375	United Kingdom	-0.304
United States	0.117	United States	-0.095

*Source: USDA Data*

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<sup>5</sup> The data, from 1996, is available from: <http://www.ers.usda.gov/data/InternationalFoodDemand/>

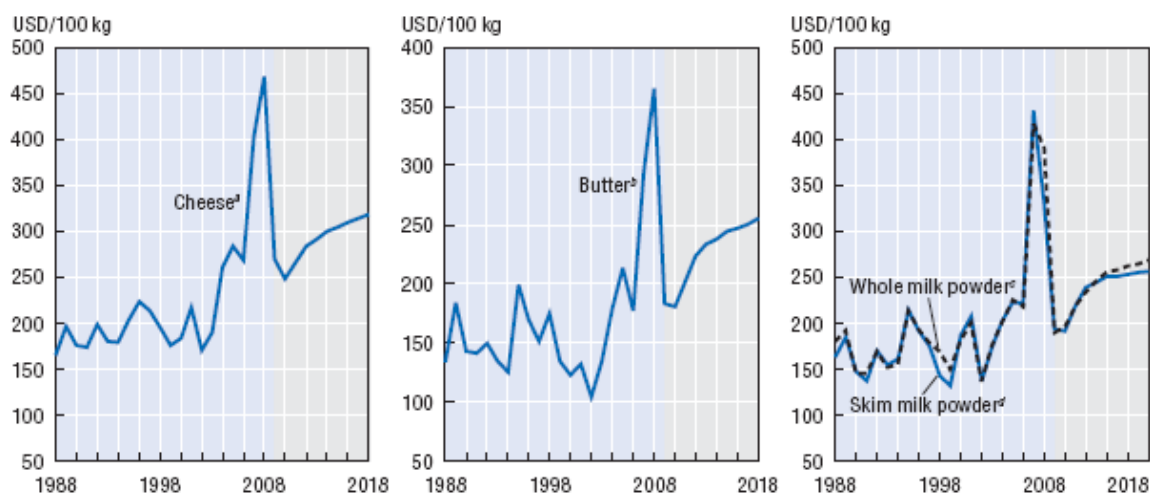
Figure 4 – Projected Growth in Global Dairy Consumption to 2012



Source: Tetra Pak

FAO and OECD in their joint publication, **OECD-FAO Agricultural Outlook 2009-2018** project cheese, butter and milk powder prices to be substantially above those of the previous two decades, as set out in Figure 5 below.

Figure 5 – FAO and OECD Price Outlook



Source: OECD-FAO Agricultural Outlook 2009- 2018

Over the last year there has been considerable pressure for policy intervention in markets, especially from some European countries. The European Commission stood firm during 2009 in response to demands from Member States for quota cuts but has provided limited assistance recently with the allocation of €300m in direct support to the sector, and intervention stocks rose throughout much of 2009. The US also raised its intervention support prices for some dairy products as a way of supporting the US farm price for milk. The recovery of EU prices during the latter months of 2009 means there is now a net outflow of produce from intervention onto the EU markets, with the exception of butter.

Despite an expected expansion in international trading, dairy markets will continue to be characterised as “thin<sup>6</sup>”. The small share of production that enters trade, high border protection in most countries, and the continued availability and potential use of export subsidies and taxes will contribute to the thinness of the international dairy market and future price volatility. Dairy markets will also remain exposed to demand reactions to variations in economic performance in developing countries, given the fact that dairy products have relatively high income elasticity and are often still considered to be luxury items in food purchases. On the other hand, as export shares of market suppliers other than New Zealand are anticipated to become more evenly spread, markets may be able to better handle any production shortfalls that may occur in the future. The exception is New Zealand which is expected to considerably strengthen its dominant position on world dairy markets implying that any major reduction in production there would likely have considerable repercussions on global markets.

Even though the long-term outlook for global dairy demand is strong, the volatility and fluctuations will continue and be very significant. Producers in all regions of the world will be exposed to greater milk price volatility going forward. We will continue to see input price volatility, both linked to feed commodity markets and increasing volatile energy supplies. Successful milk producing businesses in GB will need resilient and flexible structures to withstand market movements, and have appropriate strategies in place to mitigate production and marketing risks.

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<sup>6</sup> A 'thin' market is a market with a low number of buyers and sellers. Since few transactions take place in a thin market, prices are often more volatile and assets are less liquid

## 4 Background Information on Milk Production and Supply Chain Structure

### 4.1 Background to UK Milk Markets

The Milk Marketing Boards (MMB) was a government agency established in 1933 to control milk production and distribution in the United Kingdom. Further Boards were established in Scotland and Northern Ireland. They functioned as buyer of last resort in the UK milk market, thereby guaranteeing a minimum price for milk producers. The MMBs used market power to price milk according to end-use. Farmers were paid a 'pooled' price, after deductions of Board costs: all farmers were charged the same per litre collection and haulage costs. These strategies resulted in larger producers close to processing factories subsidising smaller producers and those distant from processing factories<sup>7</sup>.

The Board's responsibilities effectively ended in 1994 with deregulation of the British milk market following the Agriculture Act 1993. Although largely defunct since 1994 the Board was not finally dissolved until 2002 (2003 in Scotland).

In 1994, the Board's role as milk purchaser was taken by a wide range of licensed milk purchasers. These purchasers were initially classified into three categories:

- member co-operatives, of which Milk Marque was the largest;
- farmers who sold directly to milk processors; and
- milk groups<sup>8</sup>.

In 1994, Milk Marque attracted 65% of farmers and about 60% of milk. At the outset it adopted many of the MMB's milk price policies and, as it owned no milk processing capacity, it needed to sell every litre of members' milk. It did this through an auction system, selling milk in contracts differentiated by the nature of the service offered.

Milk Marque's response to loss of membership in the years following 1994 was to modernise its payment system and it also declared an objective of owning 1 billion litres of milk processing capacity by 2000. Milk Marque developments initially acquired processing capacity at Aeron Valley and North Bradon Farms, giving an estimated capacity for manufacturing 15,000 tonnes of cheese.

By the late 1990s there was concern about Milk Marque's investments in processing from other milk processors - principally on the grounds that Milk Marque would be able to exert too much influence on the

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<sup>7 7</sup> For a history of milk marketing in the UK see the paper by Franks, J.R. (2002) "*Recent Changes In Milk Marketing In The UK: The Farmers' Perspective*" presented at the 13th International Farm Management Congress, The Netherlands, Papendal Sports Centre, Wageningen, July 7th - 12th, 2002 and available at <http://www.ifmaonline.org/pdf/congress/Franks.pdf> [accessed 14 December 2009]

<sup>8</sup> Typically milk groups negotiate contracts with one (or more) milk processor on behalf of their members, after which member sign individual contracts. Whilst figures at the aggregate level are difficult to obtain it is thought that initially between 12 and 15 percent of dairy farmers' marketed milk through this type of arrangement.

price of milk. As a result the marketing of raw cows' milk in the UK was referred to the Monopolies and Mergers Commission (MMC) in 1999.

The MMC investigation found *inter alia* that Milk Marque was a scale monopolist by virtue of its 49.6 % share of supply of milk in Great Britain in 1997/98. Milk Marque had been able to exploit its monopoly position by using its selling system to price discriminate and to control the supply of milk made available to the market'. The report also found that the 'planned enlargement of its vertically integrated processing capacity would give Milk Marque the ability to exploit still further the scale monopoly situation in its favour and it may therefore be expected to operate against the public interest'. It recommended Milk Marque be divided into a number of independent quota-holding bodies. Importantly, each of these new bodies would be allowed to own processing capacity.

Although these recommendations were rejected by the Industry Minister Stephen Byers it was insisted that Milk Marque construct a new 'transparent' milk selling system, acceptable to customers and approved by the Office of Fair Trading by the end of 1999. Milk Marque was not permitted to expand its milk processing activities. After intense debate, Milk Marque accepted a voluntary break-up because it believed these new rules attached to its continuing existence would undermine its milk auction system, and in April 2000 Milk Marque divided into three, regionally based member co-operatives: Axis (midlands), Milk Link (south) and Zenith (north).

In the years that followed there was considerable re-organisation in the sector and by 2005 there were three co-operative businesses operating in the UK: First Milk, Milk Link and Dairy Farmers of Britain (DFoB). DFoB was beset by problems and eventually receivers were appointed in June 2009. This followed a prolonged period of operational and financial restructuring during which they closed down several plants and members' debts were converted into shares. Their major contract to supply fresh milk to the Co-operative Group was not renewed, resulting in the loss of one of their principal market outlets.

The remaining two co-operative businesses First Milk and Milk Link discussed merging in 2007 but negotiations did not progress and they remain fully independent businesses.

## 4.2 Producer Numbers & Volume Data

The table below summarises producer number and volume of milk data for the seven major buyers. The figures represent numbers for the milk year ending March 2009. Subsequent to the demise of Dairy Farmers of Britain, these numbers changed as farmers found new buyers for their milk. Also, the totals on the bottom of the table are for producer numbers and delivery volumes to first purchaser – they do not allow for transfers of milk through brokerage or other means.

*Table 2 - Producer Numbers and Volumes by Buyer (2008/09)*

	<b>Producer Numbers</b>	<b>Deliveries (million litres)</b>	<b>Average Producer Size</b> 2008/09 Year (million litres)
Arla	1,400	1,600	1.1
Dairy Crest	1,400	1,500	1.1
First Milk	2,600	1,750	0.7
Meadow Foods (Holdings) Limited <sup>9</sup>	520	430	0.8
Milk Link	1,600	1,000	0.6
Müller	150	200	1.3
Robert Wiseman & Sons	830	970	1.2
Total GB Producers/ Deliveries	13,041	10,979	0.8

*Source: Annual Reports, Company websites, DHI, RPA*

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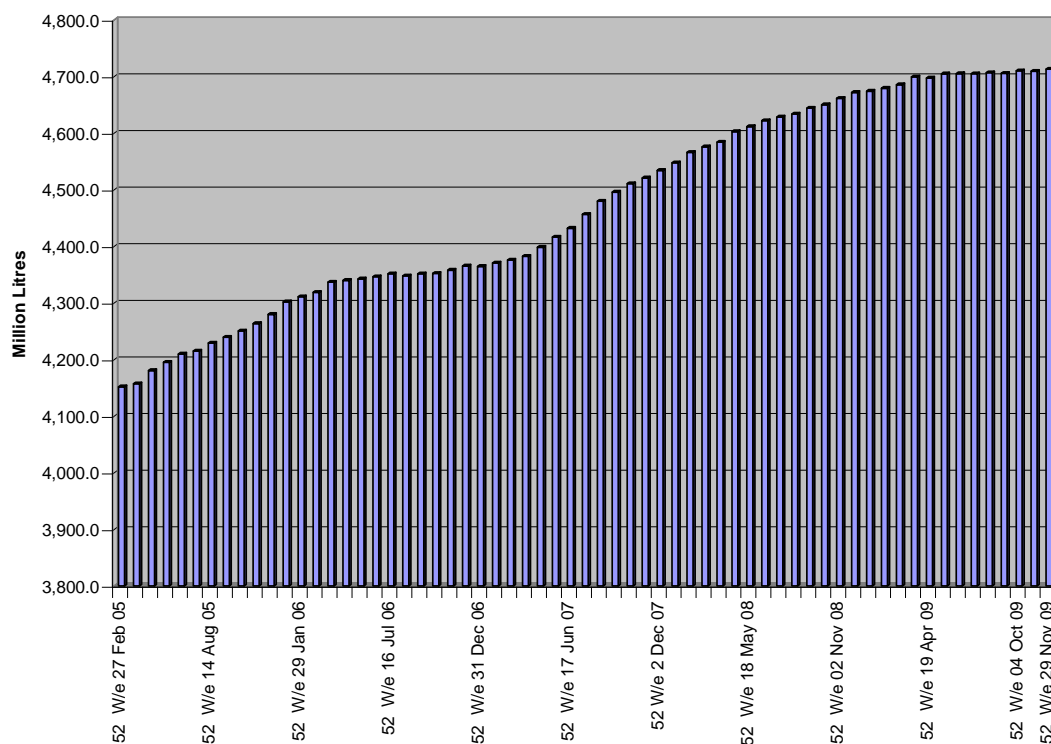
<sup>9</sup> Meadow Foods (Holdings) Limited includes the operations of Meadow Foods Lakes Ltd and Meadow Foods Ltd.

## 4.3 Retail Background

### 4.3.1 Overview

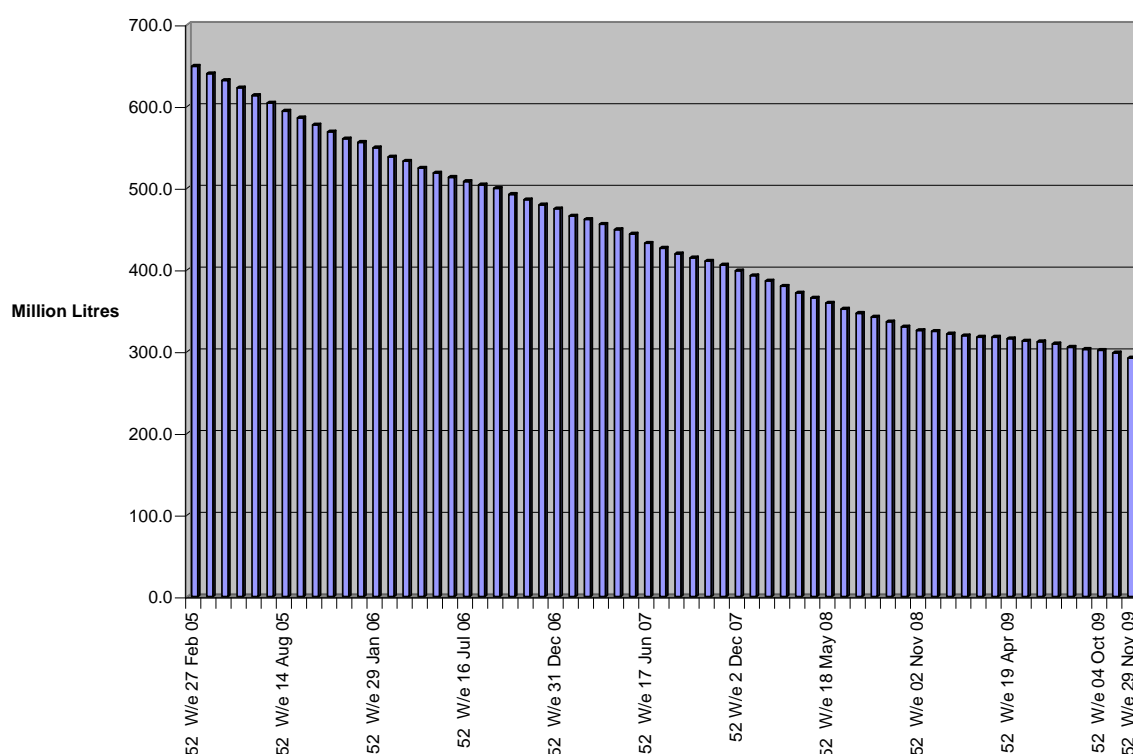
The substantial change over the past decade or more has been the rapid decline in the importance of the doorstep delivery as the principle method of retailing milk. In the mid 1990s more than 2.5 billion litres of milk were being delivered to the doorstep each year, which by 2004 had fallen to 637 million and by 2009 to under 300 million litres. Less than 6% of the milk now consumed at home comes from delivery rounds, despite the fact that the overall liquid market has grown slightly, to over 5 billion litres.

*Figure 6 – Change in GB Milk Buying 2005 to 2009 – Retail Milk sales*



Source: DairyCo

Figure 7 – Change in UK Milk Buying 2005 to 2009 – Doorstep Milk sales



Source: DairyCo

Milk is not an easy product to differentiate, but it is an important component of the retail offer for all of the major multiples. Notwithstanding the importance of price and the high cost of transporting liquid milk, there are a whole host of other reasons why most multiples would prefer to source their milk domestically rather than relying on imports from Ireland or Continental Europe.

The first of these is **security of supply** – ensuring that the milk and dairy products required can be sourced when they are needed and guaranteed to be of the correct quality.

**Provenance** is also of growing importance. Provenance means an understanding of the geographical origin of what we eat, and the methods used to produce it – this has grown in importance partly as a result of a series of food scares and partly through the growing media focus on food-related matters. However, the rules surrounding claims of provenance can be complex, and with statements of origin or logos certifying adherence to quality assurance schemes jostling for space with other information regarding issues such as nutritional content, there may be a risk of the consumer being presented with too much information.

Provenance has led to initiatives such as the Waitrose and Marks & Spencer's milk groups established through Dairy Crest and now mirrored by other retailers and buyers. The principle involves a defined group of farmer producers who are offered retail contracts which allow some premium in the milk price to the farmer reflecting the retailer requirement for assurance on the efficiency of the process and knowing more about

how that milk is produced. Therefore linked to security and provenance is a requirement for greater transparency. This can then link to greater knowledge and tracking in terms of food safety, carbon mapping etc. Apart from the 'hard' requirements of quality and competitive pricing, 'softer' targets around provenance and the environment are growing. Major retailers who are following this route include Asda, Tesco and Sainsbury.

**Traceability** is important for retailers. Traceability is the ability to trace the history, application or location of an entity by means of recorded information (as defined by ISO 8402:1994). For products, traceability is the link between materials, their origin and processing, distribution and location after delivery. Recent IT based retailer initiatives in horticulture and eggs allow a purchaser to trace the product origin accurately right back to the individual producer. There is no reason why this cannot be achieved with milk or cheese, perhaps not on an individual farm basis but certainly for a group of farmers where a processor or buyer can distinguish and track the supply chain.

**Service levels** are also important, especially for those processing businesses which are producing what is essentially a commodity product, such as own-brand cheese. By anticipating customer and retailer changes and responding accordingly, processors can add value to their offer through a customised service offering.

**Sustainability** is also rising up the agenda – not just carbon mapping of dairy supply chains but also water footprints.

Retailers are becoming more and more interested in production methods. Some major retailers are already seeking to help their farmer producers directly in reducing input costs by seeking supply chain efficiencies. Marketing dairy bull calves for beef is an example of this. Another is by helping source energy prices at lowest levels by organising collective purchasing.

All of this of course must be viewed in the context of our starting point and the difficulty of differentiating the liquid milk product. Whilst in isolated cases, it has happened, for example in the North West with Bowland Fresh and Booths Supermarkets, the wider ability to gain premium is limited – milk is and remains for the most part a commodity. However, in looking forward, the farmer supplier must be aware of the changing retail emphasis and ensure that their buyer is responding to this.

Table 3 overleaf shows the current supply base of the major retailers. Numbers may differ from those presented elsewhere due to reallocations of supply contracts by the retailers, and the recent acquisition of Somerfield by the Co-operative Group.

*Table 3 – Supply base of the major retailers*

<b>Retailer</b>	<b>Main Supplier</b>
Tesco	45% Robert Wiseman Dairies/55% Arla Foods UK
ASDA	100% Arla Foods UK
J Sainsbury plc*	50% Robert Wiseman Dairies/50% Dairy Crest
Morrisons	50% Dairy Crest/50% Arla Foods
Co-op (including Somerfield)	69% Robert Wiseman Dairies/16% Dairy Crest/15% Arla
Waitrose	100% Dairy Crest
Marks & Spencer	100% Dairy Crest

\* have awarded Arla contract for additional milk volumes through expansion of SDDG

*Source: Various, pulled together by Bidwells*

## Cheese Market

The UK cheese market was worth £2.37b in the 52 weeks to the 27<sup>th</sup> December 2009 with sales totalling 395,105 tonnes. This is growth of 4.6% in expenditure and 4.2% in volume over the same period in 2008<sup>10</sup>.

In general terms the following trends are occurring in the cheese market:

- Sales of pre-pack cheese are increasing
- Sales of loose cheese are falling
- Mild and Medium cheddar cheese sales are falling
- Mature cheese sales are increasing, this is partly related to increased level of promotion
- Branded cheese sales are rising whilst standard retailer own label sales are stable and value sales are falling

There are many brands within the Cheese category which means that market penetration by new brands is challenging. There is competition for shelf space and aggressive promotional activity is common in this market. The ability for the market to continue expanding is limited due to 89% of adults already consuming cheese in block form and 62% in packet form (e.g. grated)<sup>11</sup>. Whilst health concerns about saturated and trans-fats present a challenge to the Cheese market, they also present an opportunity for low fat (lighter) variants.

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<sup>10</sup> Kantar 2009

<sup>11</sup> Mintel Cheese Market Intelligence, April 2009.

## 5 Financial and Sales Information

Financial information in respect of each company reviewed in this document is included in the relevant company sections. This information is derived from statutory accounts and reports of each company which for public companies and co-operatives are available freely from their websites and for private companies from Companies House. The financial data presented in this report is from documents in the public domain although we were able to expand on its interpretation through discussions with the individual buyers. The profit and loss and balance sheet provided is simplified from the annual accounts for the purposes of clarity and ease of understanding. This is accompanied by a ratio analysis including 14 measures. Data is presented for the last three full years' accounts for each business although year ends do differ. It must be noted that 2009 results are for a 53 week year, which will have an effect on the ratio analysis and comparison of metrics.

The ratios are defined in Appendix B which describes the process of calculation and provides a guide to interpretation. The role of ratios is to indicate trends for an individual company or co-operative. Care must be taken in inter-company/co-operative comparison for reasons outlined below; therefore the ratios should not be interpreted in isolation but assessed in the context of the wider business strategy, its markets of focus and its point in business development.

Factors which are important when reviewing the financial condition of any company include their gearing (i.e. level of debt), their liquidity (amount of current assets available to pay current liabilities), how much cash they are generating, their interest cover (i.e. how many times greater their profit is than their interest charges) and their return on capital.

Points of note when considering the ratio analysis:

1. The level of stock in any business will be related to the markets in which the business operates. Those whose business comprises significant cheese volumes will have a higher stock level on the balance sheet, in relation to turnover, than one which sells only liquid milk. This does not mean the business producing cheese is less efficient; it is a fact of producing the product that it has a higher working capital demand.
2. Brands can carry significant value, particularly for the top performers in any market segment. Generally the value of these is not included on the balance sheet and, if brands are included, they are often at historic cost (if acquired) and may not relate to their true current value. They should be reflected in the market capitalisation of the plcs. Brand values would significantly change the balance sheets of some businesses reviewed and the effect would be a reduction in gearing (as a percentage) and an apparent decrease in asset utilisation efficiency.

3. Some companies carry significant amounts of intangible assets and goodwill on their balance sheets, which are related to acquisitions. The intangible assets often relate to brands or trademarks which have a specific value. Goodwill often arises on acquisitions and where positive, it indicates a premium over the fair value of the assets of the acquisition and where negative indicates that the asset has been acquired for less than its fair value.
4. In comparing results for different companies it is important to distinguish between those with external shareholders and those owned by their supplying members (i.e. co-operatives). The latter exist to return value to their members, largely through the milk price rather than through accumulation and distribution of retained profit. Profit is retained in a co-operative only to the extent needed to meet obligations to funders and to support business growth: long-term growth of profits or enterprise value is not a primary objective.
5. Freehold property is often included on the balance sheets at historic cost but, in some cases, the balance sheet value has been re-valued to a market one. Holding property at historic cost leads to conservative balance sheet valuations, an overestimation of gearing and an increase in asset utilisation efficiency. Historic cost underestimates shareholder and member funds. Where assets are newly constructed, they will be closer to market value. Where property is re-valued to market this is commented on in the company sections.
6. Major investment or restructuring will lead to spikes in particular ratios either of a negative or positive direction.
7. Two gearing ratios are presented. One uses gross debt (total debt on balance sheet) and the other uses net debt (which offsets cash at bank against total debt). The net debt version will normally give lower gearing. It is important that the same measure is used when making comparisons.
8. Where relevant other important factors specific to one business are detailed as appropriate in the relevant company section.

For each company, historic milk prices are based on the DairyCo Datum standard litre price. . While the standard litre average prices will not be totally representative as the average profile of the milk supply to the different companies will be different to each other and the Datum standard litre. However, the differences are unlikely to be substantial.

Retail sales information from Kantar relates to the 52 week period up to 22 March 2009 for liquid milk and the 52 week period to 12 July 2009 for cheese products. Where raw milk volumes are quoted these are either obtained from company accounts or estimations based on sales volume.

## 6 Arla Foods UK

### 6.1 Overview

Arla Foods UK is part of the Swedish and Danish farmer owned co-operative, Arla Foods amba. Arla Foods amba was formed in 2000 following a merger of the Danish MD foods and Swedish Arla. The co-operative is owned by 7,996 farmer members and is the third largest dairy business in Europe. Arla Foods amba is based in Denmark.

Arla Foods began operations in the UK when it introduced Lurpak butter around the start of the twentieth century. Since 1990, it has expanded a liquid business via acquisition, before merging with Express Dairies plc to form Arla Foods UK plc. Ownership of the newly merged company was 51% held by Arla Foods amba in Denmark. Then, in April 2007, the remaining 49% of shares were acquired by Arla Foods amba and Arla Foods UK plc was delisted from the London Stock Exchange.

Arla Foods amba currently processes approximately 8.4bn litres of milk each year, employs 16,500 people worldwide and operates in over 100 countries. The UK is the largest individual market accounting for 27% of revenues in the financial year ending 31 December 2008. The turnover of Arla Foods amba is approximately £6bn, the UK accounting for over £1.5bn of this. Currently Arla Foods UK processes 26% of the total Arla Foods amba milk pool.

Arla Foods amba functions as a true co-operative in its home nations with a democratic structure of representation leading to a supervisory board of members that oversees the business operation. In the UK there is no farmer representation on the Arla Foods UK board. However, producers are represented by Arla Foods Milk Partnership (AFMP). AFMP farmers own a 3.2% stake in Arla Foods UK plc, through a joint venture with Arla Foods amba. The role of these organisations is covered in section 5.3.

The business is structured into four divisions, Consumer Nordic, Consumer UK, Consumer International and Global ingredients.

Arla Foods UK processes almost two billion litres of milk each year and supplies liquid milk to major UK retailers, as well as producing liquid milk brands like Cravendale (produced from GB milk) and importing spreads like Anchor and Lurpak (not produced from GB milk). It operates from seven locations across the UK.

## 6.2 Financial

Arla Foods amba produces consolidated accounts for the group as a whole. The group is not required to disclose a consolidated statement for its UK operations individually. Whilst there are a number of Arla companies domiciled in the UK for which documentation is available from Companies House, it is unlikely that this accounts for all UK business and we cannot determine what trading is inter-company (which is cancelled out in consolidated statements) and what is external. Therefore we are reliant on data for the group as a whole for the years ending 31 December 2007 and 2008 (since Arla Foods UK plc was fully acquired by Arla Foods amba in April 2007). The 2006 data provided is from Arla Foods UK plc in its last full year of trading (year ending 30 Sept 2006) and consequently is not directly comparable. As a result we have included the Arla Foods amba results for the year ending 31 December 2006 which pre-date its full acquisition of Arla Foods UK plc to aid interpretation.

The pence per litre (ppl) figures are calculated using UK milk pool volumes for the 2006 financial year end and Arla Foods amba figures for 2007 and 2008<sup>12</sup>.

### 6.2.1 Summary Profit and Loss Account

Table 4 overleaf shows the profit and loss for the last three years. This is also expressed in terms of pence per litre (ppl).

