Dairy Crest Interim Results 2015

Dairies Disposal – Mark Allen

Q: Before we get to first half results, update us on the sale of the Dairies business. Why is this such a good deal for Dairy Crest's shareholders?

A: I think the first point I'd make is it's a good deal for Dairy Crest. We're left with a highly-focused, predominantly branded business that delivers good margins. It is obviously on that basis a good deal for shareholders and they've recognised it in as much as the share price today is £6.50. And when we announced the deal it was just a bit below £4.

And the reason they've recognised it is we've been able to dispose of a business that's incurred significant losses over the last four or five years. And actually there's no real possibility of those losses diminishing in the near future.

Q: So what does the sale mean for the British milk industry?

A: It's good news for the British milk industry. The three main processors, including ourselves, have not been generating satisfactory returns from this sector for a number of years. This allows two of those processors to come together and generate efficiencies that will improve the sustainability of that business, but it also allows the purchaser, Müller, to invest in the business in a way that we perhaps couldn't.

Q: Now this started out as an £80 million deal. Now you're saying it's worth £40 million to £50 million. What's changed?

A: The first point I'd make is that £40 million or £50 million for a business that's losing money and has lost money for the last four or five years, I believe, is a very good deal. It has changed. It's changed in two ways really.

Firstly, the performance in the business has deteriorated, so therefore the consideration is less. And secondly we assisted Müller in their search for a remedy by paying them £15 million to help them with that remedy over the next five to eight years.

Q: You'll soon have a smaller, simpler business on your hands. What's your strategy for delivering future growth?