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<sup>12</sup> Arla Foods amba volumes are for the whole international business

Table 4 – Arla Foods amba Summary Profit and Loss Accounts

Year End	30 Sept 2006 <sup>13</sup>			31 Dec 2006 <sup>14</sup>	31 Dec 2007			31 Dec 2008		
	£ (000s)	ppl	%	£ (00s)	£ (000s)	ppl	%	£ (000s)	ppl	%
Turnover	1,146,600	61.43	100.0	4,135,545	4,703,645	56.00	100.0	6,183,625	73.61	100.0
Cost of Sales	981,000	52.55	85.6	3,306,727	3,815,764	45.43	81.1	5,108,500	60.82	82.6
<b>Gross Profit</b>	<b>165,600</b>	<b>8.87</b>	<b>14.4</b>	<b>828,818</b>	<b>887,882</b>	<b>10.57</b>	<b>18.9</b>	<b>1,075,125</b>	<b>12.80</b>	<b>17.4</b>
Admin/Distribution Charges	143,500	7.69	12.5	723,273	738,128	8.79	15.7	931,500	11.09	15.1
<b>Operating Profit (Loss) before finance and tax</b>	<b>22,100</b>	<b>1.18</b>	<b>1.9</b>	<b>105,545</b>	<b>149,754</b>	<b>1.78</b>	<b>3.2</b>	<b>143,625</b>	<b>1.71</b>	<b>2.3</b>
Finance Costs	10,900	0.58	0.9	37,182	55,369	0.66	1.2	107,750	1.28	1.7
Other income and exceptional costs	7,000	0.38	0.6	32,273	20,000	0.24	0.4	37,750	0.45	0.6
<b>Profit (loss) on Ordinary activities before taxation</b>	<b>18,200</b>	<b>0.98</b>	<b>1.6</b>	<b>100,636</b>	<b>114,384</b>	<b>1.36</b>	<b>2.4</b>	<b>73,625</b>	<b>0.88</b>	<b>1.2</b>
Taxation on Ordinary activities	6,000	0.32	0.5	15,455	21,872	0.26	0.5	4,250	0.05	0.1
<b>Profit (Loss) on Ordinary activities after taxation</b>	<b>12,200</b>	<b>0.65</b>	<b>1.1</b>	<b>85,182</b>	<b>92,512</b>	<b>1.10</b>	<b>1.9</b>	<b>69,375</b>	<b>0.83</b>	<b>1.1</b>

Source: Company Reports

<sup>13</sup> Data for the 2006 year is for Arla Foods UK plc and is not directly comparable to the 2007 and 2008 years which are for the Arla Foods amba group as a whole. This applies to the profit and loss account, balance sheet and ratio analysis.

<sup>14</sup> Arla Foods amba results for year ending 31 December 2006 are prior to the full acquisition of Arla Foods UK plc

## 6.2.2 Summary Balance Sheet

Table 5 – Arla Foods amba Summary Balance Sheet

Year End	30 Sept 2006*		31 Dec 2006†	31 Dec 2007†		31 Dec 2008†	
	£ (000s)	ppl	£ (000s)	£ (000s)	ppl	£ (000s)	ppl
<b>Fixed Assets</b>							
Intangible Assets	300	0.02	71,273	64,039	0.76	85,875	1.02
Tangible Assets	233,900	12.53	984,273	1,050,542	12.51	1,229,750	14.64
Goodwill	77,600	4.16	207,636	443,547	5.28	417,875	4.97
Investments	3,500	0.19	169,727	163,350	1.94	167,125	1.99
Other	44,700	2.39	0	0		0	
Total Fixed Assets	360,000	19.29	1,432,909	1,721,478	20.49	1,900,625	22.63
<b>Current Assets</b>							
Stock	21,700	1.16	329,182	402,069	4.79	534,125	6.36
Debtors	102,700	5.50	532,273	590,542	7.03	700,250	8.34
Investments			70,182	196,847	2.34	432,625	5.15
Cash at Bank	35,500	1.90	54,636	116,158	1.38	92,375	1.10
Total Current Assets	159,900	8.57	986,273	1,305,616	15.54	1,759,375	20.94
<b>Total Assets</b>	<b>519,900</b>	<b>27.85</b>	<b>2,419,182</b>	<b>3,027,094</b>	<b>36.04</b>	<b>3,660,000</b>	<b>43.57</b>
<b>Current Liabilities</b>							
Trade Creditors	177,000	9.88	487,091	597,143	7.11	640,750	7.63
Borrowings	139,600	7.48	192,455	593,941	6.95	788,875	9.39
Current Tax Liabilities	1,700	0.09	4,273	1,182	0.01	750	0.01
Provisions	6,400	0.34	1,727	6,305	0.08	4,875	0.06
Other	1,200	0.06		0		0	
Total	325,900	17.46	685,545	1,188,571	14.15	1,435,250	17.09
<b>Non-Current Liabilities</b>							
Borrowings	10,000	0.54	678,727	710,148	8.45	974,125	11.60
Deferred Tax Liabilities	9,300	0.50	27,455	40,000	0.48	21,500	0.26
Other	146,000	7.82	297,182	271,429	3.23	236,500	2.82
Total	165,300	8.86	1,003,364	1,021,576	12.16	1,232,125	14.67
<b>Total Liabilities</b>	<b>491,200</b>	<b>26.31</b>	<b>1,688,909</b>	<b>2,210,148</b>	<b>26.31</b>	<b>2,667,375</b>	<b>31.75</b>
<b>Net Assets</b>	<b>28,700</b>	<b>1.54</b>	<b>730,273</b>	<b>816,946</b>	<b>9.73</b>	<b>992,625</b>	<b>11.82</b>
<b>Equity</b>							
Share and Member Capital	12,200	0.65	614,273	660,788	7.87	786,500	9.36
Share Premium	28,300	1.52					
Other Reserves	96,300	5.16	110,364	141,675	1.69	188,125	2.24
Retained Earnings	(108,100)	(5.79)					
Minority Interests			5,636	14,483	0.17	18,000	0.21
<b>Total Equity</b>	<b>28,700</b>	<b>1.54</b>	<b>730,273</b>	<b>816,946</b>	<b>9.73</b>	<b>992,625</b>	<b>11.82</b>

\*Figures relate to Arla Foods UK plc

Source: Company Reports

†Figures relate to Arla amba

### 6.2.3 Ratio Analysis Summary

*Table 6 – Arla Foods amba Ratio Analysis*

Year Ending		31 Dec 2006	31 Dec 2007	31 Dec 2008
Return on Sales	%	2.55	3.18	2.32
Sales/Tangible Assets	%	420.00	448.00	503.00
Stocks/Turnover Ratio	%	7.96	8.55	8.64
Stock/Turn Ratio	No.	20.09	18.98	9.78
Operational gearing	%	785.00	593.00	749.00
Asset utilisation ratio	%	566.00	576.00	623.00
Working Capital/Sales Ratio	x:1	0.09	0.08	0.10
Return on Capital	%	14.00	18.00	14.00
Debtor/Creditor Ratio	x:1	1.09	0.99	1.09
Current Ratio	x:1	1.44	1.10	1.23
Quick Ratio	x:1	0.96	0.76	0.85
Debt/Equity	%	112.00	144.00	168.00
Gearing (Gross Debt)	%	54.00	61.00	64.00
Gearing (Net Debt)	%	51.00	56.00	61.00
Interest Cover	x:1	2.84	2.70	1.33

*Source: Bidwells Analysis*

### 6.2.4 Financial Commentary

The basis of financial reporting changed following the year ending 30 September 2006 which was the last full year Arla Foods UK plc was listed on the London Stock Exchange. The September 2006 year end shows the performance of the sole UK operations, the December 2006 year end shows the performance of Arla Foods amba prior to full acquisition of Arla Foods UK plc. Comments below relate to the position of the combined Arla Foods amba business of which the UK is one part. It is not known how the UK operation is performing in its own right. As a result, this limits the opportunities for comparison of years and the ability to identify trends in the data.

- Operating profit was stable between the 2007 and 2008 year ends at around 1.75ppl and higher than the UK only 2006 results on pence per litre basis. Although turnover increased on a pence per litre basis from 56.00 to 73.61ppl, the effect was fully counteracted by rising cost of sales 45.43 to 60.82ppl and overheads increasing from 8.79 to 11.09ppl.

- The return on sales fell between 2007 and 2008 due to rising raw milk costs, weakening sterling and Swedish krona and higher finance costs.
- Finance charges increased significantly (near doubled from 0.66 to 1.28ppl) between the 2007 and 2008 year ends. This results in a significant depression in profit before tax and a poor interest cover level (falling from 2.70 to 1.33 times finance cost). However, they must be viewed in the context of expansion and investment in the business in this period (for example the investment in the Stourton Dairy increasing capacity to 600m litres), alongside a higher working capital demand due to rising milk values. Trends in performance are more relevant than isolated years and returns from the expansion/investment must be viewed in a longer term context.
- The business had a high gearing of 64% (gross debt) and a high debt/equity ratio (168%) with debt level increasing in the 2008 year end. This is likely to be due to recent investments and increasing stock cost requiring more working capital.
- The debtor/creditor ratio improved during the 2008 year from 0.99 to 1.09 and overall liquidity is strengthened and is satisfactory at a current ratio of 1.23.
- Stock turn is falling; this is likely to be due to increasing stock cost at year end rather than higher volumes being held on inventory. This means it is likely that their stock is continuing to move at a similar rate to earlier years.
- Interest cover level has fallen and is currently low. Due to the control the business has over member returns we would not expect this to fall further.
- Asset utilisation is rising (from 576% to 623%). This is probably due to higher dairy product values during 2008.
- The security of Arla Foods amba's debt finance is not known.
- Arla Foods amba has a positive cashflow from operating activities and a positive free cashflow. It is not known if Arla Foods UK is consistent with this. The fall in cash on the balance sheet between 2007 and 2008 is compensated by a rise in securities of £182m in the same period.

Under its co-operative structure, Arla have informed us that it is not allowed to run at a deficit.

### 6.3 Milk Supply and Contracts

Arla Foods UK currently procures approximately 80% of its milk supply via the Arla Foods Milk Partnership (AFMP). AFMP is a partnership between 1,400 British farmer members and Arla Foods UK in a 50:50 share.

The costs of running the AFMP are shared between the two parties equally. The role of AFMP is to facilitate the procurement of milk from dairy farmers in England, Scotland and Wales and to negotiate milk prices and other contractual matters.

AFMP is a democratically run organisation managed by a board with representation from regionally elected producer directors, a producer chairman and producer vice chairman, along with directors from Arla Foods UK. The Partnership is split into five regions; four regions have eight districts and the northwest region has nine. Each region has an elected representative that sits on the main board and a regional chairman. Each of the 41 districts has a district chairman and vice chairman who sit on one of the five regional committees.

Farmers who are members of AFMP own, via an investment company – Milk Partnership Limited (MPL) – a 3.2% share of Arla Foods UK. This stake was announced in May 2008 and was implemented without any need for capital payments from AFMP members. Prior to the delisting of Arla Foods UK plc from the London Stock Exchange in April 2007 when Arla Foods amba acquired all shares, the AFMP members held a 5.29% stake via MPL. When Arla Foods amba acquired the shares, the AFMP member stake was converted to loan notes rather than repaid. It is these loan notes which have now been reconverted to equity. Capital retentions are taken from members who have not reached the 1ppl investment level. Members are charged a 0.2ppl levy per year for five years in order to bring their investment up to 1ppl.

#### 6.3.1 Milk Supply Overview

Table 7 below gives details of Arla's milk supply base for the 2008/09 milk year.

*Table 7 – Arla Milk Supply Base (2008/09)*

Number of Suppliers	1,400
% of total GB suppliers	11%
Volume of raw milk supplied by contracted farmers (million litres)	1,550
% of total GB volume	14%
Volume of raw milk purchased from other dairies (million litres)	400

*Source: Bidwells Analysis*

#### 6.3.2 Milk Contracts Overview

Table 8 below details Arla Foods UK's milk contracts.

Table 8 – Arla Foods UK Milk Contracts (2008/09)

Contracts	AFMP	AFMP Non-Aligned (see 5.3.3)	AFMP Asda	AFMP Tesco
End Use	Liquid	Liquid	Liquid	Liquid
12-month average price (DairyCo standard litre)	25.64ppl	25.89ppl	26.64ppl	27.88ppl
Frequency of Review	As required			Every 6 months
Notice period of price change	None required			1 week
Catchment area	National			
Preferred milk production profile	Flat			
Notice Period – Producer	1 Year			
Are producers eligible for bonuses whilst under notice	Yes			
Notice Period – Purchaser	10 years			
Recruitment areas	Yorkshire and South of England			
Number of suppliers	420		550	490
Estimated raw milk volume/contract (m/litres) 2008/09 year	550		500	500 <sup>15</sup>
Cost of farmer investment	0.2ppl per annum (new members only)			
Return on farmer investment	n/a	n/a	n/a	n/a
Who decides milk price?	Arla Foods UK with AFMP			Tesco
What factors affect prices?	Returns from market and company performance			Cost of production
Is there a negotiation process	AFMP role			Every 6 months
Does any pricing follow a formula?	No. For suppliers on the non-aligned price there is a 0.3ppl Morrisons bonus		Arla prices plus 1ppl ASDA bonus	Promar Cost Tracker

Source: Arla / Bidwells Analysis

<sup>15</sup> This volume has since been rebalanced by Tesco to 50% of supply from 45%. The volume presented is for the 2008/09 milk year when Arla Foods UK held 45% of the Tesco account.

### 6.3.3 Contract Components

#### Base Average Daily Production (BADP)

Arla Foods UK contracts do not include a seasonality payment. Instead it operates a balancing charge based on a producer's Base Average Daily Production (BADP). The BADP is calculated on AFMP's lowest month of production (2010: October). Producers then pay a balancing charge on production in excess of their BADP. This deduction is reported to be the actual cost of balancing that Arla Foods UK incurs. Arla can balance milk at Northallerton and has supplied milk to Westbury Dairies.

#### Trough Incentive

The trough incentive was an initiative trialled by Arla Foods UK with the aim to boost production during the trough period of September to November when Arla Foods UK had to purchase milk on the spot market. This supplement was in the region of 5ppl for additional litres over the supplier's actual supply in the same months during the previous year. This initiative will not continue in 2010.

#### Non-Aligned Price

The non-aligned price is paid to those suppliers whose contracts are not specific to one retailer. In 2009, the average payment was 0.39ppl which is paid by Morrisons. Asda and Tesco have their own direct supply schemes which are outlined in table 8.

## 6.4 Processing

### 6.4.1 Summary of Processing Facilities in Operation

Table 9 below details Arla's current processing operations.

*Table 9 – Current Arla Processing Facilities*

Location	Capacity (million litres)	Products
Ashby	200-300	Liquid Milk processing and added value liquid products
Hatfield Peverel	200-300	Dairy processing fresh, organic and Cravendale
Lockerbie	100-200	Site shared with Milk Link. Processes liquid milk.
Nairn	25-50	Claymore Dairies site processing liquid milk including bottled production (subject to management buy-out)
Northallerton	100-200	Creamery processing cream and bulk powder products. Cream processing to close in 2010.
Oakthorpe	300-400	Arla's second biggest UK dairy processing fresh milk and cream
Settle	100-200	Creamery producing UHT milk and butter. This facility can provide a balancing role.
Stourton	600 when investment completes	Head Office, Distribution Centre and Major Dairy. Dairy constructed in 2004 and currently being expanded with a £70m investment. Produces liquid, Cravendale, cream, Crème Fraiche and will produce Cottage Cheese.

*Source: Bidwells Analysis*

### 6.4.2 Investment

Arla Foods UK is in the process of completing major investment to expand the Stourton dairy with a budget of £70m. This investment will add 100m litres of capacity per annum bringing the total to 600m. This includes moving the creamery operations at Northallerton to Stourton, production of cottage cheese, and will create 100 jobs.

Arla Foods UK also announced, in November 2009, its intention to construct a 1bn litre dairy on the outskirts of London to be in operation by 2012. This will be the largest liquid dairy facility in the world in full production. It is not yet known precisely where this will be located; who it will supply and what rationalisation may take place of existing Arla facilities. However, it has the potential to add significant capacity to the industry and as a consequence will be a very important development. Arla Foods UK believes that it is optimal to have a processing facility near to market rather than to the milk field. This minimises transport costs which are higher for packaged milk than bulk.

#### 6.4.3 Rationalisation

Arla Foods UK have already rationalised facilities in recent years including the closure of its Manchester dairy and the Sheffield Park/Appleby distribution facilities. The Northallerton creamery is due to cease cream production during 2010 which will move to Stourton, although milk powder production will continue.

#### 6.4.4 Claymore Dairies

Arla Foods UK announced on the 5 January 2010 that it and North Milk Co-operative will sell Claymore Dairies to a management buy-out team with effect from 1 February 2010. To serve retail customers in the Highlands, Arla will move some volume to Lockerbie and open a distribution centre in Dundee. Subject to a consultation 65 staff at Claymore will be made redundant. North Milk Co-operative will supply milk to both Arla Foods and Claymore Dairies.

### 6.5 **Brands and Markets**

#### 6.5.1 Product Portfolio

Arla sells a number of branded products in the UK, many of these are imported from their Danish and Swedish operations but some are produced in the UK. Table 10 below shows Arla's product portfolio as of March 2009. The total raw milk volumes cannot be directly compared to total deliveries as the volumes of milk going into the production of butter, spreads and cream, but rather the litres of milk required to obtain the necessary for production.

Table 10 – Arla Product Portfolio (2008/09)

Segment	Brands	Made from GB milk	Estimated share of Raw Milk Volume	Market Segment	% of Market Segment Volume	Change in market share (volume) 07/08-08/09	% of Market Segment Value	Change in market share (value) 07/08-08/09
Liquid	Cravendale	Yes	12%	Pasteurised	>4%	+<1%	6%	+<1%
	Lactofree	No	<1%					
Cheese	Castello	No	(n/a)	Total cheese	<1%	+<1%	<1%	n.c.
	Rosenborg	No	(n/a)					
	Apetina	No	(n/a)					
	Discover	No	(n/a)					
	Lactofree	No	<1%					
Butter & Spreads	Lurpak*	No	(n/a)	Yellow fats	>14%	-1%	23%	-3%
	Anchor*	No	(n/a)					
	Yorkshire Butter	Yes	<1%					
Cream	Anchor	No	(n/a)	Cream	no available data			
Yogurts & Desserts	Lactofree	No		Yogurts	no available data			

\*not produced in the UK

Source: Kantar Data, Arla, Bidwells Analysis

## 6.5.2 Core Brands

Arla Foods amba have three core brands, which are sold in the UK, Cravendale, Anchor and Lurpak. All of these sit within the top 100 UK grocery brands but only Cravendale is produced from GB milk.

### Cravendale

The liquid milk Cravendale brand was launched in 1998. The milk is filtered prior to pasteurisation in order to remove bacteria from the milk. This enables the milk to have a longer life of up to 25 days in the fridge if unopened. The brand currently uses over 165 million litres of milk with a brand value of £134m according to Arla figures. Sales broke the £100m barrier in January 2008 and are therefore showing substantial growth in its market segment a short period of time.

### Anchor

Anchor is a butter brand produced in New Zealand and packed by Arla in Denmark. Returns from this product do not affect the UK milk price.

### Lurpak

Lurpak is a butter brand produced in Denmark by Arla Foods a.m.b.a. Returns from this product do not affect the UK milk price.

#### 6.5.3 Liquid Milk (non-branded)

Arla Foods UK supply a major part of the UK liquid market. Arla Foods UK estimates its share among the top seven retailers is 44% of the liquid and cream market. Table 11 below summarises the key customers. The volumes of milk supplied to each outlet were not disclosed by Arla Foods UK, but estimations have been made from Kantar data.

*Table 11 – Arla Key Customers (2008/09)*

<b>Outlet</b>	<b>Company</b>	<b>Market Share (approximate)</b>	<b>Estimated Share of Raw Milk Volume</b>	<b>% of Market Segment</b>
Multiple Retailers	Asda	100%	35%	12%
	Tesco <sup>16</sup>	45%	30%	11%
	Morrisons	50%	13%	5%
Food Service	McDonalds	n/a	n/a	n/a

*Source: Arla Foods, Kantar, Bidwells Analysis*

#### 6.5.4 New Markets

Arla Foods UK is stated to account for 60% of the GB Crème Fraiche market which was mainly acquired from French competition. It is understood the total Crème Fraiche market is worth £35m. Involvement in the market allows Arla to add value to the cream derived from their liquid milk processing.

The new investment at Stourton will enable Arla to enter the cottage cheese market. This will utilise additional milk, with the total market currently circa 15,000t of cheese worth £45m.

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<sup>16</sup> Relates to March 2009; the volume has since been rebalanced to 50% from 45%.

## 6.6 Governance and Management Structure

Arla Foods UK has a management board which reports to the executive board of Arla Foods amba in Denmark. The executive board of Arla Foods amba reports in turn to a board of directors which includes Swedish and Danish farmer members. The UK management board is headed by Peter Lauritzen and includes Hanne Sondergaard who is deputy chief executive of Arla Foods UK and has responsibility for milk sourcing.

The Arla Foods Milk Partnership is a joint venture (JV) between AFMP farmer members and Arla Foods UK. The management board of AFMP includes Arla representatives, a chairman, vice chairman and five producer directors, representing the North West, North East, Midlands, South West and South East. Regional committees elect the producer directors.

## 6.7 Business Strategy

### 6.7.1 Long term aims and objectives

The business Vision Statement is to be "the UK's No.1 dairy company – valued by customers loved by consumers driven by our people delivering for our farmers". They have ambitious plans for the development of their operations. Specific strategic aims currently include:

- To grow into a £9bn turnover business by 2013 with the UK accounting for one third of this. This compares with the actual turnover for the year ending 31 December 2008 of just over £6 billion.
- To grow into a broader and bigger business, consolidating their position in the UK and investing accordingly.
- To improve performance in standard milk – invest in low cost production structures and achieve continuous cost improvement and waste reduction.
- To maximise growth of core value added products including Cravendale, Anchor and Lurpak.
- To build new platforms for growth and profitability such as Crème Fraiche and Cottage Cheese.

### 6.7.2 Expansion

Some key elements of their expansion plans are noted below:

- The construction of a 1bn litre dairy on the outskirts of London, representing 48% of their existing milk pool. It is not yet known what rationalisation will take place of existing facilities as a result of this major investment and what true level of additional capacity will result. However, the impact on the UK milk market as a whole will be very significant.
- Further investment to reduce their cost base enabling the business to compete more aggressively, particularly in the liquid market.

- Arla anticipates playing a role in future industry consolidation.

### 6.7.3 Sustainability

The commitment to sustainability and minimising waste is a strong one. Some key areas currently getting emphasis are:

- 
- The launch of 'Lean'<sup>17</sup> in the UK with a pilot at Stourton in January 2009. This has involved the training of over 90 managers and 190 operators to date.
- Investment in new facilities (Stourton and planned London Facility).

### 6.8 Summary

- Arla's plans indicate increasing demand for milk. Their current markets seem secure which in turn should create security of milk demand.
- Their business plans focus on growth, developing existing markets and seeking to broaden their range. Milk purchased by Arla will have many uses and undoubtedly Arla will continue to seek supply from well invested dairy units who can deliver the quality and quantities required.
- Milk price is set by them relating to market conditions and not through a formula (except Tesco contracts). Arla can demonstrate good performance against their strategy to date with the Arla Foods amba business in good financial condition.
- The new substantial investment proposed for London opens up the opportunity for significant expansion although it will impact significantly on the market place and carries risk if the returns are not realised.

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<sup>17</sup> Lean is a production practice which considers any use of resources for reasons other than value creation to the customer to be a waste.

## 7 Dairy Crest

### 7.1 Overview

Dairy Crest was established as the processing operation of the Milk Marketing Board (MMB). In 1970, the MMB processing operation established the Country Life butter brand (set up by the English Butter Marketing Company Ltd). Then, in 1981, the processing operations were made into a separate division called Dairy Crest. Dairy Crest was the buyer of last resort which purchased all surplus milk. It was not until 1987 that Dairy Crest became a limited company and then, in 1994, when deregulation of the milk market removed its status as the buyer of last resort, the company was able to purchase only the milk required for its commercial operation. In August 1996, the company floated on the London Stock Exchange with the launch of Dairy Crest Group plc. Today Dairy Crest has become a leading dairy processing public limited company.

During its evolution, Dairy Crest has made notable acquisitions including Mendip Foods Limited in 1995 in which the company acquired the market leading Cathedral City cheese brand. In 1991, the company formed a joint-venture with Yoplait SAS which bought with it the exclusive distribution rights of Yoplait brands in the UK. In 2000, it acquired the dairy and cheese business of Unigate plc (now Uniq plc). At the time this made Dairy Crest the largest UK dairy company. The St Ivel spreads business was acquired in 2002 and St Hubert operations in France in 2007.

The business head office is in Esher, Surrey and it has 14 processing sites of which one is in France and one in the Republic of Ireland. Of the mainland sites, six are liquid processing, including one which also produces skimmed milk powder, three cheese, two spreads and one specialist cream and butter.

The business handled 2.1bn litres of milk in the financial year ending 31 March 2009, of which 70% was from 1,400 farmers directly contracted to Dairy Crest. The business supplies liquid milk to retailers, middle ground and doorstep customers. Alongside retail, the business operates some notable brands including Clover, Country Life, Cathedral City, Davidstow, Friij and Utterly Butterly.

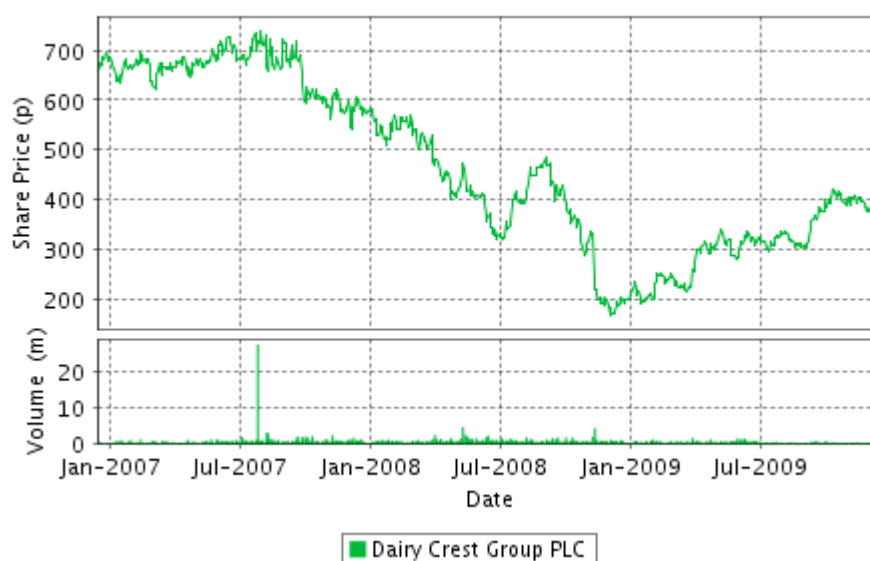
The current ownership is summarised in Table 12 overleaf, and the last three years share price in Figure 8.

Table 12 – Dairy Crest Shareholders

Analysis of ordinary shareholders as at 15 May 2009	Holder Numbers	%	Shares	%
Individuals and other holders	20,387	94.69%	34,808,146	26.12%
Insurance companies, Pension funds, banks, nominees and limited companies	1,143	5.31%	98,455,393	73.88%
<b>Total</b>	<b>21,530</b>	<b>100%</b>	<b>133,263,539</b>	<b>100%</b>
Size of holdings				
Up to 5,000 shares	19,866	92.27	26,439,025	19.84
5,001 – 20,000 shares	1,403	6.52	10,675,673	8.01
20,001 – 100,000 shares	144	0.67	6,806,496	5.11
Over 100,000 shares	117	0.54	89,342,345	67.04
<b>Total</b>	<b>21,530</b>	<b>100.00</b>	<b>133,263,539</b>	<b>100.00</b>

Source: Dairy Crest

Figure 8 – Dairy Crest Share Price and Trading Volumes 2007-2009



Source: Dairy Crest

## 7.2 Financial

Summary financial statements are presented in the tables overleaf for the last three full financial years. Dairy Crest's financial statements are the consolidated results of the plc, and include the results of the subsidiaries St Hubert (France) and Wexford Creamery (Ireland). The pence per litre figures presented above are based on its UK milk pool for each relevant year. Given that the financial statements include Dairy Crest's

operations in Ireland and France, while the ppl figures are calculated using its UK milk pool, figures will be inflated.

#### 7.2.1 Summary Profit and Loss Account

Table 13 below shows the profit and loss for the last three years. This is also expressed in terms of pence per litre (ppl).

*Table 13 – Dairy Crest Summary Profit and Loss Account*

Year End	31 March 2007			31 March 2008			31 March 2009		
	£ (000s)	ppl	%	£ (000s)	ppl	%	£ (000s)	ppl	%
Turnover	1,316,100	57.93	100.0	1,583,000	67.94	100.0	1,651,900	75.57	100.0
Cost of Sales	898,300	38.34	68.3	1,113,600	47.90	70.3	1,182,200	54.08	71.6
<b>Gross Profit</b>	<b>417,800</b>	<b>17.83</b>	<b>31.7</b>	<b>469,400</b>	<b>20.19</b>	<b>29.7</b>	<b>469,700</b>	<b>21.49</b>	<b>28.4</b>
Admin/Distribution Charges	340,500	14.53	25.9	367,200	15.79	23.2	377,600	17.27	22.8
<b>Operating Profit (Loss) before finance and tax</b>	<b>77,300</b>	<b>3.30</b>	<b>5.9</b>	<b>102,200</b>	<b>4.40</b>	<b>6.5</b>	<b>92,100</b>	<b>17.27</b>	<b>5.6</b>
Finance Costs	19,200	0.82	1.5	26,200	1.12	1.6	29,500	1.35	1.8
Other income and exceptional costs	6,500	0.28	0.5	(10,000)	(0.43)	(0.6)			
<b>Profit (loss) on Ordinary activities before taxation</b>	<b>64,600</b>	<b>2.76</b>	<b>4.9</b>	<b>66,000</b>	<b>2.83</b>	<b>4.2</b>	<b>103,200</b>	<b>4.72</b>	<b>6.2</b>
Taxation on Ordinary activities	11,300	0.48	0.9	12,500	0.54	0.8	28,900	1.32	1.7
<b>Profit (Loss) on Ordinary activities after taxation</b>	<b>53,300</b>	<b>2.27</b>	<b>4.0</b>	<b>53,500</b>	<b>2.30</b>	<b>3.4</b>	<b>74,300</b>	<b>3.40</b>	<b>4.5</b>

*Source: Company Reports*

## 7.2.2 Summary Balance Sheet

*Table 14 – Dairy Crest Summary Balance Sheet*

Year End	31 March 2007		31 March 2008		31 March 2009	
	£ (000s)	ppl	£ (000s)	ppl	£ (000s)	ppl
<b>Fixed Assets</b>						
Intangible Assets	151,500	6.67	171,400	7.36	199,400	9.12
Tangible Assets	329,400	14.50	327,300	14.05	292,100	13.36
Goodwill	283,200	12.47	313,800	13.47	342,700	15.68
Investments	3,700	0.16	5,300	0.23	2,900	0.13
Other	1,900	0.08	33,800	1.45	39,900	1.83
Total Fixed Assets	769,700	33.88	851,600	36.55	877,000	40.12
<b>Current Assets</b>						
Stock	147,500	6.49	159,500	6.85	197,800	9.05
Debtors	158,000	6.95	186,100	7.99	137,800	6.30
Investments	300	0.01	1,100	0.05	1,300	0.06
Cash at Bank	24,900	1.10	40,300	1.73	107,500	4.92
Total Current Assets	330,700	14.56	387,000	16.61	444,400	20.33
<b>Total Assets</b>	<b>1,100,400</b>	<b>48.44</b>	<b>1,238,600</b>	<b>53.16</b>	<b>1,321,400</b>	<b>60.45</b>
<b>Current Liabilities</b>						
Trade Creditors	189,900	8.36	224,800	9.65	229,400	10.49
Borrowings	122,000	5.37	29,300	1.26	2,400	0.11
Current Tax Liabilities	4,500	0.20	1,500	0.06	1,200	0.05
Provisions	700	0.03	13,300	0.57	10,800	0.49
Other						
Total	317,100	13.96	268,900	11.54	243,800	11.15
<b>Non-Current Liabilities</b>						
Borrowings	347,800	15.31	474,400	20.36	557,500	25.50
Deferred Tax Liabilities	82,400	3.63	96,300	4.13	91,200	4.17
Other	10,000	0.44	11,300	0.48	71,900	3.29
Total	440,200	19.38	582,000	24.98	720,600	32.97
<b>Total Liabilities</b>	<b>757,300</b>	<b>33.33</b>	<b>850,900</b>	<b>36.52</b>	<b>964,400</b>	<b>44.12</b>
<b>Net Assets</b>	<b>343,100</b>	<b>15.10</b>	<b>387,700</b>	<b>16.64</b>	<b>357,000</b>	<b>16.33</b>
<b>Equity</b>						
Share and Member Capital	33,100	1.46	33,300	1.43	33,300	1.52
Share Premium	66,700	2.94	70,200	3.01	70,700	3.23
Other Reserves	59,200	2.61	63,300	2.72	75,500	3.45
Retained Earnings	180,100	7.93	215,800	9.26	172,800	7.91
Minority Interests	4,000	0.18	5,100	0.22	4,700	0.22
<b>Total Equity</b>	<b>343,100</b>	<b>15.10</b>	<b>387,700</b>	<b>16.64</b>	<b>357,000</b>	<b>16.33</b>

*Source: Company Reports*

### 7.2.3 Ratio Analysis Summary

*Table 15 – Dairy Crest Ratio Analysis*

Year Ending		31 March 2007	31 March 2008	31 March 2009
Return on Sales	%	5.87	6.46	5.58
Sales/Tangible Assets	%	399.54	483.65	565.53
Stocks/Turnover Ratio	%	11.21	10.08	11.97
Stock/Turn Ratio	No.	5.28	7.25	6.61
Operational gearing	%	540.49	459.30	509.99
Asset utilisation ratio	%	383.59	408.31	462.72
Working Capital/Sales Ratio	x:1	0.09	0.08	0.06
Return on Capital	%	22.53	26.36	25.80
Debtor/Creditor Ratio	x:1	0.83	0.83	0.60
Current Ratio	x:1	1.04	1.44	1.82
Quick Ratio	x:1	0.58	0.85	1.01
Debt/Equity	%	129.67	119.53	126.72
Gearing (Gross debt)	%	57.79	56.51	61.06
Gearing (Net debt)	%	54.73	51.99	49.34
Interest Cover	x:1	4.03	3.90	3.12

*Source: Bidwells Analysis*

### 7.2.4 Segment Analysis

Segment analysis is presented in Table 16 below. This is published by Dairy Crest as part of its reporting to the London Stock Exchange. It shows the split of revenue and profit between Dairies, Cheese and Spreads. Six month figures are provided to aid comparison between periods with the 12 month totals for the year ending 31 March 2009.

Table 16 – Dairy Crest Segment Analysis

	Dairies		Cheese		Spreads	
	6 months 30 Sept 2008	6 months to 30 Sept 2009	6 months 30 Sept 2008	6 months to 30 Sept 2009	6 months 30 Sept 2008	6 months to 30 Sept 2009
<b>External Revenue (£m)</b>	540.4	528.7	127.1	131.8	135.1	137.9
<b>Segment Profit (£m)</b>	2.7	14.3	18.4	7.9	25.3	27.0
<b>Segment Margin</b>	0.49%	2.70%	14.48%	5.99%	18.73%	19.58%
<b>Segment Assets</b>	391.5	364.2	257.6	242.0	483.2	521.4
<b>Segment Return on Assets %</b>	0.69%	3.93%	7.14%	3.26%	5.24%	5.18%

Source: Company Reports and Bidwells Analysis

#### 7.2.5 Financial Commentary

- Turnover has grown by 25.5% in absolute terms and 30.5% on a per litre basis between the 2007 and 2009 year ends to 75.57ppl.
- Cost of sales has risen with turnover, over the same period, by 41.05% in pence per litre and 31.60% in absolute terms to 54.98ppl.
- The gross profit between 2007 and 2009 year ends has increased but at a slower rate than turnover due to rising cost of sales. As a percentage of turnover, gross profit levels are approximately 29% in 2008 and 2009 compared with approximately 31% in 2006/7. Return on sales fell despite increases in the profit per litre due to lower volumes.
- Investment income increased significantly in the 2009 year end, this was due to a circa £50m profit on sale of the shares in Yoplait Dairy Crest, accounting for approximately half the profit before tax in the year.
- Tax charges accelerated in the 2009 year end to 1.32ppl from 0.48ppl due to a one off change with the withdrawal of the Industrial Buildings Allowance.
- Tangible assets include freehold property at historic cost. This may underestimate the true value of tangible assets held by Dairy Crest.
- Stock levels increased during the period 2008/9 due to rising cost of cheese production; this is likely to fall as expensive stocks are sold.
- Liquidity is strong and improving with a current ratio of 1.82 at 31 March 2009 compared with 1.04 at 31 March 2007.

- Borrowings on the balance sheet are shown before offsetting cash at bank. Borrowings have increased over the three years to £557.5m. Half year results to 30 September 2009 (not shown above) show a reduction in debt with strong cash generation. Short term borrowings have fallen.
- Asset utilisation levels are increasing from 384% in year ending 31 March 2007 to 463% in year ending 31 March 2009 due to rising per litre product values.
- Debt/Equity and gearing increased over the three years. At 31 March 2009 the gearing (based on net assets) stood at 49.34%
- Interest Cover ratio is satisfactory at 3.12% but declining due to increasing cost of debt and slight reductions in profit.
- Segmental analysis shows a variable performance between markets. The dairies division (liquid milk) accounted for 67% of the turnover in the six months to 30 September 2008 but only 5.8% of profit. This situation has improved in the six months to 30 September 2009 where dairies accounted for 66.22% of turnover but 29.07% of profit. Profits in the dairy division were adversely affected by the difficulty in passing on higher milk costs to doorstep customers and a sharp fall in ingredients realisations. Returns from cheese division have weakened considerably between the two periods due to higher milk prices but this division continues to produce stronger margins than the dairies division. The spreads division continues to produce the strongest margins with a stable return on assets.
- The added value cheese and spreads divisions are the key sources of profit for the Dairy Crest business, but dairies are equally important in maintaining the benefits of being a broadly based business.
- A significant proportion of their balance sheet capital is in Goodwill<sup>18</sup> (£343m) and Intangible Assets (£199m). This includes the brands acquired in France. Goodwill is tested for impairment each year meaning it is evaluated to ensure that it is a fair representation of the asset value.
- Net cash generation (free cash) in the year to March 2009 was £67.9m; this was boosted by the Yoplait Dairy Crest share sale worth £59.9m.
- Of the £553.4m of debt facilities available to Dairy Crest, £100 million are due for renewal in November 2011; all other facilities remain in place until at least 2013.

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<sup>18</sup> Goodwill is an accounting term used to reflect the portion of a company's book value that is not attributable to its tangible assets and liabilities.

Results for the first half of the current financial year (to 30 September 2009) show a slight reduction in turnover compared with the same time last year but a 20% increase in profit before tax which is mainly related to improvements in the dairies division. These improvements relate to improved efficiency, lower milk costs and lower balancing costs. Half year net debt fell by 22% to £380.4m due to strong cash generation. This is the lowest half year debt level for three years since the acquisition of St Hubert.

### 7.3 Milk Supply and Contracts

Milk supply to Dairy Crest is split 70% from directly contracted farmers, who form part of Dairy Crest Direct (DCD), and 30% from milk brokers including First Milk. Dairy Crest Direct represents farmer members to secure both best milk price and contract terms in discussion with Dairy Crest. It has further roles to work with stakeholders to develop the dairy industry and represent members more widely.

#### 7.3.1 Milk Supply Overview

Table 17 below gives details of Dairy Crest's milk supply base for the 2008/09 milk year.

*Table 17 – Dairy Crest Milk Supply Base (2008/09)*

Number of Suppliers	1,400
% of total GB suppliers	11%
Volume of raw milk supplied by farmers (million litres)	1,500
% of total GB volume	14%
Volume of raw milk purchased from other dairies (million litres)	600

*Source: Dairy Crest, Bidwells Analysis*

### 7.3.2 Milk Contracts Overview

*Table 18 – Dairy Crest Milk Contracts (2008/09)*

Contracts	Davidstow	Liquid	Sainsbury's	M&S	Waitrose
End Use	Cheese	Liquid	Liquid	Liquid	Liquid
12 month average price (DairyCo standard litre)	Seasonal – 26.29  Level – 26.37	Seasonal – 25.63  Level – 25.72	Seasonal – 27.17  Level – 27.25	Variable – 28.39  Level – 28.47	28.29
Frequency of Review	Monthly			6 monthly	Monthly
Notice period of price change	Monthly				
Catchment area	Cornwall & Devon	England & Wales			
Preferred milk production profile	Flat				
Notice Period – Producer	12 months				
Are producers eligible for bonuses whilst under notice	Yes				
Notice Period – Purchaser	12 months				
Recruitment areas	Cornwall & Devon	England & Wales			
Number of suppliers	400	700	200	30	60
Estimated raw milk volume/contract (m/litres)	400	750	210	70	100
Cost of farmer investment	Not applicable				
Return on farmer investment	Not applicable				
Benefits to join	Independent, White Gold support package for farm assurance and Agri assist				
Who decides milk price?	Dairy Crest/DCD			Agreed Formula	Dairy Crest/Waitrose Dairy farmers
What factors affect prices?	Returns from market/ production economics			Basket of non-aligned liquid contracts, DairyCo feed and fertiliser price data	Returns from market/ production economics
Is there a negotiation process	Yes			Yes	Yes
Price formula	No			Yes	No

*Source: Dairy Crest / Bidwells Analysis*

### 7.3.3 New contracts

On 2 December 2009 Dairy Crest announced changes to existing contracts and launched two new contracts. Changes will include shorter notice periods for termination of contract, notice periods of price changes and bonus and profile payment structures. The changes will be implemented from 1 October 2010.

The new contracts are the milk&more and Farm Business Contract. The milk&more contract is aligned to Dairy Crest's doorstep initiative (see paragraph 7.5.4) and offers a two year contract with a fixed base price. The Farm Business Contract will offer larger suppliers a simpler contract and pricing structure and allow a sharing in the benefits of efficiency from large scale transport, sourcing and level supply.

In addition to contract changes, the Direct Supply Managers' (who represent Dairy Crest to suppliers) role will adapt to providing a greater level of business support and a joint venture between Dairy Crest and Dairy Crest Direct called Agri assist has been launched. Agri assist will work independently of the current Dairy Crest/Dairy Crest Direct relationship and pursue supply chain initiatives including a carbon measurement tool.

### 7.3.4 Supply Groups

Dairy Crest were the first to establish direct retailer supply groups with the formation of both the Marks & Spencer and Waitrose Select groups. These groups sought to pay premium prices to the suppliers of their milk. More recently, the Sainsbury's Dairy Development Group (SDDG) has been established. This concept has been followed by Robert Wiseman Dairies and Arla Foods UK. These groups can confer major advantages to members but are not accessible to all.

Typically, Dairy Crest select the members of these groups on the basis of the quality of milk a supplier provides, their location and their level of commercial awareness. Suppliers who have modern, well invested facilities producing high quality milk are more likely to become members of these groups.

### 7.3.5 Milk Balancing

Dairy Crest has the ability to balance its own milk supply through its processing facilities. This includes skimmed milk powder production via its ingredients business. This is not a profit centre of the business but is considered as an integral business function by Dairy Crest.

## 7.4 Processing

### 7.4.1 Summary of Processing Facilities in Operation

Table 19 below summarises the current processing facilities.

*Table 19 – Dairy Crest Current Processing Facilities*

<b>Location</b>	<b>Capacity</b> (million litres)	<b>Products</b>
Chadwell Heath	400-500	Liquid processing facility, East London
Chard	10-25	Specialist butter, cream and retail powder processing.
Crudgington		Spreads facility in Shropshire. Produces Clover, Willow and Country Life brands
Davidstow	400-500	Dairy Crest's UK Cheddar production site, manufacturing Cathedral City and Davidstow cheese
Fenstanton	200-300	Liquid processing facility, Cambridgeshire
Foston	200-300	Liquid processing facility, Derbyshire
Frome	Packing only	Cheese packing facility.
Hanworth	100-200	Former Unigate facility producing fresh and flavoured milk and fruit juice for household division
Kirkby		Spreads facility in Liverpool. Produces Utterly Butterly and Vitalite brands.
Liverpool	100-200	Fresh milk for household division facility
Nuneaton	Packing & distribution	National Distribution centre and cheese packing facility
Sevenside	500-600	Processing facility producing liquid milk, flavoured milk, butter, and branded milk Friji. The facility can produce powders and handle organic and regional milks.
Wexford, ROI	100-200	Joint venture with Wexford Milk Producers. Facility produces Irish Cheddar.
Ludres, France		French spreads facility.

#### 7.4.2 Investment

Dairy Crest have invested an average of some £40m per annum for the last 10 years on fixed assets and has also made some major acquisitions in the period. Notable investments and acquisitions in the period have included:

- i 2000 – Acquisition of Dairy and Cheese operation of Unigate plc.
- ii 2000/01 – Major investment in Severnside and Chadwell Heath dairies.
- iii 2002 – Acquisition of the St Ivel spreads operation including Kirkby site.
- iv 2004 – Completion of the first phase of a £50m upgrade at Davidstow.
- v 2004 – Acquisition of minority shares in the English Butter Company Ltd conferring full ownership of the Country Life brand on Dairy Crest.

- vi 2005 – Acquisition of the Starcross Foods business including Foston dairy and the dairy business and assets of the Midlands Co-operative society.
- vii 2005 – Acquisition of the London Foodservice business of Arla Foods UK plc.
- viii 2006 – Acquisition of Arla's Doorstep and Foodservice business including its Liverpool and Nottingham dairies.
- ix 2007 – Acquisition of St Hubert operations in France.
- x 2009 – New cheese packing operation at Nuneaton.

Dairy Crest indicates that it is likely to continue investment at a rate of around £40m per annum. The cheese operations are well invested and £75m has been allocated over the three years 2010-2012 to improve the operating efficiencies and infrastructure of its liquid dairy plants.

#### 7.4.3 Rationalisation

Dairy Crest have also rationalised facilities and operations over the period including:

- i October 2006 – Sale of retailer brand cheese production to First Milk.
- ii August 2008 – Sale of Hartington creamery which produces Stilton and speciality cheeses to Long Clawson Dairy.
- iii March 2009 – Sale of 49% stake in Yoplait Dairy Crest back to Yoplait SAS.

In total, Dairy Crest have closed or disposed of 15 factories since 2001. Closures include dairies at Birmingham, Totnes and Nottingham.

Dairy Crest has closed its glass bottling operation at Fenstanton in line with its cost control strategy.

### 7.5 Marketing

#### 7.5.1 Brand Portfolio

Table 20 below shows Dairy Crest's product portfolio by market segment as of March 2009. Approximately 81% of its total milk volume goes to the liquid milk market, including own-label, branded, flavoured and doorstep sales. The remaining 19% of the milk pool is allocated to cheese production. The cream recovered from skimming the raw milk is used for producing the butter and spreads.

Table 20 – Dairy Crest Product Portfolio 2008/09

Segment	Brand	Made from GB milk	Estimated Share of Raw Milk Volume	Market Segment	% of Market Segment Volume	Change in market share (volume) 07/08-08/09	% of Market Segment Value	Change in market share (value) 07/08-08/09
Liquid	Country Life Milk	Yes	40% <sup>†</sup>	Pasteurised Milk	Product launched in 2009; no data available			
	Frijj	Yes	1%	Flavoured Milk	50%	+7%	50%	+5%
Cheese	Cathedral City	Yes	19%	Total Cheddar	15%	-1%	17%	-1%
	Davidstow	Yes						
	Wexford Cheddar*	No						
Butter & Spreads	Clover	Yes	n/a	Butters & Spreads	23%	+5%	20%	+4%
	Country Life	Yes						
	Utterly Butterly	Yes						
	Willow	Yes						

\*produced in Ireland

Source: Dairy Crest, Kantar Data, Bidwells Analysis

<sup>†</sup>includes both conventional and organic milk not sold as own-label but excludes doorstep

Note: as butters and spreads are produced from the cream skimmed from raw milk, shares of raw milk used to produce the butter are not applicable.

### 7.5.2 Core Brands

The core brands are as follows:

#### Cathedral City

Cathedral City cheese is produced at the Davidstow Creamery in Cornwall. It is the market leading cheese brand with a sales value in 2009 of £200m<sup>19</sup>. To maintain the position of the brand in the UK market, Dairy Crest has innovated by developing Cathedra City Lighter and increased its expenditure on TV advertising. In response to the recession Dairy Crest has also increased the number of promotions.

<sup>19</sup>Source; Dairy Crest.

### Clover

Clover is a vegetable oil and buttermilk spread with a spreads market share of 38% and a retail value of £81m<sup>20</sup>.

### Country Life

Country Life is the only major UK butter brand produced in the UK and currently has a retail value of £64m<sup>21</sup>. It is supported by an advertising campaign highlighting its British Provenance and carries the Red Tractor Logo. It is also sold as a branded milk and is the only major branded organic liquid milk. Country Life Organic milk was launched in 2006 while the branded conventional milk was launched during 2009.

### Davidstow

Davidstow cheese is produced at the Davidstow Creamery alongside Cathedral City. It is sold under own retailer brand in Tesco, Sainsbury, Morrisons, Asda and Waitrose.

### Frijj

Frijj is the UK's leading fresh milkshake. It has grown strongly in recent years and now has annual retail sales of £44m<sup>22</sup>.

#### 7.5.3 Liquid Milk (non-branded)

Dairy Crest supply a major part of the UK liquid market. Key customers are set out in Table 21 below.

*Table 21 – Dairy Crest Key Liquid Customers (2008/09)*

<b>Outlet</b>	<b>Company</b>	<b>Market Share of Supply (Approximate)</b>	<b>Estimated % of Raw Milk Pool</b>	<b>Market Share (pasteurised milk)</b>
Multiple Retailers	Waitrose	100%	5%	2%
	M&S	100%	2%	1%
	Sainsbury	50%	12%	5%
	Morrison	50%	10%	5%
	Co-operative Group <sup>23</sup>	13%	2%	1%

*Source: Dairy Crest, Kantar, Bidwells Analysis*

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<sup>20</sup> Source: Dairy Crest

<sup>21</sup> Source: Dairy Crest

<sup>22</sup> Source: Dairy Crest

<sup>23</sup> Figures are effective 31 March 09 and do not include the additional 29m litres supplied to the Co-operative by DC after the collapse of DFoB.

Market share figures are based on information supplied by Dairy Crest. The volumes of milk supplied to each outlet are not disclosed by Dairy Crest and are based on Bidwells' calculations but have grown by about 10% in volume over the past year according to Dairy Crest's 2009 Interim Results.

Dairy Crest is active in the middle ground milk market which comprises schools, hospitals, small retailers and food service sectors. It does not break down the total milk sales between multiple retailers and middle-ground but the total volume supplied to these two markets is estimated at 1.4bn litres.

#### 7.5.4 Doorstep

Dairy Crest is the major player in the doorstep milk market. It supplies 300m litres of milk to 1.3m doorstep customers although this is a declining market. According to Dairy Crest's own figures, the annual decline in doorstep sales is now 8.5%, down from 10% in 2008. Dairy Crest has 2,750 milk rounds nationally operating out of 130 depots. In order to slow the decline in this market and seek to rebuild it, Dairy Crest have launched milk&more which is an internet based service enabling users to purchase a wider range of categories for supply by their milkman. Weekly spend by customers using milk&more was £6.20 in late 2009, comparing favourably with the £4.50 target. Dairy Crest has a target of 250,000 registered customers by 31 March 2010 against an existing number of 180,000<sup>24</sup>. The range of products available through milk&more includes dairy, vegetables, bakery products and household products.

#### 7.5.5 Ingredients

Dairy Crest supplies a range of dairy ingredients to the domestic and export markets. This is not a separate profit centre within the Dairy Crest group but is an integral part of operations enabling the business to extract value from the by-products of its major market production. Products include Skimmed Milk Powder, Bulk Cream, Buttermilk powder and whey products. Dairy Crest does not publish production volumes for these products, but its stated aim is to minimise milk processed into commodity dairy ingredients.

#### 7.5.6 Market Development

In response to the downturn in the economy, Dairy Crest has promoted its leading brands heavily in the last 12 months to help retain market position. Cathedral City promotions have led to 73% of volumes being sold on discount with 52% of Clover and 60% of Country Life brands sold on discount. This is above the average volume of promotional sales in these retail categories. According to Dairy Crest, growth of low fat brand variants is running at 41% in the 6 months to 30 Sept 2009, this is however from a low base.

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<sup>24</sup> As of January 2010.

Dairy Crest innovates strongly, focussing on lower-fat variants of its leading brands and environmentally-friendly packaging,

#### 7.5.7 Commodity Exposure

With the major cheese and spread brands held by Dairy Crest and the substantial processing facilities that produce them providing an opportunity for added value milk balancing, the Dairy Crest business should be less directly exposed to commodity markets than others in the sector. This seeks to provide more stability in the milk price. The ingredients operation reduces the commodity exposure further by enabling further value adding.

#### 7.5.8 New Markets

Dairy Crest is focused on developing existing markets and brands rather than entering new markets.

### 7.6 Governance and Management Structures

Dairy Crest is a public limited liability company. The main Board, responsible to the shareholders, currently comprises 9 people including Chairman, Company Secretary, Chief Executive (CEO), an executive managing director, Finance Director and four non executive directors. The Chairman and other non-executives are drawn from a wider business and food sector background. The management team, headed by the CEO, are responsible for implementing Board decisions and day to day business.

### 7.7 Business Strategy

#### 7.7.1 Long term aims and objectives

Dairy Crest positions itself as being a fully integrated milk purchaser, with liquid and processing markets both considered key to the operation of the business with a low commodity exposure.

Current aims and objectives are to:

- Build market leading positions in branded and added value markets
- Focus on cost reduction and efficiency improvements
- Reduce commodity risk to improve earnings
- Develop where appropriate business acquisitions and disposals to generate growth and focus
- Focus on cash generation (particularly in short term)

- Reduce risks associated with pension scheme
- Improve middle ground profitability
- Build a secure, sustainable direct milk supply to meet demand

#### 7.7.2 Expansion

Stated plans and aims are to:

- Invest significantly in advertising and promotions
- Focus new products on health and environment benefits
- Focus on cost reduction in order to finance promotional activities
- In the medium term, return to a policy of acquisitions where appropriate
- Direct investment towards liquid facilities

#### 7.7.3 Sustainability

As is common to all the milk buyers reviewed, there is a strong commitment to sustainability and environmental actions.

Specific key aims receiving emphasis currently are:

- To produce packaging innovations, such as Jugit, to reduce waste
- To increase use of recycled materials
- To improve sustainability and environmental care on their contracted farms

### 7.8 Summary

- With the business seeking to increase sales and drive up directly supplied volumes, security of milk demand for existing contract holders is good. Dairy Crest is less exposed to commodity markets than some others which should create conditions for more stability in its milk price.
- Dairy Crest modified its strategy to cope with the changing financial climate and its current focus is on cash generation. Its strategy is to continue to grow its key brands, and in line with this will seek more milk to meet demand for its Cathedral City and Friji brands. Further opportunities for additional supply will be available as the business drives up the proportion of milk it buys direct.
- Previous business strategies have been successful with consistent profitability and a sound balance sheet although increasing debt levels are a factor. The success of its campaign to reverse declines in

doorstep delivery together with how it responds to plans of other buyers, especially Arla and Wisemans in the South East, will be important factors in its business development.

## **8 First Milk**

### **8.1 Overview**

First Milk is a dairy farmers' co-operative registered under the Industrial and Provident Societies Act. Its stated principal activity is the marketing of milk on behalf of its members and the manufacture and sale of dairy products. The co-operative is owned by its 2,600 farmer members and its head office is based in Glasgow. First Milk was established in 2001 as the result of a merger between Axis Milk and Scottish Milk, co-operatives which emerged from the breakup of Milk Marque and the Scottish MMB. . The First Milk Group includes the following: The First Milk Cheese Company Ltd, Scottish Milk Products Ltd and Scottish Milk Dairies Ltd. The group is also a partner in a joint venture with Westbury Dairies Ltd (see later) and has investment in Robert Wiseman Dairies PLC.

First Milk describe its operation as starting as a brokerage and its ambition is to be a vertically integrated dairy business including a mix of wholly owned facilities, holding shares in other related businesses, acting as a service provider and being involved in joint ventures. An example of this is Fayrefield Food International in which it currently has a 50% stake in Promo Vita. Established in 1982 as an independent marketing dairy company, the Fayrefield Group has become internationally recognised with annual sales in excess of £230m and a strong international profile. First Milk has developed a range of initiatives including the First Milk Academy and First Milk Direct to support its farmer members, helping them to improve their efficiency, quality and standards.

First Milk handles around 1.75 billion litres of milk each year and is a large provider in the cheese and dairy ingredients sectors. Some 60% of the milk goes into liquid supply and 28% into cheese with the remainder into powders and other markets. Key customers in liquid include Wisemans, Dairy Crest and Nestle.

### **8.2 Financial**

The analysis overleaf relates to accounts ending 31 March for the last three years and shows summary profit and loss account, balance sheets and ratio analysis. It is important to note the differences between cooperative and company accounts as outlined in section 5.

#### **8.2.1 Summary Profit and Loss Account**

The pence per litre (ppl) figures stated in table 22 below are based on their total milk pool for the year.

Table 22 – First Milk Summary Profit and Loss Account

Year End	31 March 2007			31 March 2008			31 March 2009		
	£ (000s)	ppl	%	£ (000s)	ppl	%	£ (000s)	ppl	%
Turnover	484,086	24.75	100	602,047	34.21	100	581,124	35.27	100
Cost of Sales	468,298	23.94	96.7	570,727	32.43	94.8	561,272	34.07	96.6
<b>Gross Profit</b>	<b>15,788</b>	<b>0.81</b>	<b>3.3</b>	<b>31,320</b>	<b>1.78</b>	<b>5.2</b>	<b>19,852</b>	<b>1.20</b>	<b>3.4</b>
Admin/Distribution Charges	15,263	0.78	3.2	22,084	1.26	3.7	24,847	1.51	4.3
<b>Operating Profit (Loss) before finance and tax</b>	<b>525</b>	<b>0.03</b>	<b>0.1</b>	<b>9,236</b>	<b>0.52</b>	<b>1.5</b>	<b>(4,995)</b>	<b>(0.30)</b>	<b>(0.9)</b>
Finance Costs – Bank	2,943	0.15	0.6	5,471	0.31	0.9	6,058	0.36	1.0
Finance Costs – Members Interest	429	0.02	0.1	2,297	0.13	0.4	438	0.03	0.1
Other income and exceptional costs	834	0.04	0.2	1,610	0.09	0.3	1,504	0.09	0.3
<b>Profit (loss) on Ordinary activities before taxation</b>	<b>(2,013)</b>	<b>(0.10)</b>	<b>(0.4)</b>	<b>3,078</b>	<b>0.17</b>	<b>0.5</b>	<b>(9,987)</b>	<b>(0.61)</b>	<b>(1.7)</b>
Taxation on Ordinary activities	438	0.02	0.1	269	0.02	-	(2,888)	(0.18)	(0.5)
<b>Profit (Loss) on Ordinary activities after taxation</b>	<b>(2,451)</b>	<b>(0.12)</b>	<b>(0.5)</b>	<b>2,809</b>	<b>0.16</b>	<b>0.5</b>	<b>(7,099)</b>	<b>(0.43)</b>	<b>(1.2)</b>

Source: Company Reports

### 8.2.2 Balance Sheet

*Table 23 – First Milk Summary Balance Sheet*

Year End	31 March 2007		31 March 2008		31 March 2009	
	£ (000s)	ppl	£ (000s)	ppl	£ (000s)	ppl
<b>Fixed Assets</b>						
Intangible Assets			1,158	0.07	579	0.04
Tangible Assets	28,581	1.46	30,584	1.74	29,604	1.80
Investments	30,944	1.58	30,581	1.74	30,223	1.83
Total Fixed Assets	59,525	3.04	62,323	3.54	60,406	3.67
<b>Current Assets</b>						
Stock	62,995	3.22	72,070	4.10	69,101	4.19
Debtors	67,217	3.44	69,104	3.93	61,466	3.73
Cash at Bank	19,850	1.01	12,307	0.70	8,069	0.49
Total Current Assets	150,062	7.67	153,481	8.72	138,636	8.41
<b>Total Assets</b>	<b>209,587</b>	<b>10.71</b>	<b>215,804</b>	<b>12.26</b>	<b>199,042</b>	<b>12.08</b>
<b>Current Liabilities</b>						
Trade Creditors	57,721	2.95	51,267	2.91	42,912	2.60
Borrowings	14,661	0.75	7,640	0.43	7,243	0.44
Current Tax Liabilities	1,341	0.07	1,433	0.08	1,103	0.07
Other	15,337	0.78	18,205	1.03	10,610	0.64
Total	89,060	4.55	78,545	4.46	61,868	3.76
<b>Non-Current Liabilities</b>						
Borrowings	69,086	3.53	79,175	4.50	80,110	4.86
Other	11,875	0.61	6,194	0.35	9,720	0.59
Total	80,961	4.14	65,369	4.85	89,830	5.45
<b>Total Liabilities</b>	<b>170,021</b>	<b>8.69</b>	<b>163,914</b>	<b>9.32</b>	<b>151,698</b>	<b>9.21</b>
<b>Net Assets</b>	<b>39,566</b>	<b>2.02</b>	<b>51,890</b>	<b>2.95</b>	<b>47,344</b>	<b>2.87</b>
<b>Member Investment</b>						
Member Capital Accounts	31,248	1.60	36,885	2.10	44,338	2.69
Other Reserves	62	0.00	60	0.00	58	0.00
Retained Earnings	8,256	0.42	14,945	0.85	2,948	0.18
<b>Total Member Investment</b>	<b>39,566</b>	<b>2.02</b>	<b>51,890</b>	<b>2.85</b>	<b>47,344</b>	<b>2.87</b>

*Source: Company Reports*

### 8.2.3 Ratios

*Table 24 – First Milk Ratio Analysis*

Year Ending		2007	2008	2009
Return on Sales	%	0.11	1.53	-0.86
Sales/Tangible Assets	%	1694	1969	1963
Stocks/Turnover Ratio	%	13.01	11.97	11.89
Stock/Turn Ratio	No.	12.0	8.45	7.95
Operational gearing	%	3007	339	-397
Asset utilisation ratio	%	1223	1160	1227
Working Capital/Sales Ratio	x:1	0.15	0.16	0.14
Return on Capital	%	1	18	-11
Debtor/Creditor Ratio	x:1	1.16	1.61	1.2
Current Ratio	x:1	1.68	1.95	2.24
Quick Ratio	x:1	0.98	1.04	1.12
Debt/Equity	%	161.49	142.82	168.30
Gearing (Gross debt)	%	68.00	62.00	65.00
Gearing (Net debt)	%	51.82	53.58	58.98
Interest Cover	x:1	0.16	1.19	-0.77

*Source: Company Reports / Bidwells Analysis*

In the last year, First Milk has restructured its debt facility and arrangements. This has involved a change in lender and an increased facility from £100 million to £130 million. The strategy is based upon:

- Allowing further development of the processing facilities and network
- Increasing branded cheese sales both in terms of marketing and funding increased stock levels
- Expanding working capital facility
- Assuring relevant protection is in place in a fluctuating market
- Securing debt level with further headroom for variations in stock/ debtor levels.

Key financial highlights from the accounts summary are:

- Turnover increased by 20% in absolute terms between 2007 and 2009, although it fell in 2009 compared to the previous year. The decrease can be linked to a decrease in whey and powder

returns plus lower cheese volumes in the latter part of the year at a time when global prices fell significantly.

- Gross Profit reached 5% in the 2008 year but fell back to the 2007 level of 3% in 2009. This links directly to the reduced turnover. Cost of sales remained fairly static at 96% of turnover, linked to a continued drive to further increase efficiency in this area. The fall in the return on sales ratio relates to falling commodity prices.
- Gearing on a gross debt basis fell from 68% to 62% between 2007 and 2008 but has increased to 65% in 2009. During this last year, due primarily to the lower turnover and a non-recurring charge of £3.6 million for restructuring activity aimed at cost reduction, First Milk took a strategic decision to utilise retained earnings (which are effectively member reserves). It is recognised that this was a one-off use to help shelter members from the global downturn in the latter half of the 2009 financial year and help maintain milk price. Effectively they overpaid for milk during this period. It plans to rebuild reserves by implementation of the strategy for growth and development.
- The balance sheet remains stronger than two years ago with net assets at the end of 2008/09 at a level slightly below 12 months previously. In constructing the balance sheet, the practice stated is for investment properties to be valued annually and any surpluses or deficits transferred to the revaluation reserve.
- Employee costs have reduced in 2008/09 linked to a fall in head count based upon creating a leaner organisation with emphasis on improved performance and efficiency. There have also been investments in IT to create a single integrated business system.
- The business net debt generally fluctuates between £90-100m. Gearing (gross debt) is at 65% in 2009 which is similar to previous years. The interest cover ratio has fallen due to lower profits rather than rising finance costs.
- The current ratio is strong at 2.24 in 2009, up from 1.68 two years earlier. This means First Milk have £2.24 of current assets for each pound of current liabilities, which represents sufficient cover. The current liabilities fell between 2007 and 2009, principally due to lower trade creditors.
- The asset utilisation level is stable around the 1200% mark. This means for each £1 of Net assets, £12 of turnover are generated. This figure is high probably reflecting a low balance sheet asset valuation.
- New debt facilities are in place until summer 2012.

- In the financial year ending 31 March 2009 there was a negative cashflow from operating activities of £5m with a negative free cashflow. This was because they supported members' milk price using the prior year's reserves. Cash at bank fell 34.4% between 2008 and 2009.

### 8.3 Milk Supply and Contracts

First Milk offer two contracts, one for liquid and one for manufacturing, although a review is being undertaken looking at possible simplification of arrangements. Contracts are offered on a one year notice period, that length being seen as essential to ensure security of supply. Return to members is made up of milk price, dividend payment and interest payment. Involvement in Business Clubs is also seen as a positive return to members. Member numbers have been around 2,600 but are now rising with the introduction of some ex Dairy Farmer of Britain producers. Given its co-operative structure, the return to farmer members for milk must be viewed as a combination of per litre price together with return on investment.

#### 8.3.1 Member Capital

An important element of the operation of the business is member capital. Effectively farmers benefit from milk price together with a return on their investment in the business. The member capital has now been split 90% into a B Account which offers an interest payment, and 10% into an A Account which attracts a dividend entitlement. In the last year, the average First Milk member received circa £2K in dividend which related to the 2007/8 financial year. The new Dairy Farmers of Britain members have been offered contracts with 0.3 pence per litre retention. Existing members no longer pay a capital retention.

#### 8.3.2 Milk Supply Overview

The milk supply base for the milk year 2008/09 is set out in table 25 below.

*Table 25 – First Milk Supply Base (2008/09)*

Number of Suppliers	2,600
% of total GB suppliers	20%
Volume of raw milk supplied by farmers (million litres)	1,750
% of total GB volume	15%
Volume of raw milk purchased from other dairies (million litres)	0.00

*Source: Bidwells Analysis*

#### 8.3.3 Milk Contracts Overview

Table 26 overleaf summarises the current contracts.

Table 26 – First Milk Contracts (2008/09)

Contracts	Liquid	Compositional	Highlands & Islands	Tesco
End Use	Liquid	Processing	Processing	Liquid
12-month average price (DairyCo standard litre)	Dual Pricing – 25.03 Profile – 24.49	Dual Pricing – 24.77 Profile – 24.23	Dual Pricing – 26.05 Profile – 25.50	Dual Pricing – 27.46 Profile – 27.02
Frequency of Review	As required			6 months
Notice period of price changes	During month before change becomes effective (but have implemented retrospective changes in the past)			
Catchment area	Scotland, Northern England and Midlands		Highlands and Islands	Wales
Preferred milk production profile	Autumn peak			Level
Notice Period – Producer	1 year			
Are producers eligible for bonuses whilst under notice	All except 0.5ppl loyalty bonus			
Notice Period – Purchaser	1 year			
Recruitment areas	Scotland, Northern England and Midlands		Highlands and Islands	Wales
Number of suppliers	1,525	955	60	60
Raw milk volume/contract (m/litres)	1,000	655	50	45
Cost of farmer investment	nil for existing producers, 0.3ppl retention for new producers			
Return on farmer investment	Interest Payment and Dividend Payment worth circa £2k to the average producer in 2007/8 which is effectively a 0.3ppl on the milk price.			
Who decides milk price?	First Milk			Tesco Cost of Production Model
What factors affect prices?	Returns from markets which include liquid milk, cheese, butter, skimmed milk powder			Cost of Production
Is there a negotiation process	No			No
Does any pricing follow a formula?	No			Yes

Source: First Milk, Bidwells Analysis

First Milk is currently in the process of changing its milk contracts. These changes include the introduction of Market Related Pricing and changes to the pricing schedule. The producers will be split into two pools, Liquid

A and Standard. Liquid A will include milk going directly to a liquid customer which is collected and delivered most efficiently. Standard will include all other milk fields which serve cheese sites, liquid with significant secondary haulage costs and liquid with high primary haulage costs due to low density milk fields. The price will be related to the gross returns from milk in that pool less primary and secondary haulage with business running costs applied equally between pools.

The main changes to the pricing schedule include higher prices for larger volumes and for those whose production is growing. A protein bonus will be introduced for those supplying cheese sites and the loyalty bonus for resigning members will be removed. These contract changes will apply from 1 April 2010.

## 8.4 Processing

First Milk has a joint venture arrangement for its Westbury Dairies operations which acts as a milk balancing facility. Westbury Dairies was originally held on the basis of 40% shareholding from First Milk, 40% from Dairy Farmers of Great Britain and 20% Milk Link. With the pulling out, and then demise, of Dairy Farmers of Britain, this is now two thirds owned by First Milk.

### 8.4.1 Summary of Processing Facilities in Operation

These are set out in table 27 below.

*Table 27 – Current First Milk Processing Facilities*

Location	Capacity (million litres)	Products
Haverfordwest	200-300	Creamery
Isle of Bute	10-25	Creamery
Campbeltown	25-50	Creamery
Isle of Arran	10-25	Creamery
Lake District	200-300	Creamery
Wrexham	200-300	Dairy Ingredients business & cheese packing operation
Westbury	800	2/3rds owned – milk balancing facility

*Source: First Milk/Bidwells Analysis*

### 8.4.2 Investment

First Milk has plans for a substantial investment in a new site at Campbeltown. This is a facility with its milk supplied by circa 40 members. The old site will be sold to Tesco which will go towards funding the investment together with help from the Scottish Government and some use of cash through existing borrowing facilities. Approximately 75% of the development cost is funded by the site sale and Scottish Government.

First Milk plan to invest in its Creamery at Aspatria (Lake District) to modernise the facility. The Haverfordwest site has benefited from Welsh Assembly Government investment.

The revenue from the sale of Wiseman shares (see 8.4.3) will be used to invest in both the Campbeltown and Aspatria creameries. Some cash will also be used at the Wrexham cheese packing site.

#### 8.4.3 Rationalisation

First Milk has recently disposed of 4,170,171 ordinary shares in Robert Wiseman Dairies Ltd. (representing 5.7% of the issued share capital) at a price of 450 pence per share. First Milk purchased these shares at 250 pence in November 2004. Following this disposal, First Milk holds 7,162,026 shares in the company, representing 10% of the issued share capital. This disposal will enable First Milk to invest further capital into its cheese operations as part of its strategy to increase the volume of cheese sold under brands. This may also be in part related to the earlier utilisation of reserves to maintain the milk price during the last financial year.

First Milk has stated that it has no current plans to dispose of its remaining shareholding in Robert Wiseman Dairies and expressed its commitment to a long term strategic partnership.

### 8.5 Marketing

#### 8.5.1 Milk Utilisation

According to First Milk, approximately 60% of the milk pool is sold into liquid markets (notably Robert Wiseman Dairies), 28% is utilised for cheese and the remainder enters the ingredient markets. Table 28 shows the First Milk brands and its sales.

*Table 28 – First Milk Product Portfolio (2008/09)*

Segment	Brand	Estimated Raw Milk Volume 000/litres (% of milk pool)	Market Segment	% of Market Segment Volume	Change in Market Share (volume) 07/08-08/09	% of Market Segment Volume	Change in Market Share (value) 07/08-08/09
Cheese	Lake District	<1%	Cheddar	1%	+<1%	1%	+<1%%
	Scottish H&I/Pride	1.5%					
	Pembrokeshire	n/a					

*Source: First Milk, Kantar, Bidwells Analysis*

### 8.5.2 Core Cheese brands

#### Lake District Cheese Company Range

The Lake District Cheese Company uses Lake District milk to produce three versions of cheddar, Mature, Extra Mature and The Cumbrian Smokey. These are produced at the Aspatria Creamery which was formerly owned by Dairy Crest.

#### The Pembrokeshire Cheese Company

The Welsh Cheese offer is produced at Haverfordwest under the Pembrokeshire Cheese Company banner. It is produced from 100% Welsh milk with Mature, Extra Mature and Organic cheddar variants.

#### Scottish Highlands and Islands/Scottish Pride

The Highland and Island Cheese brands are produced on Island creameries at Campbeltown, Rothesay and Torrylinn. The Island brands are premium mature cheddars. The Scottish Pride cheese is a mass market family cheddar cheese produced solely from Scottish milk. Volume sales have grown by over 150% between 2008 and 2009, albeit from a low base, and accounted for around 1% of the total retail sales of Cheddar cheese in the 52-week period ending 12 July 2009.

### 8.5.3 Cheese Market Development

Recognising market changes and the increasing importance of provenance, First Milk aim to increase market penetration for its current brands rather than focus on new ones. In particular it will focus on developing the Lake District brands. The Lake District Cheese Company range rose to 5<sup>th</sup> best selling specialist brand 18 months from its launch in November 2007 according to Kantar data. Its Welsh cheese brands became number one best seller in Wales in its first year. Indeed, similar sourced statistics indicate that in the 12 month period up to 12 July 2009 there was almost a 40% increase in the number of households buying Welsh cheese. A strategic aim is to increase emphasis on branded cheeses linked to the growing interest in provenance. Currently branded cheese accounts for 20% of the cheese volume sold by First Milk, up from 5% in the previous year. This percentage increase is partly down to falling volumes.

Looking forward, the brands holding positions above Lake District are big sellers eg, Cathedral City, and further penetration will be difficult to achieve, supported as they are by heavy discounting and promotions. The UK cheese market is dominated by retailer own-brand (accounting for 60% of the market) with many brands accounting for the remaining 40%<sup>25</sup>.

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<sup>25</sup> Mintel Cheese Market Intelligence 2009.

## 8.6 Governance and Management Structures

First Milk has had a main Board comprising 11 members although this is currently being reviewed. The Chairman is at present acting in an executive capacity in the period until a new Chief Executive (CEO) is appointed. He has broad director level experience in the food sector. The Board is currently made up of six elected directors, all farmer producers of milk for the co-operative, two non executive with a wide business background and two members of the executive team, namely the CEO and the Finance Director. The farmer directors are elected through local farmer groups. The proposal going forward is to reduce the number of elected farmer directors from six to three. It is proposed that the three places freed would be available to co-opt three farmer members with proven commercial backgrounds. In effect therefore there will still be six farmer directors but their skills will change.

## 8.7 Business Strategy

### 8.7.1 Aims and Objectives

Currently stated strategic aims for future development include:

- To continue to grow organically and exploit opportunities to add value where possible and appropriate
- To put emphasis on re-shaping Westbury Dairies to improve its efficiency and restructuring and rationalising cheese packing facilities
- To build up financial reserves over the medium term

### 8.7.2 Expansion

Discussions with management identify the following key points in relation to expansion plans and related activity:

- First Milk is not currently planning to enter the liquid market or to build any new green field sites.
- Investment will continue as needed with targeting on continued improvement on own label facilities and improved efficiency in cheese packing.
- Continued developments will take place at the Haverfordwest site to drive up efficiency further and increase volume.
- The Lake District site needs modernisation and will get investment following the RWD share sale.
- The construction of the new site at Campbeltown will be completed. This is a facility with its milk supplied by circa 40 members. The old site will be sold to Tesco, the revenue from this sale will go

towards funding the investment, together with help from the Scottish Government and some use of cash reserves which includes revenue from selling RWD shares.

#### 8.7.3 Sustainability

First Milk is committed to sustainability and behaving ethically in its business practices working with members, employees and the wider community. Some key ways in which this is being achieved are:

- Cutting energy consumption, carbon emissions and water use at its creameries.
- Working in partnership with Tesco to achieve a 15% reduction in the packaging weight of its own label cheese through a major project involving procurement, technical, packaging and quality teams.
- Driving change and increasing awareness at every level.

#### 8.8 Summary

- Security of milk supply for existing contract holders would seem good assuming key retail contracts to Robert Wiseman Dairies and others are maintained, although there is unlikely to be a significant increase in new contracts. Returns for milk will depend upon the success of measures currently being taken and led by the Executive Chairman. These seek to improve efficiency of operations and ensure all strategies are in place to maximise returns from current markets.
- The current strategy is one of developing and growing current markets rather than entering new ones. Farm suppliers need to respond to this and ensure they can supply milk in the quantities and quality levels required. The new contract structure will require adaptation of farm businesses.
- Clearly these actions to create stability and restore reserves will be critical as they move forward.

## 9 **Meadow Foods**

### 9.1 **Outline**

Meadow Foods is an independent dairy group with its focus on supplying milk and dairy ingredients to major food manufacturers. Of its total milk supply, some is sold to liquid milk processors, some is sold directly to the liquid market and the remainder is used in its processing sites. A large proportion of turnover is driven by milk sales to the liquid market.

Its dairy ingredients business includes cream, sweetened condensed milk, milk fat, chocolate crumb and other cultured dairy products. Currently it handles 580 million litres of milk with 430 million of this being supplied by 520 directly contracted farmers. 50 million litres is purchased from third parties to enable appropriate balancing of supply to customers. The remaining volumes are traded to liquid customers by Meadow Foods' specialist milk supply and balancing team. The 520 farmers contracted to Meadow Foods produce around 74% of Meadow Food's total milk pool. All the milk is sold either directly to liquid milk processors or used in its own milk processing sites.

Meadow Foods process cream, produce Anhydrous Milk Fat (AMF) and produce butter and cultured dairy products for major food manufacturing companies. Meadow Foods is a substantial cream processing business in the UK (over 100,000 tonnes), a substantial producer of AMF and the sole independent manufacturer of chocolate crumb and sweetened dairy products.

The business was founded in 1992 in Buckinghamshire as a dairy trading business focused on selling products in the UK and Europe. In 1995, it merged with a dairy processing business, Bodfari. In recent times, it has grown significantly with the acquisition of the West Lakes Dairy Park milk field in 2008 and the acquisition of the business and assets of Nene Valley Foods in 2009, which previously had been a wholly owned subsidiary of Dairy Farmers of Britain.

It is a privately owned limited company; the main shareholders are set out in table 29 below.

*Table 29 – Principal Shareholders of Meadow Foods (Holdings) Limited (April 2009)*

Shareholder	Number of Shares
S Chantler	8,036,110
D O Pickering	3,572,420
N R Oldmeadow	2,978,150
John Pickering & Family	4,249,620
Grosvenor Farms Ltd	355,000
Mrs H Howarth	102,333
Mrs C J Shone	100,000

*Source: Companies House*

## 9.2 Financial

The data below is taken from filed annual accounts for Meadow Foods (Holdings) Limited and subsidiary undertakings covering the last three years. This company is the ultimate holding company for a group of businesses. The Group's principal activity is the processing and marketing of dairy products.

### 9.2.1 Summary Profit and Loss Accounts

For purposes of this analysis, the pence per litre figures stated for years ending 2008 and 2009 are calculated using their total milk pool for the year. Given business growth over the period, this figure is very approximate representing the total of milk supplied by contract, traded and purchased.

Table 30 – Meadow Foods Summary Profit and Loss Account

Year End	31 March 07			31 March 08			31 March 09		
	£ (000s)	ppl	%	£ (000s)	ppl	%	£ (000s)	ppl	%
Turnover	199,979		100.00	244,602	49.75	100.0	246,688	50.17	100.0
Cost of Sales	183,019		91.5	220,745	44.90	90.2	219,090	44.56	88.8
<b>Gross Profit</b>	<b>16,960</b>		<b>8.5</b>	<b>23,857</b>	<b>4.85</b>	<b>9.8</b>	<b>27,598</b>	<b>5.61</b>	<b>11.2</b>
Admin/Distribution Charges	16,366		8.2	18,274	3.72	7.5	22,900	4.66	9.3
<b>Operating Profit (Loss) before finance and tax</b>	<b>594</b>		<b>0.3</b>	<b>5,583</b>	<b>1.14</b>	<b>2.3</b>	<b>4,698</b>	<b>0.96</b>	<b>1.9</b>
Finance Costs	589		0.3	562	0.11	0.3	553	0.11	0.2
<b>Profit (loss) on Ordinary activities before taxation</b>	<b>5</b>		<b>0.0</b>	<b>5,021</b>	<b>1.02</b>	<b>2.0</b>	<b>4,145</b>	<b>0.84</b>	<b>1.7</b>
Taxation Credit/Charge on Ordinary activities	45		0.0	1,378	0.28	0.6	1,203	0.24	0.5
<b>Profit (Loss) on Ordinary activities after taxation</b>	<b>(40)</b>		<b>(0.0)</b>	<b>3,643</b>	<b>0.74</b>	<b>1.4</b>	<b>2,942</b>	<b>0.60</b>	<b>1.2</b>

Source: Company Reports from Companies House

## 9.2.2 Balance Sheet

*Table 31 – Meadow Foods Summary Balance Sheet*

Year End	31 March 2007		31 March 2008		31 March 2009	
	£ (000s)	ppl	£ (000s)	ppl	£ (000s)	ppl
<b>Fixed Assets</b>						
Intangible Assets			2,213	0.45	2,274	0.46
Tangible Assets	13,799		13,333	2.71	12,838	2.61
Goodwill	(4,014)		(3,491)	(0.71)	(2,968)	0.60
Total Fixed Assets	9,785		12,055	2.45	12,144	2.47
<b>Current Assets</b>						
Stock	5,355		7,102	1.44	6,330	1.29
Debtors	22,228		27,348	5.56	26,892	5.47
Total Current Assets	27,583		34,450	7.01	33,222	6.76
<b>Total Assets</b>	37,368		46,505	9.46	45,366	9.23
<b>Current Liabilities</b>						
Trade Creditors	20,952		23,228	4.72	23,014	4.68
Borrowings	4,004		5,739	1.17	4,838	0.98
Current Tax Liabilities	227		1,738	0.35	892	0.18
Other	1,119		3,107	0.63	3,763	0.77
Total	26,302		33,812	6.88	32,507	6.61
<b>Non-Current Liabilities</b>						
Borrowings	2,594		1,845	0.38	1,105	0.22
Deferred tax liabilities	643		525	0.11	489	0.10
Total	3,237		2,370	0.48	1,504	0.31
<b>Total Liabilities</b>	29,539		36,182	7.36	34,101	6.94
<b>Net Assets</b>	7,829		10,323	2.10	11,265	2.29
<b>Equity</b>						
Called Up Share Capital	2,178		2,178	0.44	2,178	0.44
Share Premium	43		43	0.00	43	0.00
Retained Earnings	5,608		8,102	1.65	9,044	1.84
<b>Total Equity</b>	7,829		10,323	2.10	11,265	2.29

*Source: Company Reports from Companies House*

### 9.2.3 Ratios

*Table 32 – Meadow Foods Ratio Analysis*

Year Ending		2007	2008	2009
Return on Sales	%	0.3	2.28	1.9
Sales/Tangible Assets	%	1449	1835	1922
Stocks/Turnover Ratio	%	2.68	2.9	2.57
Stock/Turn Ratio	No.	32.58	35.44	32.62
Operational gearing	%	2855	427	587
Asset utilisation ratio	%	2554	2369	2190
Working Capital/Sales Ratio	x:1	0.033	0.045	0.041
Return on Capital	%	8	54	42
Debtor/Creditor Ratio	x:1	1.06	1.18	1.17
Current Ratio	x:1	1.05	1.02	1.02
Quick Ratio	x:1	0.85	0.81	0.83
Debt/Equity	%	84	73	53
Gearing (gross debt)	%	46	42	35
Interest Cover	x:1	1.008	9.934	8.495

### 9.2.4 Financial Commentary

Meadow Foods acquired the West Lakes Dairy business and milk field during the year ending 31 March 2008. However, while this will have impacted the financial status of the company, the substantial change in financial performance between the 2007 and 2008 year ends is more to do with better fats and sugar returns during the period. As a result, comparisons between these years should be treated with care.

- There has been consistency in many of the ratios over the three years. This reflects a stable business when both the dairy market was volatile and continued investment and growth was taking place.
- Turnover has grown from some £200 million in 2006/07 to £247 million in 2008/09 (+23.5%). The forecast turnover for the year ending 31 March 2010 is £261 million, a further 6% growth against the previous year.
- Set in the context of this significant turnover increase, operating profit level has been relatively stable between the 2008 and 2009 year ends. The increase in returns on sales and return on

capital between 2007 and 2008 was primarily due to increased returns from the sugar and fats markets.

- Despite continued investment, finance costs have remained stable and the interest cover ratio is good at approximately 8.5 in the year ending 2009.
- The business has a strong balance sheet and relatively low borrowings. This provides a good platform for further growth where appropriate opportunities exist.
- Business gearing (based on gross debt) has fallen in the period from 46% to 35% and the debt to equity ratio significantly fallen from 84% to 53%.
- Stock turn has fallen slightly but it is not significant and likely to be due to rising stock values at the year end.
- While asset utilisation has fallen in the three years reviewed, it remains very strong at 2,190% in the year ending 2009.
- The business shows positive cash generation from operating activities and positive free cash generation.
- Its debt funding is subject to an annual review by its bank, and all sales are credit assured.
- The negative goodwill relates to the acquisition of assets for less than their fair value.

The business demonstrates stability in performance and operation. It has a strong capital position enabling the business to meet unexpected demands and changes, and to grasp opportunities as and when they arise.

### 9.3 Milk Supply and Contracts

The farmer network supplying Meadow Foods is concentrated in the North West of England and North Wales and is set out in table 33 below.

*Table 33 – Meadow Foods Supply Base (2008/09)*

Number of Suppliers	520
% of total GB suppliers	4%
Volume of raw milk supplied by farmers (million litres)	430
% of Total GB Producer Volume	4%
Volume of raw milk purchased from other dairies (million litres)	50 million litres purchased from third parties; 100 million litres traded

*Source: Meadow Foods, Bidwells Analysis*

### 9.3.1 Contracts overview

Meadow Foods have two contracts in place with its farmer suppliers. The first is for its producer base in Shropshire, Cheshire, Staffordshire, Derbyshire, Lancashire and North Wales. The other contract is for its West Lakes Dairy Park producers in Cumbria. The producers there had preference for certain aspects of their previous contract and so these have been retained with practical adjustments aligned to Meadow Foods' needs. Both contracts have the same core terms, and any variation in average prices through the year are due to milk delivery profiles.

Meadow Foods purchase a producer's entire production. From April 1 2010, it is introducing an incentive scheme. This will provide bonuses to farmer suppliers who submit forecast volumes for the year ahead and an additional bonus for the accuracy of such forecasts. This will enable the business to balance milk more accurately.

As demand from its food manufacturing customers continues to grow, Meadow Foods is seeking to increase the milk supplied by its contracted farmers either through increasing production from existing or recruiting new suppliers. The following factors are important for Meadow Foods in recruiting suppliers:

- Location
- Level production profile
- Milk quality
- Attitude towards long term working relationships

An overview of milk contracts is presented in table 34.

*Table 34 – Meadow Foods Milk Contracts (2008/09)*

<b>Contracts</b>	<b>Meadow Foods</b>	<b>Meadow Foods Level</b>
12-month average price (DairyCo standard litre)*	25.82ppl	26.03ppl
Frequency of Review	No defined schedule – emphasis is on minimising frequency of price change to help provide some stability & certainty to producer base	
Notice period of milk price change	Producers must be notified during month preceding month changed (i.e. to change the December price notice must be given during November).	
Catchment area	Principally Shropshire, Cheshire, Staffs, Derbyshire, Lancs. , Cumbria, Monmouthshire & North Wales	
Preferred milk production profile	Any	Level
Notice Period – Producer	1 year with exit points quarterly	
Are producers eligible for bonuses whilst under notice	Yes	
Notice Period – Purchaser	1 year	
Recruitment areas	As needed, focus would be as catchment area	
Number of suppliers*	520	
Estimated raw milk volume/contract (m/litres)	430 million litres	
Cost of farmer investment	not required	
Return on farmer investment	n/a	
Who decides milk price?	Purchaser	
What factors affect prices?	Returns from Market Some sales contracts include comparison with basket element of other companies' prices	
Is there a negotiation process	No negotiation but purchaser takes into account producer views linked to market conditions	
Does any pricing follow a formula?	No formula applies	

\*the difference in average milk prices is due to variations in milk delivery profiles

*Source: Meadow Foods / Bidwells Analysis*

#### 9.4 Processing

Meadow Foods have milk processing facilities in Chester, Holme on Spalding Moor in Yorkshire and at Peterborough. The facilities at Peterborough resulted from Meadow Foods' acquisition of Nene Valley Foods.

Meadow Foods operate in three key dairy markets:

- Fresh dairy products (for food manufacturers)
- Sweetened dairy products
- Milk supply and milk balancing

Meadow Foods' product range, apart from fresh dairy products, includes butter, yogurt, chocolate crumb and condensed milk. The company balance its milk by processing through all its sites and supplying cheese makers and other third parties.

#### 9.4.1 Summary of Processing Facilities in Operation

Table 35 below summarises the current processing facilities

*Table 35 – Meadow Foods Current Processing Facilities*

Location	Capacity (million litres)	Products
Holme on Spalding Moor, Yorkshire	50-100	A focus on chocolate crumb & sweetened condensed milk
Chester	350	A focus on Anhydrous Milk Fat production
Nene Valley, Peterborough	50-100	A focus on packaged cream for the food ingredients business

*Source: Bidwells Analysis*

The Holme on Spalding Moor site processes more than 10,000 tonnes each of chocolate crumb and sweetened condensed products every year. Chocolate crumb is made from fully refined sugar, milk and cocoa to produce a powder and is used in chocolate manufacture to provide its distinctive flavour. Sweetened condensed dairy products include condensed skimmed milk and 8% butterfat condensed milk. To these sugar is added before the product is concentrated to a maximum of 72.5% total solids. It is then distributed to manufacturers in bottles, drums, boxes or in bulk. These products make use of the purchased and traded cream.

The Nene Valley site can handle over 25,000 tonnes of packaged cream as well as producing a broad range of specialist products including sour cream and cultured ingredients. Meadow Foods use the cream from its own milk and purchase significant volumes of fresh cream from other dairies. This cream is used in the production of Anhydrous Milk Fat (AMF) as well as products like sour cream and cultured ingredients. The skimmed milk remaining is concentrated. Meadow Foods do not see cream as a commodity due to its capacity to add value to the by-product with a processing capacity of over 100,000 tonnes.

#### 9.4.2 Investment

Notable investments and acquisitions in its history have included:

- 1995 – Merger with the dairy processing business, Bodfari, acquiring new processing plant in Chester to produce Anhydrous Milk Fat
- 1999 – Building additional milk protein plant at Chester site
- 2002 – Purchase of Holme on Spalding Moor processing site
- 2003 – Installation of first reverse osmosis (PO) concentrate plant
- 2007 – Commissioning of new butter plant
- 2008 – Acquisition of West Lakes Dairy Park; second PO plant commissioned with milk protein standardisation; new chilled butter warehouse
- 2009 – New packing plant commissioned at Holme on Spalding Moor

### 9.5 Marketing

#### 9.5.1 Brand Portfolio

Meadow Foods does not produce any retailer branded products, all its sales are to the major food manufacturing companies. It is an important brand in dairy ingredients for the UK food manufacturing sector. Its milk, cream, cultured and sweetened dairy products are used in the production of a wide range of foods from ice cream, yogurt, chocolate and confectionery to ready meals, pastry, soups, sauces, biscuits and cakes.

Key products from Meadow Foods are:

##### 1. Sweetened Dairy Products:

- Chocolate Crumb – provides chocolate with its distinctive caramelised milky taste. Chocolate crumb is a blend of refined sugar, cow's milk and cocoa. The use of fresh milk in chocolate crumb makes the flavour different to chocolate made from milk powders.
- Sweetened condensed dairy products – such products include condensed skimmed milk and 8% butterfat condensed milk which is used in confectionery for toffees, caramel and similar products.

##### 2. Unsweetened Dairy Products:

- Cream – growing consumer demand for skimmed and semi skimmed liquid milk has increased volumes of available excess cream. Meadow Foods have substantially developed its market for cream and currently process over 100,000 tonnes per annum.

- Anhydrous Milk Fat – this is produced from fresh butter or cream. The fat is separated and extracted from the cream to create a yellow liquid used to create ice cream, soft spreadable butters and the like. It can also be used in reconstituted milks. The product comprises 99.8% fat.
- Butter – this is supplied for use in manufacturing across a range of products. The product range includes sweetcream butter churned from fresh pasteurised cream. The company also supply to manufacturers lactic or sour cream butter.
- Cultured Dairy Products – these are made by adding culture pellets to cream, fermenting and incubating. These products are used in manufacturing sauces for ready meals yogurts and fromage frais.

#### 9.5.2 Market Development

Meadow Foods continue to seek growth in its principal markets and, as this occurs, it intends to meet the extra demand through investment to increase capacity and efficiency and by growth in its milk supply.

#### 9.5.3 New Markets

The company remain focused on its current markets and obtaining growth within them through increasing sales to existing customers and serving new customers.

### 9.6 Governance and Management Structures

Meadow Foods is a private company. The management team is led by an Executive Chairman supported by three other executive directors and two non executives. One of the non executives was a co-founder of Meadow Foods and has a background in food manufacturing and dairy trading. The other was previously Managing Director.

### 9.7 Business Strategy

#### 9.7.1 Long term Aims and Objectives

Meadow Foods have a strategy for future growth long term and four key components of this are through:

- Developing operations at a sustainable rate through organic growth and where appropriate acquisition where rationalisation in the industry provides opportunities.
- Growing milk supply. It seeks to achieve sustainable year-on-year growth in milk purchases to match projected volume growth in provision to customers.

- Continuing to review its business structures to ensure they remain fit for purpose and that the right skills are in place to respond to continued fluctuations in the milk market and to adapt effectively to changing market demands.
- Providing a high level of service to customers in order to meet changing needs and strengthen business relationships.

The business seeks to offer its customers a secure supply of dairy products in a dynamic and ever changing market.

#### 9.7.2 Expansion

- Meadow Foods is currently experiencing growth in all sectors and seek to capitalise upon its current position as an independent producer of dairy products and a major supplier of liquid milk to UK dairy groups.
- The company states that it 'will continue to develop both its business and its approach to farmer contracts in the light of these changes in the supply chain striving to ensure long term health of all its components.
- They will continue its programme of ongoing investment in milk processing facilities to meet demands.

#### 9.7.3 Sustainability

As is common to all the milk buyers reviewed, there is a strong commitment to sustainability and environmental issues in both current operations and going forward. Key areas under attention here are:

- Factory operation seeking efficiencies in energy use and reductions in waste
- Innovations in packaging, again to minimise waste and ease recycling

### 9.8 Summary

- Meadow Foods offer good security in terms of milk demand and offer opportunity for growth to farmers who match its requirements. Milk prices offered are set by them and will very much link to the success of its core markets for dairy products.
- It has demonstrated strong past performance. It will continue to develop existing markets and will seek from its suppliers, milk in volume and quality to match such needs. Its recent incentives for producers linked to forecast production may be developed to other areas in future.
- The business develops from a strong financial base and a record of success with its future and that of its farmer suppliers dependent on continued growth of its core markets.

## 10 Milk Link

### 10.1 Overview

Milk Link is a farmer owned business formed following the breakup of Milk Marque. It is a Members' voluntary co-operative, registered under the Industrial and Provident Societies Act 1965. Its principal milk field started in the South West and South of England, but has since spread to include significant milk pools centred on North Wales, Cheshire, Cumbria and South West Scotland. From its initial starting point as a milk broker, its focus is now very much on being an added-value processor. It is fully owned by 1,600 farmer members supplying a milk volume of 1 billion litres<sup>26</sup> per annum and an average member production of 666,000 litres.

Currently, Milk Link handles in excess of 1.35 billion litres of milk, the majority of which it processes at eight valued-added processing facilities located across the UK. It supplies all major food retailers, food processors and foodservice organisations with cheese, long life milk and creams, extended shelf life products, flavoured milk drinks, butter and custards. It also supplies raw milk to the fresh liquid milk sector and produces a range of dairy ingredients for the food manufacturing sector in the UK and Europe.

In line with its objective of increasing returns to its Members, over the last three years Milk Link has significantly restructured its processing business to remove underperforming areas, improve efficiencies, and increase its focus on producing added value dairy products. For example Milk Link now does not operate its own fresh milk facilities having sold its regional fresh milk business to Robert Wisemans Dairies in 2006. The sale also secured a major new milk supply contract to Robert Wisemans' fresh liquid dairy constructed in Somerset. It currently supplies circa 110m litres per annum to Robert Wisemans in Bridgwater. Its principal activities, as defined in its Annual Report 2009, are the collection of members' milk and its processing into dairy products.

Along with First Milk, it has investment in Westbury Dairies. This was a 20% stake but, with the exit from the Westbury Dairies by Dairy Farmers of Britain, the new arrangement gives them a one third share, with First Milk holding the other two thirds. Westbury Dairies is a modern powder and butter production facility and provides an important milk balancing capability. Milk Link completed the sale of its Staplemead Creamery – a fresh dairy ingredients and skimmed milk powder drying facility – to Andros, a French fresh dairy products business. This has taken Milk Link out of fresh dairy ingredients, a loss making activity, and was part of the move to drive down costs and increase efficiency.

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<sup>26</sup> These figures relate to the 2008/09 milk year. Milk Link has subsequently increased its direct supplier numbers to 2,100, who supply 1.35b litres of milk, with approximately 500 of these on long-term supply contracts.

In 2009 Milk Link opened a new Innovation Centre at its Taw Valley Creamery and the focus is on developing new dairy brands, products and improved packaging formats. It is seen as providing a platform for driving increased value from its processing activities and further developing partnerships with retail and foodservice customers.

The creation of a new 'Specialist Cheese' business was announced in 2009, which will focus on the production of a variety of crumbly and hard territorial cheese such as Stilton, Cheshire and Red Leicester. It will be complemented by its cutting and packing plant located alongside its existing Reece's Creamery.

## **10.2 Financial**

The data overleaf is taken from Milk Link's Annual Reports covering the periods 2007 to 2009. They represent the consolidated position incorporating Group performance and its share of joint venture activity.

### **10.2.1 Summary Profit and Loss Accounts**

The pence per litre figures stated are calculated using their total milk pool for each financial year end. These are based volumes from own suppliers and external purchasing. Table 36 below shows the summary profit and loss account.

Table 36 – Milk Link Summary Profit and Loss Account

Year End	04 April 2007			04 April 2008			04 April 2009		
	£ (000s)	ppl	%	£ (000s)	ppl	%	£ (000s)	ppl	%
Turnover	509,076	32.69	100.0	522,839	37.67	100.0	547,064	42.07	100.0
Cost of Sales	405,059	26.04	79.6	418,174	30.13	80.0	445,800	34.29	81.5
<b>Gross Profit</b>	<b>104,017</b>	<b>6.68</b>	<b>20.4</b>	<b>104,665</b>	<b>7.54</b>	<b>20.0</b>	<b>101,264</b>	<b>7.79</b>	<b>18.5</b>
Admin/Distribution Charges	84,687	5.44	16.6	83,618	6.02	16.0	81,662	6.28	14.9
<b>Operating Profit (Loss) before finance and tax</b>	<b>19,330</b>	<b>1.24</b>	<b>3.8</b>	<b>21,047</b>	<b>1.52</b>	<b>4.0</b>	<b>19,602</b>	<b>1.51</b>	<b>3.6</b>
Finance Costs – Bank	1,930	0.12	0.38	5,895	0.42	1.1	4,640	0.37	0.8
Finance Costs – Paid to Members	1,604	0.10	0.32	6,354	0.46	1.2	4,139	0.32	0.8
Other Income and Exceptional Costs	(811)	(0.05)	(0.2)	101	0.01	0.0	(10,339)	(0.79)	(1.9)
<b>Profit (loss) on Ordinary activities before taxation</b>	<b>14,985</b>	<b>0.96</b>	<b>2.9</b>	<b>8,899</b>	<b>0.64</b>	<b>1.7</b>	<b>484</b>	<b>0.04</b>	<b>0.1</b>
Taxation Credit/Charge on Ordinary activities				(1,505)	0.11	(0.3)	3,369	(0.26)	0.6
Minority Interest	1,163	0.08	0.2						
<b>Profit (Loss) on Ordinary activities after taxation</b>	<b>13,822</b>	<b>0.89</b>	<b>2.7</b>	<b>7,394</b>	<b>0.53</b>	<b>1.4</b>	<b>3,853</b>	<b>0.30</b>	<b>0.7</b>

Source: Company Reports

## Balance Sheet

Table 37 – Milk Link Balance Sheet

Year End	04 April 2007		04 April 2008		04 April 2009	
	£ (000s)	ppl	£ (000s)	ppl	£ (000s)	ppl
<b>Fixed Assets</b>						
Intangible Assets <sup>27</sup>	29,624	1.90	27,617	1.99	23,503	1.77
Tangible Assets	46,643	3.00	47,613	3.43	49,162	3.78
Investments	1,031	0.07	1,157	0.08	577	0.04
<b>Total</b>	<b>77,298</b>	<b>5.01</b>	<b>76,387</b>	<b>5.50</b>	<b>72,792</b>	<b>5.60</b>
<b>Current Assets</b>						
Stock	53,440	3.43	70,932	5.11	75,031	5.77
Debtors	62,398	4.01	65,739	4.74	59,831	4.60
Cash at Bank	9,259	0.60	6,886	0.50	8,707	0.67
<b>Total</b>	<b>125,197</b>	<b>8.04</b>	<b>143,557</b>	<b>10.34</b>	<b>143,569</b>	<b>11.04</b>
<b>Total Assets</b>	<b>202,495</b>	<b>13.00</b>	<b>219,944</b>	<b>15.85</b>	<b>216,361</b>	<b>16.64</b>
<b>Current Liabilities</b>						
Trade Creditors	32,524	2.09	37,629	2.71	36,840	2.83
Borrowings	42,591	2.74	19,126	1.38	26,825	2.06
Current Tax Liabilities	1,616	0.10	2,759	0.20	1,354	0.10
Other	28,339	1.82	34,168	2.46	27,761	2.14
<b>Total</b>	<b>105,070</b>	<b>6.75</b>	<b>93,682</b>	<b>6.75</b>	<b>92,780</b>	<b>7.14</b>
<b>Non-Current Liabilities</b>						
Borrowings	50,809	3.26	73,741	5.31	57,957	4.46
Other	4,255	0.27	1,701	0.12	4,740	0.36
<b>Total</b>	<b>55,064</b>	<b>3.54</b>	<b>75,442</b>	<b>5.44</b>	<b>62,697</b>	<b>4.82</b>
<b>Total Liabilities</b>	<b>160,134</b>	<b>10.28</b>	<b>169,124</b>	<b>12.18</b>	<b>155,477</b>	<b>11.96</b>
<b>Net Assets</b>	<b>42,361</b>	<b>2.72</b>	<b>50,820</b>	<b>3.66</b>	<b>60,884</b>	<b>4.68</b>
<b>Member Investment</b>						
Member Capital Accounts	46,243	2.97	50,592	3.64	53,886	4.15
Other Reserves					11,330	0.87
Retained Earnings	(3,882)	(0.25)	228	0.02	(4,332)	(0.33)
<b>Total Member Investment</b>	<b>42,361</b>	<b>2.72</b>	<b>50,820</b>	<b>3.66</b>	<b>60,884</b>	<b>4.68</b>

Source: Company Reports

<sup>27</sup> Assets which do not have a physical presence. E.g. brands, trademarks.

## 10.2.2 Ratios

*Table 38 – Milk Link Ratio Analysis*

Year Ending		2007	2008	2009
Return on Sales	%	3.80	4.03	3.58
Sales/Tangible Assets	%	1091	1098	1113
Stocks/Turnover Ratio	%	10.5	13.57	13.72
Stock/Turn Ratio	No.	7.21	6.72	6.11
Operational gearing	%	538	497	517
Asset utilisation ratio	%	1202	1029	899
Working Capital/Sales Ratio	x:1	0.16	0.19	0.18
Return on Capital	%	46	41	32
Debtor/Creditor Ratio	x:1	1.92	1.75	1.62
Current Ratio	x:1	1.19	1.53	1.55
Quick Ratio	x:1	0.68	0.78	0.74
Debt/Equity	%	198.39	169.19	124.95
Gearing (Gross debt)	%	69.00	65.00	58.00
Gearing (Net debt)	%	61.90	59.84	52.23
Interest Cover	x:1	5.47	1.72	2.23
Contingent Liabilities	%	0	0	0

*Source: Bidwells Analysis*

Highlights from the financial analysis are:

- Turnover has increased consistently and, over the two years summarised, is up by 7.5%. When measured against total milk supply, it equally represents an increase of 28.7% (9.38ppl). The projection for 2009/10 is that this might fall back slightly on a pence per litre basis (due to feed through of lower producer prices and lower cheese prices). Half year trading results for the period up to 4 October 2009 showed a group turnover of £271 million compared to £278 million in the same half year in 2008/09 (although taking into account that the previous period was a 27-week half year rather than a 26-week half year, then turnover was slightly up on a like-for-like basis).
- Although slightly below in 2009, the gross profit stands at circa 20% in the three years examined, equivalent to 7.79ppl. The lower gross margin in 2009 is affected by the increase in both sales prices and milk price paid to Members.

- Cost of sales rose due primarily to the higher price paid to Members for milk being utilised in the processing of cheese and other dairy products. Profit and Loss on ordinary activities after taxation has fallen in the period although the 2009 figures include some £7,007k exceptional items related to discontinued operations (disposal of Staplemead) and strategic actions taken to improve efficiency and effectiveness. If these figures are taken out, the profit and loss figure on ordinary activities before taxation would be £7,491k in 2009 compared to £8,899k in 2008 and £14,985k in 2007.
- The Members' interest payments in 2008 includes both the 2007 payment (made during 2008) and an accrual for the 2008 payment which makes the 2009 payment appear lower.
- There was an exceptional impairment charge of £2,607k in 2009 relating to the closure of the Kirkcudbright dairy.
- Liquidity is improving with a strong Current ratio of 1.55 and Debtor/Creditor ratio of 1.62. These both mean that Milk Link can meet all their short term liabilities without distress sales.
- Gearing (using gross debt) has fallen from 69% in 2006 to 58% in 2009. The Net debt to equity ratio has declined significantly in the period reviewed from 198% to 125% and there has been a strong increase in Members' funds, standing at £60,884K at 4 April 2009. We understand Milk Link intend to continue to reduce dependency on borrowing for core assets. There is an increase in current borrowings in 2009 due to a more long term debt becoming due for repayment. Finance charges have fallen due to falling gearing.
- In dealing with Members' funds, a capital retention of 0.5 pence per litre is in place to maintain adequate reserves. Milk Link has always paid interest on its Members' capital (see below).
- The declining investments on the balance sheet between 2008 and 2009 year ends relates to the disposal of Staplemead.
- There was a property revaluation in 2009 which added £11.3m to the property valuation, increasing the tangible fixed assets on the balance sheet.
- Asset utilisation has fallen over the period due to declining milk volumes although the 2009 ratio is skewed by the impact of the revaluation of properties. This is likely to stabilise at current levels.
- Positive net cashflow from operating activities of £23.9m in year ending 4 April 2009 with a free cashflow of £1.8m.
- All of the Group debt is scheduled for repayment within 5 years. We expect that many of the facilities will be renewed.

In the half year results up to 4 October 2009, profit before tax was £4.9m up from the equivalent period last year by £3.5m. This increase is due to there being no exceptional costs in the six months to October 2009. When exceptional income and costs are included earnings are lower in 2009 than 2008 first half. This was a consequence of decisions to increase relative milk price paid to members, reversal of cheese stock profits, a

slightly lower mix of cheeses sales due to the high level of branded promotions and certain customers making substitution of cheaper imported cheeses.

Results for the first half of the 2009/10 year show continued debt reductions in existing operations (although inclusion of the Llandyrnog Creamery increases net debt), Member funds have also risen. The effect of the Llandyrnog acquisition results in gearing increasing from the position at the 4 April 2009 but lower than the same time last year. Turnover was down by £7m (note it is based on a 27-week half year) with Earnings before Interest, Tax, Depreciation and Amortisation down £5m to £12.5m.

### 10.3 Milk Supply and Contracts

In the last year, Milk Link has recruited over 500 new members and direct suppliers (mainly from DFoB) with a supply of circa 350 million litres. Added to existing milk production from Members, this brings total production to some 1.35 billion litres which replaces the majority of milk bought in from third party brokers and secures milk for added value processing. Milk Link's Member production continues to increase annually and in the last 12 months, the total pool from existing members has increased by some 4% in their trading year 2008/09 compared to a slight drop nationally. Total milk production by their members now represents some 12% of the total GB supply.

Milk price is discussed and agreed by a Board which comprises experienced Non-Executive Directors, Executive Directors and Farmer Elected Directors, the latter being always in the majority. Reward for farmer Members is a combination of milk price and a processing interest payment representing a return on Member's Qualifying Loans funded out of profits generated by the business. In 2008/09, Milk Link provided a 10.8% return to Members related to their Qualifying Loans. Since 2007 the return on Members Qualifying Loans has exceeded 10% and been worth between 0.30 and 0.42ppl.

#### 10.3.1 Milk Supply Overview

Table 39 shows the milk supply base of Milk Link for the 2008/09 milk year.

*Table 39 – Milk Link Supply Base (2008/09)*

Number of Suppliers	1,600
% of total GB suppliers	12%
Volume of raw milk supplied by member farmers (million litres)	1,000
% of total GB volume	9%
Volume of raw milk purchased from other dairies or other suppliers (million litres)	300

*Source: Bidwells Analysis*

### 10.3.2 Milk Contracts Overview

Table 40 sets out the current contracts.

*Table 40 – Milk Link Contracts (2008/09)*

<b>Contracts</b>	<b>London Liquid</b>	<b>Manufac-turing</b>	<b>Tuxford &amp; Tebbutt</b>	<b>Northern Expansion</b>	<b>Cumbrian</b>	<b>Llandyrnog</b>
End Use	Liquid	Processing	Cheese	Processing	Processing	Processing
12- month average price (DairyCo standard litre)	25.48	A/B – 25.03 Seasonal – 25.12	27.12	A/B – 25.03 Seasonal – 25.27	27.17 (7 month average)	n/a
Frequency of Review	As required					
Notice period of price change	During month before change becomes effective					
Catchment Area	Southern England	National	Melton Mowbray region	Scotland/ Northern England	Cumbria	Llandyrnog area
Preferred production profile	No preference					
Notice Period – Producer	1 year					
Are Members eligible for bonuses whilst under notice	Yes					
Notice Period – Purchaser	Evergreen contract - no notice can be given by the Society					
Recruitment Areas	As per catchment areas					
Number of suppliers	1,600					
Estimated raw milk volume/contract (m/litres)	1,300m litres					
Cost of farmer Member investment	0.5ppl per annum					
Return on farmer Member investment	Interest payment on capital invested					
Who decides milk price?	Milk Link (Farmer Elected Members represented on Board)					
What factors affect prices?	Returns from market and profitability					
Is there a negotiation process	Member representation on management board					
Does any pricing follow a formula?	No				Higher of MCVE <sup>28</sup> and a basket of other milk prices	No

<sup>28</sup> MCVE is the Milk for Cheese Value Equivalent which derives from the mild cheese market including whey products.

## Milk prices

While the milk price is not subject to a formula Milk Link balance two requirements when deciding on the milk price. These are maximising returns from milk and ensuring that the processing business gets the right quality of milk, at the right place and time (which boosts Member returns from processing).

### 10.4 Processing

Milk Link creameries include Taw Valley Creamery, Devon, Tuxford & Tebbutt Creamery, Leicestershire, Reece's Creamery, Cheshire, Llandyrnog Creamery, North Wales and Lockerbie Creamery, Scotland. It also has a high volume cheese packing facility in Oswestry, Shropshire, a Specialist Cheese packing facility in Malpas, Cheshire and a milk beverage and cream processing facility at its Crediton Dairy, Devon.

Over the last three years Milk Link has undertaken a programme of investment in its processing assets. These have focussed on improving the technology at its creameries to enhance efficiency and increase capacity. In addition it has acquired the Llandyrnog Creamery in North Wales from Dairy Farmers of Britain for £25 million. Table 41 summarises the current facilities.

*Table 41 - Summary of Processing Facilities in Operation*

Location	Capacity (million litres)	Products
Taw Valley Creamery, Devon	350	Creamery producing Cheddar and Territorial cheeses
Reece's Creamery, Cheshire	25-50	Creamery producing crumbly territorial cheeses & packing plant
Lockerbie Creamery, Scotland	200-300	Creamery producing Cheddar and butter.
Oswestry, Shropshire	Cheese cutting & packing	Cheese packing facility
Crediton Dairy, Devon	100-200	Dairy producing long-life milk and cream, ESL products and flavoured milks
Tuxford & Tebbutt Creamery, Leicestershire	10-25	Creamery producing Stilton
Llandyrnog Creamery, North Wales	100-200	Creamery producing Welsh Cheddars
Westbury Dairies, Wiltshire	800	Skimmed milk powder and butter, balancing facility (One third owned by Milk Link)

*Source: Milk Link and Bidwells Analysis*

#### 10.4.1 Investment

Over the last three year, Milk Link has invested over £30 million in upgrading its processing facilities and operations. Notable recent investments include:

- Introduction of efficiency programmes at Crediton, Taw Valley, Lockerbie and Oswestry
- Investment in IT systems to aid business management
- Investment in cheese packing equipment to reduce labour requirement including automated blocking facilities at Taw Valley and robotic case packers at Oswestry.
- Investment in added value liquid milk facilities including high speed filling equipment for long life and flavoured milk at Crediton.
- Construction of an Innovation Centre at Taw Valley which cost £1.2m and employs eight people. The role of this facility is to develop new brands, products and packaging solutions and provide a platform for further development of relationships with key retail and foodservice customers.
- Building of new Speciality Cheese packing plant alongside the Reece's' Creamery.
- Acquisition of the former DFoB Llandyrnog Creamery in June 2009 for £25m, including stocks and debtor book. Since its acquisition Milk Link has undertaken a strategic review of the creamery to return it to profitability and as a results, some 79 redundancies have taken place and the packing operation have been transferred to the Oswestry facility.

#### 10.4.2 Rationalisation

Over the last three years, Milk Link has significantly restructured its processing business to remove underperforming areas, improve efficiencies, increase its focus on producing added value dairy products and ultimately improve returns to its Members relative to the market. The restructuring has included the:

- Sale of the Staplemead Creamery to Andros. This facility had a role in balancing milk but given Milk Link's access to Westbury Dairies skimmed milk powder and butter processing capacity, it is no longer required. Sale of this facility boosted profits by £3.4m.
- Closure of the Kirkcudbright dairy with the refocus of Long Life and Extended Shelf Life (ESL) milk production at Crediton.
- Sale of small regional liquid milk dairies at Pensilva and Okehampton to Robert Wiseman Dairies in 2006/07 year.

## 10.5 **Marketing**

### 10.5.1 Brand Portfolio

The main Milk Link brands are shown in table 42 with sales value and volume data for the 2008/09 period. Branded products currently account for a small proportion of the milk field but the growth rates are strong in volume and sales value in some market segments.

Table 42 – Milk Link Product Portfolio (2008/09)

Segment	Brand	Market Segment	Estimated Share of Raw Milk Volume 000/litres	% of Market Segment Volume	Change in market share (volume) 07/08-08/09	% of Market Segment Value	Change in market share (value) 07/08-08/09		
Liquid	Moo (white and flavoured)	Pasteurised	<3%	<1%	n.c	<1%	n.c		
	Flora Pro Activ								
	Scottish Pride								
	Mars								
	Galaxy								
Cheese	Tickler	Cheddar	7%	1%	+<1%	1%	+<1%		
	Lockerbie								
	Cadog								
	Yeo Valley Organic Cheese								
	Tuxford & Tebbutt	Blue		Figures not available					
	Bladen	Food service		unavailable					

Source: Kantar, Bidwells Analysis

## 10.5.2 Core Brands

### Moo

Moo was launched in 2004 as 1 litre skimmed and semi skimmed UHT milk, the range was extended in 2005 to include organic. Moo one% was launched in July 2008 to develop a lower fat product to meet consumer demand but still with full flavour. Moo long life and extra shelf life flavoured milk have seen sales growth of 42% in the last 12 months..

### Flora Pro Activ

Flora Pro Active semi skimmed milk drink is made from fresh milk with added plant sterols. Flora Pro-Active sales have grown 9% in the last 12 months and account for approximately 30% of the speciality milk market

in volume and value terms. The use of such a licensed brand also extended to Mars and Galaxy for example, is an important and interesting development. It currently has approximately 30% share of the retail market in terms of volume and value.

#### Tickler

Tickler was launched in 2007. Tickler is an extra mature cheddar produced at the Taw Valley Creamery in Devon. Tickler was launched to develop the extra mature cheddar market. Sales growth in the last year is approximately 30%.

#### Tuxford & Tebbutt

Tuxford & Tebbutt branded products are produced at the Stilton Creamery in Melton Mowbray, Leicestershire and include Stilton, mini portions and a British Speciality Cheese selection pack, which includes Double Gloucester, Red Leicester and Mature Cheddar cheeses. Products are stocked by major UK supermarkets, foodservice operators and are distributed to over 20 countries globally, including the USA, Canada, and Europe.

#### Bladen

Bladen is Milk Link's foodservice brand, and offers caterers a range of dairy products from high volume grated cheeses, cheese slices to butter portions and milk jiggers. It accounts for one third of all cheese produced by Milk Link in the foodservice sector.

### 10.5.3 Retailer Own Label

Milk Link produce significant volumes of retailer own label cheese. Major customers include Sainsbury's, Marks & Spencer, Waitrose, Tesco, the Cooperative (including Somerfield), Morrisons and Iceland. Products range from value cheese to premium retailer brands. The names of Milk Link Creameries now appear on some products in Sainsbury's, Marks & Spencer and Waitrose. In September 2009, Milk launched their new 'Lighter' cheese and has secured retail listings in Waitrose, Sainsbury's and the Co-operative along with accounts with foodservice, distributors and wholesalers.

In addition, Milk Link produce retailer own label long life milk for Sainsbury's, Morrisons, the Co-operative and Iceland. It also produces all of Tesco's own label flavoured milk drinks.

In the foodservice sector, Milk Link is a major supplier of customer branded dairy products for companies such as Booker, Brakes and is the only strategic dairy supplier to 3663<sup>29</sup>.

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<sup>29</sup> 3663 are a food service business supplying food to organisations like schools, hospital, canteens, restaurants and pubs

Milk Link focus on ensuring good customer service to secure its relationships with retailers.

#### 10.5.4 Brand Strategy

Milk Link regards itself as a price maker operating in an integrated market and puts significant emphasis on being either number 1 or 2 in terms of each market it operates in. It seeks to generate value for its farmer Members by focusing on the supply of value-added dairy products to leading retailers, primarily in the form of own-label brands and premium branded products. While focus is on supplying the UK domestic market, there is some export of premium cheeses to a range of countries.

Milk Link has been expanding its delivery of premium cheeses, notable of which are Tickler Extra Mature Cheddar, The Red One, Cadog, Lockerbie Mature Cheddar and Tuxford & Tebbett Blue Stilton. In volume terms, it is the UK's largest cheese maker with over 20 branded varieties. Recently it has been growing its market for convenience cheese products – sliced, grated etc. The capability to offer a wide range of cheeses to its customer has also been enhanced by their investment in new Specialist Cheese packing facilities at Reece's Creamery in Malpas.

Long and Extended Shelf Life (ESL) milks and cream products, together with a range of flavoured milks, are another key market for Milk Link. Indeed they currently supply circa 30% of the long life retail market and some 20% of the ESL<sup>30</sup> sector. Flavoured milks such as Moo, Mars and Galaxy are examples of ESL milk. Long Life white milk is produced both under the Moo brand and for retailer own brands.

There is growth in lighter cheeses (low fat) and a new 30% reduced fat cheese is proving particularly valuable in the food service sector.

#### 10.5.5 Liquid Milk Supply

Milk Link supply unprocessed raw liquid milk to major processors including Robert Wiseman Dairies' Bridgwater facility and Arla Foods UK, along with food/dairy processors such as Cadburys, and to smaller farmhouse/specialist cheese producers.

### 10.6 Governance and Management Structures

Milk Link has a governance structure which seeks to provide transparent representation of Members' interests on the Board. The main Board is a minimum of five persons, comprising the Chief Executive (CEO), Farmer Elected Directors and other executive or non executive directors as the Board requires. The Farmer

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<sup>30</sup> Long life milk is milk heated to a high enough temperature to kill all micro-organisms and spores without significantly changing flavour, extended shelf life (ESL) milk is heated to higher temperatures than standard pasteurisation but not as high as Long Life milk. Long Life milk requires no refrigeration whereas ESL does.

Elected Directors must hold the majority and serve for three year terms, retiring by rotation to ensure annual elections for one or more Farmer Elected Directors.

The Farmer Elected Directors are required to be currently consigning milk to the co-operative. The management team, headed by the CEO are responsible for implementing Board decisions and day to day business. Local Member Groups are elected onto the Council, which in turn elects a majority of the Directors of the Board. The Council provides a channel for the dissemination of all necessary information from the Board to the Members, and for the raising of issues by Members to the Board. The structure is designed so that there is effective two-way communication between the membership and the Board.

## 10.7 **Business Strategy**

### 10.7.1 Aims and Objectives

Key priorities in taking forward its business are in terms of delivering security, stability and sustainability to Members. As described earlier in the report, there is considerable volatility in the milk market at a time when the UK dairy industry is already fragile. As a co-operative, Milk Link remains focused on minimising impact on members. Milk Link seeks to continue to grow both organically and by investment

Key priorities are:

- Continuing to improve total returns to Milk Link Members relative to the market
- Continuing to secure, through investment and other means, increasing efficiency from its processing facilities
- Growing and continuing to strengthen key customer relationships
- Developing further the integrated approach to its market in terms of its products, customer base and sales channels
- Continuing to operate the business at 'PLC' standards and with an increasing focus on customer service levels, currently very high based on surveys. The intention is to remain at this level.
- Continuing to operate independently in the market place establishing partnerships and implementing targeted acquisitions where the opportunity arises and it is sensible for the business.

The business will also continue to develop its level of partnership working with examples being producing cheese for Yeo Valley, extended shelf life flavoured milk with Mars, as well as milk supply contracts to Wisemans and Arla and organic milk to OMSCo. With regards to the latter, while overall demand for organic products has declined in recessionary times, the market for dairy products has been fairly robust.

### 10.7.2 Expansion

Milk Link has been involved in a series of strategic structural changes in the last 18 months, involved with realigning and refocusing the business aimed at improving efficiencies and profitability. This has included:

- The sale of Staplemead.
- The creation of a central executive management team replacing the previous divisional structure and consolidation of their Head Office with savings in excess of £2 million.
- Investment in IT especially linked to planning and management information systems.
- The creation of a dedicated marketing team to oversee and promote the development of customer branded ranges, branded cheeses and milks as well as appropriate licensing agreements.
- Acquisition of Llandyrnog Creamery, formerly owned by Dairy Farmers of Britain, and a realignment of operational activities to deliver more effective and efficient production.
- Investment programmes at its processing facilities including Crediton, Taw Valley, Lockerbie, Reece's and Oswestry.

The total amount invested by Milk Link in upgrading its processing facilities since inception is over £30 million.

### 10.7.3 Sustainability

Milk Link's environmental policy statement outlines its commitment to meet the needs of its customers in an environmentally sound and sustainable manner by the effective and efficient use of resources. Some examples are:

- Operating plants gaining and retaining ISO 14001:2004 (Environmental Management Systems) certification – an international standard.
- Membership of the Climate Change Levy discount scheme.
- Reducing packaging waste by cleaning 'dirty' plastic and re processing for manufacturing purposes.
- Removing less efficient lighting and replacing with lower energy systems.
- Working with its members on farm across a range of initiatives seeking to reduce energy and water use, recycle plastic at reduced cost and generally seek to reduce environmental impact.

## 10.8 Summary

- Milk Link offers good security of milk demand and project continued growth in requirements. Returns to milk producers are based upon milk price and return on investment and will reflect market conditions in the liquid and relevant processing markets. These are balanced to ensure a competitive milk price and the right quality of milk at the right time to the processing operation. Farmer influence on price and strategy is significant given its structure.
- The business has performed well against previous plans and its current strategy of growing and developing existing markets based on appropriate investment and innovation gives significant confidence going forward. Its strategy focuses on developing brands and ensuring a high level of service to retail customers whose own-brand products they produce and pack.
- It has a strong financial base with reducing debt levels and positive cash generation.
- Future conditions in the cheese market and how Milk Link fares within it are important factors for the future.

## 11 **Müller**

### 11.1 **Overview**

The business was started in 1896 by Ludvig Müller in Bavaria, Germany with a small dairy producing products for local consumers. When Theo Müller took over in 1970 the business began its development into a national brand and then multinational. In 1980, Müller Rice was launched followed by Müller Corner later in the decade. In the UK, Müller Corner was launched in 1988 followed by Müller Rice and Müller Light in 1990. With rapid sales growth, Müller started construction of a UK production facility in 1991 at Market Drayton in Shropshire. The investment carried a £30m value and the location was chosen due to the potential milk field available in the Shropshire region. In 1992, Müller became market leader in the yogurt market.

Müller still operate from its Market Drayton location with several extensions to facilities taking place since 1991.

Müller remain focused on the original brands with Corner, Light and Rice remaining strong alongside a number of newer products including Vitality, Little Stars and Amoreé.

The UK Business Müller Dairy (UK) Limited is wholly owned by Molkerei Alois Müller GMBH & Co KG which holds all of the 10,000 shares in the company.

### 11.2 **Financial**

The financial results presented below are from the UK limited company, not the consolidated statements of the German parent company. The pence per litre figures are based on a milk pool of approximate 230m litres for each of the financial years.

#### 11.2.1 **Summary Profit and Loss Account**

Table 43 below summarises the profit and loss account for Müller Dairy (UK) Ltd.

Table 43 – Müller Summary Profit and Loss

Year End	31 December 2006			31 December 2007			31 December 2008		
	£ (000s)	ppl	%	£ (000s)	ppl	%	£ (000s)	ppl	%
Turnover	433,223	181.39	100.0	374,193	154.83	100.0	397,813	169.47	100.0
Cost of Sales	247,406	103.59	57.1	257,900	106.71	68.9	296,758	126.42	74.6
<b>Gross Profit</b>	<b>185,817</b>	<b>77.80</b>	<b>42.9</b>	<b>116,293</b>	<b>48.12</b>	<b>31.1</b>	<b>101,055</b>	<b>43.05</b>	<b>25.4</b>
Admin/Distribution Charges	161,642	67.68	37.3	80,107	33.15	21.4	87,066	37.09	21.9
<b>Operating Profit (Loss) before finance and tax</b>	<b>24,175</b>	<b>10.12</b>	<b>5.6</b>	<b>36,186</b>	<b>14.97</b>	<b>9.7</b>	<b>13,989</b>	<b>5.96</b>	<b>3.5</b>
Finance Costs	(10,059)	(4.21)	(2.3)	(9,170)	(3.79)	(2.4)	(16,849)	(7.18)	(4.2)
Other income and exceptional costs	(300)	(0.13)	(0.1)	(41)	(0.02)	(0.0)	(12,328)	(5.25)	(3.1)
<b>Profit (loss) on Ordinary activities before taxation</b>	<b>33,924</b>	<b>14.20</b>	<b>7.8</b>	<b>45,315</b>	<b>18.75</b>	<b>12.1</b>	<b>18,510</b>	<b>7.89</b>	<b>4.6</b>
Taxation on Ordinary activities	10,211	4.28	2.4	13,673	5.66	3.7	5,334	2.27	1.3
<b>Profit (Loss) on Ordinary activities after taxation</b>	<b>23,713</b>	<b>9.93</b>	<b>5.5</b>	<b>31,642</b>	<b>13.09</b>	<b>8.4</b>	<b>13,176</b>	<b>5.61</b>	<b>3.3</b>

Source: Company Documents from Companies House

### 11.2.2 Summary Balance Sheet

*Table 44 – Müller Summary Balance Sheet*

Year End	31 December 2006		31 December 2007		31 December 2008	
	£ (000s)	ppl	£ (000s)	ppl	£ (000s)	ppl
<b>Fixed Assets</b>						
Tangible Assets	102	0.04	391	0.16	224	0.10
Total	102	0.04	391	0.16	224	0.10
<b>Current Assets</b>						
Stock	5,154	2.16	4,951	2.05	7,662	3.26
Debtors	43,426	18.18	50,458	20.88	56,619	24.12
Investments	79,068	33.11	78,695	32.56	1,418	0.60
Cash at Bank	158,529	66.37	193,160	79.92	27,290	11.63
Total	286,177	119.82	327,264	135.41	92,989	39.61
<b>Total Assets</b>	<b>286,279</b>	<b>119.86</b>	<b>327,655</b>	<b>135.57</b>	<b>93,213</b>	<b>39.71</b>
<b>Current Liabilities</b>						
Trade Creditors	2,116	0.89	551	0.23	2,154	0.92
Current Tax Liabilities	4,972	2.08	8,133	3.37	1,716	0.73
Other	68,072	28.50	76,210	31.53	68,857	29.33
<b>Total Current Liabilities</b>	<b>75,160</b>	<b>31.47</b>	<b>84,894</b>	<b>35.13</b>	<b>72,727</b>	<b>30.98</b>
<b>Net Assets</b>	<b>211,119</b>	<b>88.39</b>	<b>242,761</b>	<b>100.45</b>	<b>20,486</b>	<b>8.73</b>
<b>Equity</b>						
Share and Member Capital	10	0.00	10	0.00	10	0.00
Retained Earnings	211,109	88.39	242,751	100.44	20,476	8.72
<b>Total Equity</b>	<b>211,119</b>	<b>88.39</b>	<b>242,761</b>	<b>100.45</b>	<b>20,486</b>	<b>8.73</b>

*Source: Company Documents from Companies House*

### 11.2.3 Ratio Analysis Summary

*Table 45 – Müller Ratio Analysis*

Year Ending		31 December 2006	31 December 2007	31 December 2008
Return on Sales	%	5.58	9.67	3.52
Stocks/Turnover Ratio	%	1.19	1.32	1.93
Stock/Turn Ratio	No.	51.84	51.04	47.06
Operational gearing	%	768.63	321.38	722.39
Working Capital/Sales Ratio	x:1	0.11	0.15	0.16
Return on Capital	%	11.45	14.91	68.29
Debtor/Creditor Ratio	x:1	20.52	91.58	26.29
Current Ratio	x:1	3.81	3.85	1.28
Quick Ratio	x:1	3.74	3.80	1.17
Interest Cover	x:1	(2.40)	(3.95)	(0.83)

### 11.2.4 Financial Commentary

Müller Dairy (UK) Ltd is the UK subsidiary of a much larger German business. As a result, the figures contained in the table above may not provide a whole representation of the business. They represent only the portion of the business which is included in the UK limited company. In particular, we believe that many fixed assets and the borrowings are held in Germany. Therefore great care should be taken in any conclusion or interpretations of these results.

Some comments from the financial information are summarised below:

- The turnover reduction between the 2006 and 2007 year ends is related to changes in accounting and fully compensated by reductions in distribution cost. There is no impact on profit before finance and tax of this turnover fall.
- Turnover grew due to higher volumes between 2007 and 2008 and was worth 169.47ppl in 2008.
- Cost of sales increased to 126.42ppl in 2008, this is linked to increases in raw material costs. These should slow in 2009.
- Gross profit fell between 2007 and 2008 to 43.05ppl due to increases in cost.
- Turnover and profit remain high on a comparative basis when stated as pence per litre.

- Pre tax profit per litre is strong but declined considerably between 2007 and 2008 to 7.89ppl due to rising cost of sales and overheads.
- The balance sheet includes no borrowing and it is believed that many assets are held in Germany. We do not believe these statements represent the full picture.
- The current ratio is strong at 1.28 in 2008 but down on previous years.
- Small negative operating cashflow in the year ending 31 December 2009.
- The fall in administration and distribution charges in between 2006 and 2007 are compensated by a fall in turnover and do not affect the profit levels. Between 2007 and 2008 changes have taken place which is probably related to the way the UK company transacts with parent and sister businesses. These include the fall in investments, fall in net assets, fall in cash at bank, fall in current ratio, fall in debtor/creditor ration and positive finance costs. These are not necessarily evidence of problems.

### 11.3 Milk Supply and Contracts

Müller aims to procure approximately 90% of its milk from directly contracted farmers within 30 miles of Market Drayton. The remaining 10% is procured locally from Robert Wiseman Dairies or Dairy Crest and occasionally brokers. Surplus milk is sold on. The total milk volume used by Müller is approximately 230 million litres.

#### 11.3.1 Milk Supply Overview

The current milk supply base is set out in table 46 below.

*Table 46 – Müller Supply Base (2008/09)*

Number of Suppliers	150
% of total GB suppliers	1%
Volume of raw milk supplied by member farmers (million litres)	205
% of total GB volume	2%
Volume of raw milk purchased from other dairies (million litres)	25

*Source: Bidwells Analysis*

### 11.3.2 Milk Contracts Overview

The details of the milk contract are set out in table 47.

*Table 47 – Müller Milk Contract (2008/09)*

<b>Contracts</b>	<b>Müller</b>
End Use	Processing
12-month average price (DairyCo standard litre)	Not available
Frequency of Review	As required
Notice period given of price change	1 month
Catchment area	30 mile radius of Market Drayton
Preferred milk production profile	Flat
Notice Period – Producer	6 months (12 for new producers)
Are producers eligible for bonuses whilst under notice	Yes
Notice Period – Purchaser	12 months (24 for new producers)
Recruitment areas	30 mile radius of Market Drayton
Number of suppliers	169
Raw milk volume/contract (m/litres) 2008/09 year	205
Cost of farmer investment	Not applicable
Return on farmer investment	Not applicable
Who decides milk price?	Müller
What factors affect prices?	Input Costs, Returns from Market
Is there a negotiation process	No
Does any pricing follow a formula?	No

*Source: Müller / Bidwells Analysis*

### 11.3.3 Notice Periods

The notice period for new producers differs from that in place for existing producers. The current contract was launched in 2008 with existing producers on six months notice. The standard notice period for new producers is 12 months with Müller required to give 24 months notice; these can be extended by negotiation.

### 11.3.4 Price Decisions

While Müller communicate with its milk suppliers, the pricing decisions are solely those of Müller and there is no formal negotiation procedure in place. Müller are required to give one month notice of any changes to

prices and do, where possible, give more notice. Müller's level of communication with producers has increased considerably in recent years.

#### 11.3.5 Incentives

The contract has no seasonality payment but includes incentives for butterfat and protein content. There is also a monthly volume bonus which is calculated on the average daily delivery in that month. Currently only 7.3% of producers receive less than the standard price (which is the price before bonuses or penalties).

### 11.4 Processing

#### 11.4.1 Market Drayton

Müller operates one facility in the UK. This is at Market Drayton in Shropshire. The site was established with a £30 million investment in 1991 and was followed by a further £24m to extend the warehouse and distribution facility in 1999. In 2001, the dairy was extended with a £55m investment. The site processes 230million litres of raw milk and produces 95% of Müller's UK needs.

#### 11.4.2 Investment

Müller plan to produce 100% of the UK market need from Market Drayton without importing from Germany. During 2009 it is investing £20m which includes £12m on new Corner machinery. It currently produces about 14m pots per week and needs to produce 15m pots per week to get to 100%. There is little ability to further expand the existing site once current investment is complete but Müller own 55 acres adjacent to the site for further development. They already have outline planning permission for this land.

#### 11.4.3 Rationalisation

Currently no rationalisation is taking place or planned.

## 11.5 Marketing

### 11.5.1 Brand Portfolio

The product portfolio is set out in table 48 below.

*Table 48 – Müller Product Portfolio (2008/09)*

Segment	Brand	Brand Value (where known)
Yogurts	Müller Corner	£220m
	Muller Light	£132m
	Müller Rice	£53m
	Müller Amore	Not known
	Müller Vitality	Not known
	Müller Little Stars	Not known
	Cadbury Brands	Not known

*Source: Müller*

### 11.5.2 Core Brands

The main three Müller brands are well established (Corner, Light and Rice). Müller Vitality is a probiotic yogurt launched in 2000. This brand is performing well and is likely to be a front runner in its product offer.

### 11.5.3 Market Development

Müller brands are well established with a 26% share in the UK yogurt market. This market is continuing to grow with the Chilled Yogurt and Pots Dessert category growing by £53m in the last 12 months, Müller gained £22m of this. Müller products have a 77% household penetration (a measure of the proportion of households which buy the product). Müller are actively pursuing the 23% of households in which they are not present. Historically Müller had neglected the food service sector but this is now being targeted to increase its share of an important sector.

### 11.5.4 New Markets

In Germany, the Müller business is engaged in a greater range of dairy markets than the UK business. Müller is likely to remain focused on growth within the existing category in the UK market and not enter other markets.

Müller do not intend to enter the retail own-brand market which is typically lower margin.

## 11.6 Governance Structures

Müller is a multinational company. Müller Dairy (UK) Ltd. has an executive management team which reports back to the main board and has responsibility for implementing Board decisions and day to day operational management.

## 11.7 Business Strategy

### 11.7.1 Long term aims and objectives.

Müller's long term aims and objectives are:

- Continued growth in its existing market category.
- Access to 23% of households not currently purchasing Müller products.
- Continued penetration of the food service sector.

### 11.7.2 Expansion

Müller's aims are to:

- Increase UK production from 95% of market need to 100%, displacing imports from Müller Germany.
- When market demand requires, develop the adjacent land owned by Müller to extend the processing facility.

### 11.7.3 Sustainability

Environmental Sustainability and Corporate Social Responsibility is increasingly important in business strategy. Müller is part of the Courtauld Commitment to reduce packaging waste. In addition it is increasing dialogue with farmer suppliers to develop supply chains and hosting school visits to farms to increase children's understanding of food production.

## 11.8 Summary

- Müller offers good security of milk demand and some opportunities for growth. The milk price is understood to be competitive but suppliers are required to meet quality standards.

- It has recently put greater emphasis on farmer contact and understanding its supply chain. The strategy going forward is to increase market penetration and there is potential for higher contracted volumes from suppliers.
- The company strategy going forward is an extension of its current products and, given previous history, would seem to provide a secure future for the business.

## 12 Robert Wiseman Dairies

### 12.1 Outline

Robert Wiseman Dairies (RWD) was established in 1947 in East Kilbride, delivering milk to customers by horse and cart. Having recognised the trend in America towards large volume sales in supermarkets, the business moved into milk wholesaling in the 1970s. It was in 1988 that the business constructed its first major dairy. The facility at Glasgow enabled RWD to bid for and win its first supermarket contract. The business started to expand southwards in 1991 with the construction of a Manchester distribution centre. In 1994, the company listed on the London Stock Exchange and, following abolition of the Milk Marketing Boards the company established the Wiseman Milk Partnership with farmers who contracted directly with them. With funding from the stock listing, a Manchester dairy was constructed in 1995 and began processing English liquid milk. In 1996, the company was processing 300m litres of milk which has since grown through acquisitions and the construction of further processing facilities at Droitwich Spa, Bridgwater and a distribution facility at Northampton. The most recent investment is in a distribution centre at Amesbury enabling RWD to service the South East.

The business processed 1.6 billion litres of milk for the liquid milk market in the year ending 31 March 2009 and processed around 850 million litres in the six months to 30 September 2009. RWD produces liquid milk for major retailers including Tesco and Sainsbury and a range of branded milk products including freshnlo, Puriti and 'the One'.

The ownership is set out in table 49.

*Table 49 – Robert Wiseman Dairies Ownership (November 2009)*

Shareholder	Number of Shares Held	% Shareholding
Robert Tennant Wiseman	12,689,896	17.53
Alan William Wiseman	11,031,314	15.24
Aberforth Partners LLP	7,223,129	9.98
First Milk Ltd	7,162,026	10.00
F&C Asset Management PLC	3,676,363	5.08
Standard Life Invs Ltd	3,370,568	4.66
AXA Framlington Inv Mgmt	3,049,472	4.21
G J Wiseman	2,188,999	3.02

*Source: Wiseman Dairies Investor Website*

Figure 9 – Robert Wiseman Dairies Share Price and Trading Volumes 2007-2009



Source: Wiseman Dairies Investor Website

## 12.2 Financial

### 12.2.1 Summary Profit and Loss Account

The pence per litre figures presented below are based on the total milk pool for each financial year end, including volumes from own suppliers and external purchasing.

Table 50 – Robert Wiseman Dairies Summary Profit and Loss Account

Year End	31 March 2007			29 March 2008			4 April 2009		
	£ (000s)	ppl	%	£ (000s)	ppl	%	£ (000s)	ppl	%
Turnover	605,289	41.83	100.0	721,983	49.53	100.0	847,702	52.33	100.0
Cost of Sales	448,594	31.00	74.1	551,829	37.86	76.4	667,309	41.19	78.7
<b>Gross Profit</b>	<b>156,695</b>	<b>10.83</b>	<b>25.9</b>	<b>170,154</b>	<b>11.67</b>	<b>23.6</b>	<b>180,393</b>	<b>11.14</b>	<b>21.3</b>
Admin/Distribution Charges	121,036	8.37	20.0	138,509	9.50	19.2	145,246	8.97	17.1
<b>Operating Profit (Loss) before finance and tax</b>	<b>35,659</b>	<b>2.46</b>	<b>5.9</b>	<b>31,645</b>	<b>2.17</b>	<b>4.4</b>	<b>35,147</b>	<b>2.17</b>	<b>4.1</b>
Finance Costs	1,163	0.08	0.2	2,617	0.18	0.4	4,514	0.28	0.5
Investment income	96	0.00	0.0	156	0.01	0.0	134	0.01	0.0
<b>Profit (loss) on Ordinary activities before taxation</b>	<b>34,592</b>	<b>2.39</b>	<b>5.7</b>	<b>29,184</b>	<b>2.00</b>	<b>4.0</b>	<b>30,767</b>	<b>1.90</b>	<b>3.6</b>
Taxation on Ordinary activities	10,436	0.72	1.7	9,864	0.68	1.4	24,186	1.49	2.9
<b>Profit (Loss) on Ordinary activities after taxation</b>	<b>24,156</b>	<b>1.67</b>	<b>4.0</b>	<b>19,320</b>	<b>1.33</b>	<b>2.7</b>	<b>6,581</b>	<b>0.41</b>	<b>0.8</b>

Source: Company Reports

## 12.2.2 Summary Balance Sheet

*Table 51 – Robert Wiseman Dairies Summary Balance Sheet*

Year End	31 March 2007		29 March 2008		4 April 2009	
	£ (000s)	ppl	£ (000s)	ppl	£ (000s)	ppl
<b>Fixed Assets</b>						
Intangible Assets	1,701	0.12	1,410	0.10	1,105	0.07
Tangible Assets	176,309	12.19	216,455	14.85	221,881	13.70
Goodwill	4,345	0.30	4,394	0.30	4,394	0.27
Other			101	0.01		
Total	182,355	12.60	222,360	15.26	227,380	14.04
<b>Current Assets</b>						
Stock	7,079	0.49	8,887	0.61	10,581	0.65
Debtors	48,928	3.38	58,436	4.01	61,127	3.77
Cash at Bank	3,425	0.24	4,284	0.29	9,287	0.57
Total	59,432	4.11	71,607	4.91	80,995	5.00
<b>Total Assets</b>	<b>241,787</b>	<b>16.71</b>	<b>293,967</b>	<b>20.17</b>	<b>308,375</b>	<b>19.04</b>
<b>Current Liabilities</b>						
Trade Creditors	74,015	5.12	85,895	5.89	93,782	5.79
Borrowings	1,075	0.07	3,818	0.26	73	0.00
Current Tax Liabilities	6,708	0.46	5,821	0.40	7,218	0.45
Provisions			6,327	0.43	6,100	0.38
Total	81,798	5.65	101,861	6.99	107,173	6.62
<b>Non-Current Liabilities</b>						
Borrowings	10,000	0.69	40,000	2.74	35,000	2.16
Deferred Tax Liabilities	10,049	0.69	12,597	0.86	29,988	1.85
Other	144	0.00			1,693	0.10
Total	20,193	1.40	52,597	3.61	66,681	4.12
<b>Total Liabilities</b>	<b>101,991</b>	<b>7.05</b>	<b>154,458</b>	<b>10.60</b>	<b>173,854</b>	<b>10.73</b>
<b>Net Assets</b>	<b>139,796</b>	<b>9.66</b>	<b>139,509</b>	<b>9.57</b>	<b>134,521</b>	<b>8.30</b>
<b>Equity</b>						
Share and Member Capital	7,263	0.50	7,294	0.50	7,227	0.45
Share Premium	27,637	1.91	35,510	2.44	35,897	2.22
Other Reserves	1,966	0.14	(2,898)	(0.20)	(595)	(0.04)
Retained Earnings	102,930	7.11	99,603	6.83	91,992	5.68
<b>Total Equity</b>	<b>139,796</b>	<b>9.66</b>	<b>139,509</b>	<b>9.57</b>	<b>134,521</b>	<b>8.30</b>

*Source: Company Reports*

### 12.2.3 Ratio Analysis Summary

*Table 52 – Robert Wiseman Dairies Ratio Analysis*

Year Ending		31 March 2007	29 March 2008	4 April 2009
Return on Sales	%	5.89	4.38	4.15
Sales/Tangible Assets	%	343.00	334.00	382.00
Stocks/Turnover Ratio	%	1.17	1.23	1.25
Stock/Turn Ratio	No.	63.56	69.13	68.55
Operational gearing	%	439.00	538.00	513.00
Asset utilisation ratio	%	433.00	418.00	630.00
Working Capital/Sales Ratio	x:1	-0.03	0.03	0.03
Return on Capital	%	25.51	22.68	26.13
Debtor/Creditor Ratio	x:1	0.66	0.68	0.65
Current Ratio	x:1	0.73	0.70	0.76
Quick Ratio	x:1	0.64	0.62	0.66
Debt/Equity	%	5.47	28.34	19.17
Gearing (Gross debt)	%	7.34	23.90	20.68
Gearing (Net debt)	%	5.07	21.56	15.20
Interest Cover	x:1	30.66	12.09	7.79

*Source: Bidwells Analysis*

### 12.2.4 Financial Commentary

- Steady turnover growth in the last three financial years due to volume growth and value gains. Value gains per litre are likely to fall back in 2010 financial year end (as lower milk prices filter through to retail markets). The 2009 year end showed a turnover of 52.33ppl.
- Gross profit stable on a pence per litre basis at around 11.14ppl with total rising due to volume growth.
- Overhead charges were stable on per litre basis at around 9ppl with increases in absolute level linked with rising volumes and new investment (Bridgwater).
- Finance costs were higher in 2009 financial year at 0.28ppl due to rising debt following Bridgwater development.
- Tax spike in 2009 year end related to withdrawal of Industrial Buildings Allowance, this is a one off.

- Profit per litre in 2009 year end suffered due to a poor first half and rising costs.
- Real debt level is lower than the balance sheet indicates due to accelerated debtor recovery and other factors reducing the debt level as stated in the 2009 year end statements. The real core debt at the end of the 2009 year end was approximately £50m with a working capital cycle of £20 million peaking following raw milk payments mid month.
- Asset utilisation ratio is increasing with volume growth and value gains at 630%.
- Gearing and debt/equity ratios increased significantly on construction of the Bridgwater facility. This is now reducing with repayment. For the 2009 year end gearing (gross debt) stood at 20.68%. Non-current borrowings have fallen over the 3 year period.
- Strong interest cover ratio exists albeit declining due to increased debt levels in the period.
- Strong cashflow generation has enabled repayment of debt and dividend payments. This has increased cash at bank.
- Present gearing and interest cover levels are not at a level which would preclude further debt finance being raised if required. By sector standards, the debt level is modest.
- Strong positive cashflow of £57.9m from operating activities. Positive free cashflow of £5m.
- Of the £100m debt facilities available to RWD (drawn and undrawn facilities) £20m expire during the current financial year.

Figures for the first half of the current financial year show milk volumes up 11.3% with turnover growing 7% and operating profit increasing 62.4% compared with the same time last year. This places operating profit per litre at 2.54ppl. Net debt stood at £26.7m compared with £50.2m at the same point last year.

### 12.3 Milk Supply and Contracts

Robert Wiseman Dairies procure milk through two streams, 60% is from the Wiseman Milk Partnership and 40% is from the co-operatives, First Milk and Milk Link.

#### Wiseman Milk Partnership

The Wiseman Milk Partnership (WMP) was established in 1994 as a producer group for farmers on direct supply contracts. Currently this group has a membership of 888 producers supplying some 1,150m litres per annum and the company are seeking to recruit more direct suppliers in England with particular focus on the South West milk field. The WMP members elect a board who meet with representatives of RWD on a

quarterly basis to seek to resolve strategic, procurement and technical issues. Within this group are some dedicated sub groups whose milk is directed to Tesco and Sainsbury. Recruitment for direct suppliers to the Bridgewater site is currently being considered.

#### Co-operatives

RWD does not have the ability to balance its own milk due to having no processing facilities for powders or creameries. The co-operatives, Milk Link and First Milk, are used to enable supplies to be balanced. Milk Link supplies the balancing requirements of the new Bridgewater facility with remaining facilities supplied by First Milk. First Milk supply approximately 470 million litres of the total Wiseman milk pool and Milk Link supply 110 million litres of the pool.

#### 12.3.1 Milk Supply Overview

The milk supply base is summarised in table 53.

*Table 53 – Robert Wiseman Dairies Milk Supply Base (2008/09)*

Number of Suppliers	830
% of total GB suppliers <sup>7</sup>	6%
Volume of raw milk supplied by member farmers (million litres)	970
% of total GB volume	9%
Volume of raw milk purchased from other dairies (million litres)	630

### 12.3.2 Milk Contracts Overview

The milk contracts are summarised in table 54.

*Table 54 – Robert Wiseman Dairies Contracts (2008/09)*

Contracts	Wiseman Partnership	Wiseman Sainsbury	Wiseman Tesco
End Use	Liquid	Liquid	Liquid
12-month average price (DairyCo standard litre)	26.11	27.69	27.98
Frequency of Review	As required		6 monthly
Notice period given of price change	1 month notice to Wiseman Milk Partnership Board		
Catchment area	National	National	National
Preferred milk production profile	No preference		
Notice Period – Producer	3 months	3 months	3 months
Are producers eligible for bonuses whilst under notice	Yes		
Notice Period – Purchaser	1 year	1 year	1 year
Recruitment Areas	National		
Number of suppliers	74	201	515 <sup>31</sup>
Estimated raw milk volume/contract (m/litres)	800	225	575
Cost of farmer investment	n/a	n/a	n/a
Return on farmer investment	n/a	n/a	n/a
Who decides milk price?	RWD/WMP	RWD/WMP	RWD/WMP
What factors affect prices?	Market price of raw milk and commodity returns	Market price of raw milk and commodity returns	Cost of production. Tesco price guaranteed on 90% of previous year's production in current year.
Is there a negotiation process	WMP role	WMP role	WMP role
Does any pricing follow a formula?	no	no	no

*Source: Robert Wiseman Dairies / Bidwells Analysis*

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<sup>31</sup> As at March 2009, Tesco have since rebalanced supply and reduced RWD from 55% of volume to 50%.

## 12.4 Processing

### 12.4.1 Summary of Processing Facilities in Operation

*Table 55 – Robert Wiseman Dairies Current Processing Facilities*

Location	Capacity (million litres)	Products
Aberdeen	100-200	Acquired in 1994 this dairy processes milk for the Northern Scotland market
Bridgwater	500 (when phase 3 complete)	Newly constructed 500m litre capacity liquid processing facility. Construction is in 3 phases with phase two complete and capacity currently running at 375m litres. Phase 3 is due for completion in September 2010 and will add 125m litres capacity.
Droitwich Spa	600	600m litre liquid processing facility opened in 2001
Manchester	300	First Dairy processing facility built in England by RWD. Constructed in 1995.
Glasgow	200-300	Constructed in 1988 the first bespoke dairy constructed by RWD
Okehampton	50-100	Acquired from Milk Link. Produces regional milk.

*Source: Bidwells Analysis*

### 12.4.2 Investment

RWD are continuing to invest in its Bridgwater facility. The project has comprised three phases. Two of these are now complete and plans have been finalised for the third. Phase one constructed the building and site with the installation of three production lines. Phase two added one further line and phase three will add the last line. Capacity is 375m litres in December 2009. Phase three is due for completion in September 2010, and will increase capacity to 500m litres, and will cost £10m to install. Phase one of the Bridgwater development cost £80m and phase two £7.5m.

RWD are also investing in a new distribution facility at Amesbury in Wiltshire at a cost of £14m which will enable South East customers to be better serviced. This will lead to the movement of some distribution operations currently taking place at Bridgwater to the new facility.

### 12.4.3 Rationalisation

Currently no rationalisation is taking place or planned.

## 12.5 Marketing

Robert Wiseman Dairies focus on the liquid market and do not process milk into cheese, spreads or other consumer products. Its operations focus on the major multiple retailers and the middle ground milk markets. Its major competitors are Arla Foods UK plc and Dairy Crest.

### 12.5.1 Brand Portfolio

Current product portfolio is set out in table 55.

*Table 55 – Robert Wiseman Dairies Product Portfolio (2008/09)*

Segment	Brand	Market Segment	Estimated Share of Raw Milk Volume	% of Market Segment Volume	Change in market share (volume) 07/08-08/09	% of Market Segment Value	Change in market share (value) 07/08-08/09
Liquid	Black & White	Pasteurised milk	19%	6.6%	2.3%	5.6%	1.7%
	freshnlo						
	Puriti						
	the One						

*Source: Kantar, Robert Wiseman Dairies, Bidwells Analysis*

### 12.5.2 Core Brands

15% of the RWD milk pool is sold as branded product liquid. While these are referred to as core brands, in reality, branding is not a core part of the Wiseman business.

#### Black & White

This is the core RWD brand which is widely available in the middle ground milk markets. This started in the 1980s and is available in organic and regional provenance variants.

#### freshnlo

freshnlo was the first semi-skimmed milk to be sold in the UK when it was launched in 1981. In 2008 it became widely available in the UK, particularly in Tesco stores where it became part of the retailers discount brands offer. The brand has now been replaced with a Tesco Creamfields brand in the retailers' stores. This will reduce the sales of freshnlo. Creamfields is also produced and packed by RWD.

#### Puriti

Puriti is an extended shelf life milk produced by RWD. In addition to pasteurisation, the milk is passed through a filtration process to remove bacteria.

#### the One

the One was the first 1% fat milk to be sold in the UK when launched in March 2004. Like freshnlo, this has been replaced in Tesco stores with the Creamfields brand.

## Shock

Shock is a flavoured fresh milk aimed at children. It is available in chocolate, strawberry and banana flavours.

### 12.5.3 Liquid Milk (non-branded)

RWD supplies a major part of the UK liquid market. 76% of the total milk sales in the financial year end March 2009 were to five major retail customers, including Tesco, Sainsbury's, the Co-operative, Somerfield and Iceland. The three major customers for the 2008/09 financial year are detailed in table 57.

*Table 57 – Key Customers (2008/09)*

<b>Outlet</b>	<b>Company</b>	<b>Share of Supply (Approximate)</b>	<b>Estimated % of Raw Milk Pool</b>	<b>Market Share (pasteurised milk)</b>
Multiple Retailers	Tesco <sup>32</sup>	55%	36%	13.4%
	Sainsbury	50%	15%	5.4%
	Co-operative <sup>33</sup>	43%	9%	3.4%

*Source: RWD Data and Bidwells Analysis*

### 12.5.4 Market Development

RWD is focused on liquid milk where product differentiation is hard to sustain without branding which is only a small part of RWD business. The focus of the business is on the supply of retailer own-label commodity liquid milk to multiple retailers.

### 12.5.5 Cream

The business produces 1.86m litres of cream each week on average of which approximately 15% is sold into consumer markets with the remaining 85% sold onto the bulk commodity markets. The business is susceptible to movements in commodity markets with a £100/tonne movement in the bulk cream price impacting operating income by £800,000. This has an impact on the value of raw milk of approximately 0.05ppl per £100/tonne commodity price movement.

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<sup>32</sup> As at March 2009, these figures have since reduced to 50% of volume from 55%.

<sup>33</sup> RWD gained more volume (116m litres) with the Co-operative from August 2009 and currently supply 78% of the Cooperative's own-label milk (this does not include subsequent supply to Somerfield following the acquisition by the Co-operative).

#### 12.5.6 New Markets

It is understood that RWD has no intention to enter non-liquid markets.

### 12.6 Governance and Management Structures

Robert Wiseman Dairies was founded in 1947 and floated on the London Stock Exchange in 1994. The family retains a significant shareholding in the business. Alan Wiseman is the Chairman and Robert Wiseman is the Chief Executive (CEO). The Chairman has overall responsibility for strategy and the CEO deals with all operational matters. Other members of the management team comprise directors for Finance, Operations and Commercial. The management team have considerable experience and been on the team for a long period.

### 12.7 Business Strategy

#### 12.7.1 Long term aims and objectives

The key parts are:

- Aim to expand share of liquid market from 30% to 33% but RWD recognise that market share growth potential is limited once this point is reached.
- There is no intention to enter unfamiliar international markets where liquid is less important.
- There is no intention to diversify into cheese, butter or other processed products.
- It aims to pay off and reduce core debt but retain external working capital finance and feed benefit of cash generation to shareholders.
- An intention is to secure an operating profit of 3ppl, currently it operates around the 2.5ppl level.

#### 12.7.2 Expansion

- Expansion rate likely to be led by retail sales growth.
- Continued investment in both existing and new facilities as the need and opportunity arises.
- Complete phase three of the Bridgwater facility taking production capacity up from 375m litres to 500m litres per annum.
- Opening of Amesbury distribution centre to serve South East market more effectively.

### 12.7.3 Sustainability

This is a key corporate aim and some key ways of achieving this are:

- Establishment and measurement of five key performance indicators for environmental standards, electricity, gas, water and CO<sub>2</sub> emissions per tonne of milk processed as well as tonnes of material sent to landfill.
- Reductions in packaging waste being sought with involvement in the Courtauld Commitment (a voluntary agreement between WRAP and major UK grocery organisations to reduce packaging waste).
- The Bridgwater development includes an effluent treatment plant to reduce the water impact of the facility.

### 12.8 Summary

- Wisemans Dairies operate from a strong financial position and offer a high level of security in milk demand and should offer similar security in offering competitive milk prices to producers.
- There is likely to be opportunity for existing contract holders to increase supply. Aim to increase the number of direct suppliers in England over the next two to three years. If co-op supply was reduced then direct supplies from farmers would need to be increased. There is an integrated supply chain to Tesco and Sainsbury with direct contracts which enables growth alongside any retail sales growth.
- Its strategy is to continue growing where opportunities arise and is based on its core liquid product without diversification into processing. Milk producers need to be fully aware of this in structuring their enterprises.
- Going forward competition to secure retail markets will intensify but the business is well placed to meet these challenges with low debt and strong cash generation. Arla's proposal to construct a 1bn litre facility may have a bearing on future supply and milk prices depending on the level of additional capacity it creates, and the degree to which it reduces Arla's cost base.

## 13 Summary

This review, based upon visits to and discussions with key staff from the seven buyers together with related research and analysis, provides insight into current milk volumes and operations as well as looking into longer term objectives and performance to date. More specifically it has sought to assist milk producers in addressing the following three key questions:

- What is the potential for my milk buyer in terms of milk price and security of milk demand?
- What is the long-term strategy of my milk buyer and how can I best structure my dairy enterprise to fit in with that strategy?
- How is the company performing against this strategy?

### 13.1 Arla Foods UK plc

Arla is a significant player in the UK market with its contracted producers supplying just over 13% of the total GB volume. This represents 87% of Arla's total requirement which currently is some 2 billion litres in the UK (according to Arla Foods UK). Arla is an international farmer owned co-operative. While full analysis of financial information is difficult to interpret in a UK context, it has a strong balance sheet despite a significant investment programme and it has consistently delivered profits. It demonstrates a good track record in delivering its plans with well invested processing facilities.

Plans for growth in the UK and elsewhere are ambitious both in terms of total turnover targeted (+50% in the next five years) and a broadening of its business consolidating its UK position. This will impact upon its competitors as, although Arla is confident that they can grow the total UK market, such expansion will significantly affect the total market. The announcement of an intention to construct a 1 billion litre dairy near to London is just one element of these growth plans and it remains to be seen what rationalisation of existing Arla facilities might take place alongside this investment. The other impact will be the degree to which the reduction in its cost base will enhance its ability to compete in the liquid milk market.

Arla offer long term contracts to its suppliers and, if it grows as planned, it will be seeking to increase the number of farmers contracted to it as well as support extra production from existing suppliers. Arla's contract milk price is based upon market conditions but, given it is a declared democratically run organisation, there is farmer involvement in the process through AFMP. A potential threat would be if its growth plans are not realised – the investment planned will require returns and this will be highly dependent upon growth being achieved. This growth will be particularly important if debt levels rise significantly to fund this investment.

In summarising its position in relation to the potential as a milk buyer, its long term strategy and its current performance, key issues are:

- Arla's plans indicate increasing total demand for milk supplies, both in Arla Foods UK plc and Arla Foods amba. Its current markets seem secure which in turn should create security of milk demand.
- Its business plans focus on growth developing existing markets and seeking to broaden its range. Milk purchased by Arla Foods UK will have many uses and undoubtedly Arla will continue to seek supply from well invested dairy units who can deliver the quality and quantities required.
- Milk price is set by Arla relating to market conditions and not through a formula (except Tesco contracts). Arla can demonstrate good performance against its strategy to date with the Arla Foods amba business in good financial condition.
- The new substantial investment proposed for London opens up the opportunity for significant expansion although it will impact significantly on the market place and carries risk if the returns are not realised.

### 13.2 Dairy Crest

Dairy Crest is a limited company and describes itself as an integrated business. In volume terms, its contracted producers in 2008/09 supplied about 14% of the total volume produced by GB farmers. Its current requirements are around 2.4 billion litres of milk (according to Dairy Crest figures) and 70% comes from farmers contracted to it. It is believed that the proportion supplied from contracted farmers is likely to rise. Against a significant increase in turnover in the period reviewed (+25%), it has maintained a consistent profit level at about 4% of turnover. The balance sheet is healthy but carries a not insignificant debt level, partly related to the working capital requirement of maturing cheese stocks. A significant portion of the balance sheet capital is also Intangible Assets (such as brands) and Goodwill (arising from acquisitions). Linked to brand strength and ability to balance milk supplies into added value markets, the business has a relatively low exposure to commodity markets.

Dairy Crest act as the price setter for its milk supply based upon returns from the market and analysis of costs of production; this is in discussion with Dairy Crest Direct. Dairy Crest were the first to establish direct retailer supply groups for major retail contracts such as Marks & Spencer. In the direct supply contracts, milk price is often linked to a formula or premium. It delivers higher prices but in the context of delivering defined quality levels as well as producers being suitably located geographically and demonstrating strong commercial awareness with modern facilities. Recently Dairy Crest has announced the introduction of two new contract arrangements from 2010 encouraging increased direct supply volumes. The first relates to its

new internet based doorstep initiative (see below) which is offering a two year fixed base price. The second seeks to offer larger suppliers a simpler contract and pricing structure.

Dairy Crest has rationalised its operation greatly over recent years seeking to optimise productivity. Its current strategy has a focus on cash generation and seeking to hold market position for its branded and added-value markets. This could lead to increases in its milk pool, and it also aims to increase the proportion of milk from direct suppliers to 85% from the current 70%. The future of its doorstep delivery service is clearly critical to its plans. In order to counter decline in the activity, it is supporting an internet based service designed to deliver a much wider product range to the doorstep.

In summarising their position in relation to the potential as a milk buyer, its long term strategy and its current performance, key issues are:

- With the business seeking to drive up directly supplied volumes, security of milk demand for existing contract holders is good. Dairy Crest is less exposed to commodity markets than some others which should create conditions for more stability in their milk price.
- For the present, the focus is on cash generation and seeking to hold and develop market position for their branded and added value markets. This would indicate only modest increases in total milk supply needs but the new direct contracting will open up opportunities for additional supply contracts as the business drives up direct supply volumes.
- Previous business strategies have been successful with consistent profitability and a sound balance sheet although increasing debt levels are a factor. The success of its campaign to reverse declines in doorstep delivery, together with how it responds to plans of other buyers especially Arla and Wisemans in the South East, will be important factors in its business development.

### 13.3 First Milk

First Milk is a fully owned UK farmer co-operative with currently some 2,600 members. Unlike some of the other buyers, First Milk started with initial assets as part of the breakup of Milk Marque, both a challenge as well as opportunity. Essentially First Milk describes itself as a milk brokerage with an ambition to become a vertically integrated dairy business. In volume terms, First Milk farmers produce 15% of the total volume produced by GB farmers. Milk price is set by First Milk on the basis of market conditions and there is no formula in place. The state of the cheese market is a key factor in price determination despite 60% of its milk volume entering the liquid market, as the returns from cheese are prone to wide fluctuations. First Milk currently offer two types of contract, one for liquid and the other for manufacturing, although this is changing

with more end-use focused contracts and prices. As a co-operative, supplier members receive their return both in terms of milk price and return on their investment.

First Milk has experienced some difficult times linked to the decline in whey and milk powder returns as well as the challenging conditions in the cheese market in the past 12 months. Given its significant involvement in the latter, it carries high stock levels and, in seeking to maintain producer prices in volatile times, it has had to draw heavily on financial reserves and seek to restructure its lending and investment strategies. The business has a relatively strong exposure to commodity markets both directly through cheese markets and indirectly through the value of its liquid milk to liquid processors, the price of which is affected by cream returns. Recently there have been Board changes and the new Chairman is leading a full and comprehensive review of all aspects of the business. This seeks to restore profits back to the business, rebuild reserves and provide a platform for future development. It has involved close examination of its cost structure and, at least for now, outsourcing of certain functions to ensure it operates at the highest levels of efficiency and effectiveness.

The balance sheet in equity terms remains healthy. While First Milk will of course seek any opportunity to add value to its business, the current emphasis is on re-building financial reserves with targeted investment, key to which is the Campbelltown development. It is unlikely that First Milk will be seeking to increase its supplier numbers and they are clear that they have no intention to move into the liquid retail market and compete directly with, for example, Robert Wiseman Dairies. Its success in stabilising the business and restoring reserves will be critical as it moves forward.

In summarising its position in relation to the potential as a milk buyer, its long term strategy and its current performance, key issues are:

- Security of milk supply for existing contract holders would seem good although there is unlikely to be a significant increase in new contracts. Returns for milk will depend upon the success of measures currently being taken and led by the Executive Chairman. These seek to improve efficiency of operations and ensure all strategies are in place to maximise returns from current markets.
- The current strategy is one of developing and growing current markets, not entering new ones. Farm suppliers need to respond to this and ensure they can supply milk in the quantities and quality levels required. The new contract structure may require adaptation of farm businesses to maximise the value of the milk.
- The business has historically performed well against its strategy with only recently external market conditions for its commodities creating major financial losses and negative cash generation.
- Clearly these actions to create stability and restore reserves will be critical as they move forward.

#### 13.4 Meadow Foods

Meadow Foods is an independently owned business with a focus on supplying milk and dairy ingredients to major food manufacturers. Its three key markets are in fresh dry products, sweetened dairy products and milk supply and balancing. A key development in recent years has been its acquisition of West Lakes Dairy Park (doubling its milk field). Currently it purchases 430million litres from its own milk field of 520 farms, and purchase an additional 50 million litres to meet processing requirements. A further 100 million litres is traded to liquid customers. The business turnover has increased by almost 24% over the three year period reviewed and in that period operating profit levels have been stable and sufficient both to service debt and allow an overall reduction in borrowings. The business demonstrates stability in performance and operation with a capital position allowing the business both to meet unexpected demands and changes and to grasp opportunities as and when they arise.

Meadow Foods-contracted farmers are mainly in the North West of England and North Wales. By comparison to other buyers, it has a smaller percentage volume of supply from contracted farmers, some 3% of the total volume supplied by GB farmers. In 2010 it is to introduce an incentive scheme linked to individual producers forecasting production levels a year ahead and an additional bonus for the accuracy of the same. The key priority is to get as full a match of production to requirement as possible. Milk price paid to farmers is based upon conditions in its principal markets and ensuring 'fairness at every level in its supply chain'. The business strategy is based upon growth in supply to existing manufacturing customers and gaining new customers. It has no branded products of its own; its focus is and will remain supplying the needs of its food manufacturing customers. It will seek to increase milk supply linked to growth in sales. It has a continuing investment programme in facilities to ensure optimum productivity and efficiency. It is also well positioned financially for further acquisitions as appropriate and if opportunities were to arise.

In summarising its position in relation to the potential as a milk buyer, its long term strategy and its current performance, key issues are:

- Meadow Foods offer good security in terms of milk demand and offer opportunity for growth to farmers who match its requirements. Milk prices offered are set by them and will very much link to the success of its core markets for dairy products.
- It demonstrates strong past performance. It will continue to develop existing markets and will seek from its suppliers' milk in volume and quality to match such needs. Its recent incentives for producers linked to forecast production may be developed to other areas in future.
- The business develops from a strong financial base and a record of success with its future and that of its farmer suppliers dependent on continued growth of its core markets.

### 13.5 Milk Link

Milk Link, is a UK co-operative, fully owned by its Members. Originally based in the South West and South of England, its milk field has grown northward to include Wales, the Midlands, North West of England and South West Scotland. In 2008/09, it has 1,600 Members producing a total milk flow of 1 billion litres. The total volume produced by its Members comprised 9% of the total volume supplied from GB farmers. This has increased significantly in recent times with the demise of Dairy Farmers of Britain. In the last year, Milk Link has recruited over 500 new Members and long term direct supplier farmers, increasing the milk pool to 1.35 billion litres. It is also committed to development and has recently made significant investment at its processing facilities and the Taw Valley Innovation Centre.

Against a background of consistent increases in turnover, it maintained profit levels. Price is set by Milk Link based upon market conditions but with strong involvement from its farmer Members through board positions. In line with the rest of the industry, recent market conditions have put pressure on the business in maintaining adequate prices for its Members. Milk Link has sought in recent times to invest in its plants to secure greater efficiency and effectiveness. It has established a leaner, more direct executive management structure. Overall its strategy will seek to take opportunities when they arise but are largely based upon continuing investment in value-added processing facilities, further developing relationships with its farmers and delivering security and stability as much as is in its control.

The balance sheet is strengthening with significant reductions in debt and gearing and there is growth in Members' returns via interest payments and the milk price relative to the market average.

The development of the cheese market, and Milk Link's positioning within it, will be significant for its future and consequently its Members but its current operation is strong and based upon sound strategies and business principles.

In summarising its position in relation to the potential as a milk buyer, its long term strategy and its current performance, key issues are:

- Milk Link offers good security of milk demand and project continued growth in requirements. Returns to milk producers are based upon milk price and return on investment and will reflect market conditions in the liquid and relevant processing markets. These are balanced to ensure a competitive milk price and the right quality of milk at the right time to the processing operation. Farmer influence on price and strategy is significant given its structure.
- The business has performed well against previous plans and its current strategy of growing and developing existing markets based on appropriate investment and innovation gives significant confidence going forward. Its strategy focuses on developing brands and ensuring a high level of service to retail customers whose own-brand products it produces and packs.

- It has a strong financial base with reducing debt levels and positive cash generation.
- Future conditions in the cheese market and how Milk Link fare within it are important factors for the future.

### 13.6 Müller

Müller is a specialist business in relation to the other buyers reviewed. It is a market leader in yogurt and seeks to continue its growth in this market category by both organic growth and increasing market penetration. It also seeks growth in the food service sector. In 2008/09, its 169 farmer milk producer members produced a volume just under 2% of the total volume supplied by all GB farmers. Current volume of milk used by Müller is approximately 230 million litres of which 90% is produced by farmers directly contracted to it. Müller's strategy is very much about continuing to invest in its plant to increase productivity and efficiency. The UK processing facility can produce 95% of the product needed for its retail sales. It wishes to reach 100% to avoid the need for importing from its German operations.

This change will create some opportunity for dairy farmers in terms of higher supply needs. However, it is more likely to arise from increased quantities from existing contracted farmers. Müller puts emphasis upon supplies of milk from a local catchment area, endorsed by its marketing promotions, and so farmer producers are likely to remain very concentrated close to its Shropshire factory.

Premium prices are paid to suppliers based upon set quality standards especially around the percentage of butter fat and protein. Penalties for not achieving the target quality are set but equally premiums for achieving this, and more, are significant. In recent years Müller has put emphasis on its support for farmers, something that perhaps was less evident previously.

Müller is a German owned business with a strong financial position. It will remain a key buyer, but set in the context of its targeted market and volume needs, relying in the main on its existing farmer network.

In summarising its position in relation to the potential as a milk buyer, its long term strategy and its current performance, key issues are:

- Müller offers good security of milk demand and opportunities for growth for existing suppliers but limited opportunities for new suppliers. Its milk price is considered to be competitive but needs suppliers to deliver high quality standards.
- It has recently put greater emphasis on farmer contact and understanding its supply chain. The strategy going forward is to increase market penetration and there is potential for higher contracted volumes from suppliers.

- The company strategy going forward is an extension of its current products and, given previous history, this would seem to provide a secure future for the business.

### 13.7 Robert Wiseman Dairies

Wisemans has been a company of considerable growth solely focused upon the liquid market and with a targeted approach to their operations. In the last trading year, it purchased some 1.62 billion litres of milk with a strong focus on the major retailers and an increasing emphasis on branded liquid milk products to support its core activity. Its balance sheet position is strong with a low debt level compared to others in the sector.

In volume terms, milk supplied by its contracted farmers represented 8.4% of the total GB milk production. This was for the 2008/09 milk year. However, production from its contracted farmers represents just 60% of its need. The remaining 40% largely is procured from the two UK co-operatives, First Milk and Milk Link. The major recent investment has been at Bridgwater and it is another player set upon creating a better service to its South East customers which has triggered investment in a new distribution centre in Wiltshire. Again, set against Arla's intent, this will lead to interesting times in the market place.

Wisemans seek a continued growth in UK market share but see a limit to this. It does not plan to establish markets overseas and do not wish to diversify from its core product, liquid milk. In the short term, it will seek to generate greater margins allowing better returns to its shareholders as well as reducing core debt and putting themselves in a stronger position to meet future challenges and opportunities. The actions of others in the UK market will be very important and competition to secure retail markets will intensify. Wisemans seem well placed to meet that challenge.

In summarising its position in relation to the potential as a milk buyer, its long term strategy and its current performance, key issues are:

- Wisemans operate from a strong financial position and offer a high level of security in milk demand and should offer similar security in offering competitive milk prices to producers. However, there is exposure to commodity cream markets.
- There is likely to be opportunity for existing contract holders to increase supply. Significant growth in the milk field is less likely however this will be related to the success of its other principal suppliers, the co-operatives. There is an integrated supply chain to Tesco and Sainsbury with direct contracts which enables growth alongside the retail customer.

- Its strategy is to continue growing where opportunities arise and is based on its core liquid product without diversification into processing. Milk producers need to be fully aware of this in structuring their enterprises.
- Track record is one of success. Going forward competition to secure retail markets will intensify but this business is well placed to meet these challenges with low debt and strong cash generation. Arla's proposal to construct a 1bn litre facility may have a bearing on future supply and milk prices.

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## **Company Strategy and Performance report**

### **Introduction**

DairyCo wishes to commission a report into the strategy and performance of the top seven British milk buyers. This will be the seven largest milk buyers in Britain by volume of milk purchased directly from farmers:

1. First Milk
2. Dairy Crest
3. Arla
4. Milk Link
5. Robert Wiseman Dairies
6. Meadow Foods
7. Muller

This document serves as a background commissioning brief for a report looking into the business strategies and performance of these seven milk buyers.

DairyCo is responding to a need identified by levy payers who are keen to gain a greater understanding of how dairy processing companies are planning to adapt to ongoing structural changes in the dairy industry, what strategies dairies have put in place to face the challenges that further rationalisation of dairy markets implies and, consequently, how these strategies impact on their own dairy farming businesses.

Levy payers want to know how milk buyers are performing and what their long term demand for milk is likely to be. In turn, it is hoped that the report will provide further transparency within the dairy supply chain, assist milk producers to make informed business decisions such as who to supply their milk to and improve relationships between dairy farmers and milk buyers.

### **Background to DairyCo**

DairyCo is the milk sector organisation (non commercial and not-for-profit) working on behalf of dairy farmers to provide services not supplied by the industry. We are a division of the Agriculture and Horticulture Development Board (AHDB).

DairyCo is funded entirely by milk producers, via a statutory levy on all milk sold off-farm, at the rate of 0.06p per litre. This provides an annual income of around £6.5m.

DairyCo's remit is to solve market failure in the industry – to tackle issues not currently being dealt with sufficiently to meet industry needs.



One of the roles of DairyCo is to provide high quality information to help farmers make the most of dairy markets and opportunities. To this end the dairy market intelligence team within AHDB's Market Intelligence Directorate provides accurate and impartial information to farmers to aid business decision making.

## **Organisation and market intelligence objectives**

DairyCo's core objective is to promote world class knowledge to British dairy farmers so they can profit from a sustainable future. As a key part of this objective the dairy market intelligence department seeks to provide farmers with information to aid decision making. Currently Market Intelligence meets the unfulfilled need for the industry regarding information on input costs, milk pricing, domestic and global wholesale markets and dairy consumption trends.

## **The challenge**

Since the deregulation of the UK milk market in 1994 the UK dairy industry has undergone significant changes at all levels of the supply chain. However, the need for continued evolution of the industry continues.

Since 1994 the number of dairy farmers in the UK has halved, however UK milk production has only fallen by 8%. The average dairy farmer today has 60% more cows than 15 years ago, each producing an extra 1,500 litres per year. As a result of this rapid change on farm, and in a climate of less stable prices, dairy farmers have been required to become more business minded.

At the other end of the supply chain, consumers have developed new consumption patterns. In 1994 whole milk accounted for nearly half of all liquid milk consumption, today this has fallen to just 26%, yogurt consumption has increased by 42% and cheese consumption by 12%. The way consumers purchase products has also been evolving. Consumers continue to demand a wide variety of dairy products at various different price levels and British milk processors have had to develop their businesses and innovate to meet these needs.

Although information is available on the financial performance of the majority of the top seven milk buyers, DairyCo believes there is a need for this, and other information on the performance of the company, to be analysed further and presented in a way where farmers can easily make comparisons and decisions to suit their businesses.

Furthermore, milk prices over recent years have been at too low a level to allow for much on farm investment. After years of little significant investment many dairy farmers are now facing the prospect of having to invest a significant amount in their businesses. In an environment of increasing price volatility farmers need confidence to allow them to invest and much of this confidence comes from knowing that they are selling their milk to a milk buyer who has planned for the future challenges of the evolving market place.



## Aims and objectives

The aim of this comprehensive project from a farmer's perspective is threefold:

- What is the potential for my milk buyer in terms of milk price and security of milk demand?
- What is the long-term strategy of my milk buyer and how can I best structure my dairy enterprise to fit in with that strategy?
- How is the company performing against this strategy?

It is proposed that the report covers the following sections for each dairy company:

1. **Financial information**; to include income, balance sheet, cash flow statements, standard financial ratios, investment record, ownership and potential for mergers and acquisitions.
2. **Milk supply**; looking at milk requirements, regions collected from, transport factors.
3. **Processing**; to include capacity and location, efficiency, joint ventures and opportunities.
4. **Marketing**; to include product portfolios, security of markets accessed, brands and innovation.
5. **Strategy**; looking at long term aims, underlying short term goals and rate of progress towards these goals/aims.

The methodology used should allow for meaningful comparisons to be made between companies. Further suggestions of appropriate layout and comparison measures are provided in the Appendix to this document although adjustments to this can be suggested by tendering agencies.

The output from this work will then be provided to dairy farmers as a tool to aid on farm decision making.

This project will involve communicating directly with the top seven milk buyers identified as well as desk top research. DairyCo believes that the milk buyers should view this as a further way of communicating with their suppliers and a way of improving relationships within the supply chain.

## Proposal submission

Applying agencies need to demonstrate through credentials or through working in partnership with other agencies their understanding and/or experience of working within the dairy industry and obtaining and presenting insightful information in an informative and comprehensible report format.



Should you wish to submit a proposal, an electronic copy must be received no later than 5pm **on 31 July 2009** by Stephen Rossides, Market Intelligence Directorate, Agriculture & Horticulture Development Board, Stoneleigh Park, Kenilworth, Warwickshire, CV8 2TL, ([stephen.rossides@ahdbms.org.uk](mailto:stephen.rossides@ahdbms.org.uk)) providing the following details. Any questions should also be directed to Stephen Rossides or Helen Eustace (see contact details below).

1. Project title
2. Name of Project Leader
3. Organisation(s) and their expertise
4. Project summary (maximum 250 words)
5. Project duration (by end of November 2009 at latest)
6. Key targets and date of achievement (milestones)
7. Proposed budget (to include breakdown of staffing, consumables, travel, equipment, overheads, sub-contracts or consultancy and miscellaneous costs).

Project staffing – please list the names and job titles of all staff that will be involved with the project and include a brief CV for each project team member outlining the experience that they have in line with their responsibility within the project.

DairyCo will review tenders following the closing date, and may consult with interested parties as part of the selection process.

Following presentation of initial concepts, DairyCo may seek further clarification of capabilities and methodologies to be used prior to arriving at a definitive decision.

Short-listed applicants may be requested to present their case to the selection panel at the DairyCo offices in Stoneleigh, though this will be decided on reviewing the tenders received.

Written response to include all costs, VAT and expenses, and a detailed description of all intended output including timings.

The agency should inform DairyCo if the project can be achieved satisfactorily within the time and approach objective outlined in this proposal.



### **Contacts:**

Contacts for any communication regarding this brief are:

#### **Stephen Rossides**

##### **Market Intelligence Directorate**

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#### **Helen Eustace**

##### **Acting Head of Dairy Market Information**

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### **Administration**

It should be noted that;

1. Any questions concerning this brief should be submitted in writing or by e-mail. DairyCo will issue a copy of all questions and answers to those bidders who have notified intent to bid. The answers will not contain the questioner's identity.
2. DairyCo reserves the right to award a contract or contracts for all or part of the work covered by this brief or to make no award.
3. Proposals must be valid for at least thirty (30) days from the date of submission.
4. DairyCo reserves the right to accept or reject proposals that arrive late without giving reasons.

### **Timing**

The work should commence as soon as the contract is awarded and **the final report to be delivered by 31 November 2009 or earlier if possible (please state end date in tender)**.

The draft final report should be completed and presented to DairyCo at a meeting in the week ending **13 November 2009**.

The final report should be presented in a Word Document using Arial font 11pt, all graphs used in the document must also be supplied in a separate excel sheet.

The successful bidder will be required to sign AHDB's standard Contract terms and conditions.

Please note this report will be badged solely as a DairyCo report.



## Appendix

The suggested content of each section of the report is detailed below. DairyCo would welcome suggested changes to both the layout and information contained within it and this should be detailed within the submitted proposal

### 1. Financial information

Financial data needs to be collated from annual accounts reports and other sources including the profit and loss and the balance sheet and any other information the agency deems important to dairy farmers. As well as total amounts, results should also be expressed in pence per litre (ppl) based on the total milk volume processed by the given company. Ratios covering activity, leverage and profitability should also be included. It is envisaged that data from the last three financial years should be presented (covering the same periods for all the companies) together with an average for the seven companies for the most recent financial year (in ppl) to aid comparison.

It is suggested that this information is presented in a tabular format. This table could be followed by the major financial highlights/explanations of changes in position, large exceptional costs etc

In addition, average milk prices paid to farmers alongside other costs, turnover and profits expressed as in ppl will be required in order for easy comparisons to be made.

### 2. Milk supply

This section focuses on milk supply and contracts/pricing for each company.

<b>Milk supply</b>	<b>Year 06/07</b>	<b>Year 07/08</b>	<b>Year 08/09</b>
Number of suppliers			
Volume of raw milk supplied by farmers (million litres)			
Volume of raw milk purchased from other dairies (million litres)			
Volume of raw milk sold to other dairies (million litres)			

It would also be useful to identify average transport costs from farmgate to factory and from factory to customer for each milk buyer.



## Contracts in Year 08/09

DairyCo has some information on the contracts offered by different milk buyers, however more detailed information would be useful to aid farmers decision making.

<b>Contracts</b>	<b>Contract 1</b>	<b>Contract 2</b>	<b>Contract ...</b>
Type – end-use			
Characteristics			
DairyCo price (3 year average)	In - house	In - house	In house
Frequency of review			
Current Catchment area			
Target Area			
Period of notice for the producer			
Period of notice for the company			
Conditions of supply			
Pricing drivers			
Recruitment areas			
Number of suppliers			
Milk volume/contract			
Cost of farmer contribution/investment			
Return on farmer contribution			
Benefits to join			
Who decides on milk price changes?			
What factors affect milk price changes	Highlight differences for different contracts		
Is there a negotiation and agreement process with supplier representatives	If so give details		
Does any of the contract pricing follow a formula?	If so provide details		

Within the conditions of supply it would also be useful to identify the criteria of eligibility (size of the farm, location, quality of milk etc.) to recruit a supplier.

It would be useful to highlight the additional benefits to supplying the milk buyer? (For example some are able to negotiate reduced utility prices or provide training).



It would be useful to highlight the last three years return on farmer contribution (if any), what mechanisms determine how much this will be and, if possible, what is the expected return on farmer contribution in the next few years.

### 3. Processing

The processing section should look at the location of manufacturing facilities, their product capacity and utilisation, their efficiency using specific indicators, their age, the investment made in recent years in processing operations and joint ventures and identify possible opportunities for the future. This section should also list products produced by type including % of raw milk used for the production of each product.

### 4. Marketing

This section outlines each company's product portfolio and outlets and should include brands (and the % of raw milk that goes into each brand), volume share of the market (specify market), year on year growth, value share of the specified market and year on year value growth, as detailed in the table below. Further information on number of new product launches and innovation would also be required.

It is also important to understand the dynamics of the individual markets that the milk buyer is supplying products to. For example are they growing or shrinking? By how much? Why? What are the key influencing factors? What are the main competing products in the market?

Product portfolio (Figures relate to the milk year 08/09)

Products	% of raw milk used	Brands	Total market share (%)	Volume & product portfolio share (%)	Volume growth(% diff. 07/08-08/09)	Sales (£) & sales share (%)	Sales growth (% diff. 06/07-07/08)
Liquid products (litre)							
Cheese (tonne)							
Butter & spreads (tonne)							
Cream (tonne)							
Chilled yogurts and desserts (tonne)							



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Dairy ingredients

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Other products

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## TOTAL

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Further information should be obtained regarding the markets the companies operate within, including: customers, market share at various outlets and volumes of product. This information would be useful for liquid milk, total cheese, cheddar and yogurt.

### Markets – liquid milk

Outlets	Company's name	Volume	Market share (% per outlet)	Market share growth )
Doorstep delivery				
Processors/food manufacturers				
Food service				
Multiple retailers	Tesco Waitrose			
Export				

This section should also include competitors, security of markets, market share within the largest retailers, rate and success of innovation, etc.

### 5. Business strategy

This document must include details on the long-term aims of the milk buyer, the potential for merger and acquisitions, security of supply, evidence of and potential for entry into new markets, the expansion of the business, the implementation of environmentally-friendly measures.

A PESTLE analysis (Political, Economic, Social, Technological, Legal, Environmental) may be appropriate in this section.

### Comparison of the seven dairies

The reports aims at providing dairy farmers with objective information on the largest seven milk buyers in the UK in order to help them make informed decisions. Therefore, a table that summarises the main strengths and weaknesses, opportunities and threats (SWOT analysis) of each milk buyer would be easy to understand and would highlight the most important outcomes of this research project.



## Appendix B DairyCo Report – Financial Appendix

Ratio	Calculation	Description	Interpretation
Return on Sales Ratio	Profit before interest and tax/Turnover	PBIT as a percentage of turnover.	Higher percentage indicates higher profitability
Return on Capital Employed	Profit before interest and tax/Capital Employed	PBIT as a percentage of employed capital	Higher percentage indicates higher profitability
Sales/Tangible Assets	Turnover/Tangible Assets	Turnover generated as a percentage of tangible assets	Higher percentage indicates greater tangible asset utilisation (Note: can be influenced by asset valuation method.
Stocks/Turnover Ratio	Closing Stock/Turnover	Stocks held in the business as a percentage of turnover	Lower percentages indicate fast stock movement and lower working capital need (Note: a business producing cheese requiring maturation will be higher than one selling liquid milk)
Stock/Turn Ratio	Cost of Sales/Average Stock	Number of times stock is turned over per year	Higher numbers denote higher efficiency (Note: Comment for above ratio applies)
Debtor Creditor Ratio	Debtors/Trade Creditors	Value of Debtors per £1 of Creditors	Decreasing debtor values indicates increasing efficiency in debt collection or increasing delay in creditor payments
Working capital/Sales Ratio	(Stocks+ Trade Debtors-Trade Creditors)/Turnover	Indication of business working capital demand and efficiency	Lower values (including negative) indicate high efficiency and lower working capital demand.
Current Ratio	Current Assets/Current Liabilities	Indication of business liquidity	Values greater than one indicate sufficient liquidity to meet current liabilities. Large businesses can operate at lower levels than smaller businesses.
Quick Ratio	(Current Assets – stock)/Current Liabilities	Similar to Current Ratio but with stocks removed (stocks are traditionally less liquid)	As per Current Ratio
Debt/Equity Ratio	Total Borrowings/Shareholders or Members Equity	Borrowings as a percentage of Equity.	Lower borrowings indicate lower debt and finance charges. The trend is more important than the absolute level in many cases. (Note: cash deposits have not been offset against borrowings)
Gearing Ratio	Liabilities/Capital Employed	Borrowing as a percentage of total capital (equity plus debt)	As above
Interest Cover	Profit before interest and tax/Finance Costs	Profit per £1 of finance costs	Indicates the amount of cover a business has of its finance costs. Declining cover is a cause for further investigation as is low cover.
Operational Gearing	(Turnover-cost of sales)/Operational Profit	Gross profit as a percentage of Operating profit (PBIT)	Indication of overhead efficiency. Falling percentages indicate improving overhead efficiency.
Contingent liabilities/Shareholders Funds	Contingent liabilities/Shareholders or Members Funds	Contingent liabilities as a percentage of Shareholders or Members funds	Shows the impact contingent liabilities would have on the business if they became current.
Asset Utilisation Ratio	Turnover/Net Assets	Turnover as a percentage of Net Assets	Higher percentages indicate higher asset utilisation efficiency. (Note: this ratio does not account for debt funding of assets, highly geared businesses will need higher results than a lower geared business.



### **Arla Foods amba**

The Arla Foods amba financial statements include the results of the following entities as at 31 December 2008:

- 100% Arla Foods UK Holdings Limited
- 94% Arla Foods UK Plc
- 100% Arla Foods Finance Limited
- 100% Arla Foods Holdings Co. Limited
- 100% Arla Foods UK Services Limited
- 100% Arla Foods Creamery Limited
- 75% Claymore Dairies Ltd
- 100% Arla Foods Ltd UK
- 100% Arla Foods UK Property Co. Limited
- 50% Arla Foods UK Farmers JV Co. Limited

- Plus the results of 58 wholly owned non-UK entities and 27 part owned non-UK entities.

### **Dairy Crest plc**

The Dairy Crest plc financial statements include the results of the following entities as at 31 March 2009:

- 100% Dairy Crest Limited
- 100% Philpot Dairy Products Ltd
- 80% Wexford Creamery Ltd
- 100% St Hubert SAS
- 100% Dairy Crest France SAS
- 50% Fayrefield – Foodtec Ltd

### **First Milk**

The First Milk financial statements include the results of the following entities as at 31 March 2009:

- 100% First Milk Limited
- 100% First Milk Cheese Company Ltd

### **Meadow Foods**

The Meadow Foods (Holdings) Ltd financial statements include the results of the following entities as at 31 March 2009:

- 100% Meadow Foods Limited
- 100% Meadow Foods Lakes Limited

### **Milk Link**

The Milk Link financial statements include the results of the following entities as at 31 March 2009:

- 100% Milk Link Ltd
- 100% Milk Link Holdings Ltd
- 100% Milk Link Processing Ltd
- 100% Milk Link Investments Ltd
- 100% The Cheese Company Holdings Ltd
- 100% The Cheese Company Investments Ltd
- 100% Tanner Foods Ltd

**Muller**

The Muller Dairy (UK) Limited financial statements include only the results of that entity as at 31 December 2008.

**Robert Wiseman Dairies plc**

The Robert Wiseman Dairies plc financial statements include the results of the following entities as at 31 March 2009:

- Robert Wiseman & Sons Limited
- Robert Wiseman Property Limited
- Robert Wiseman Property Holding Limited
- Robert Wiseman Property Investments Limited
- The Devon Dairy Company Limited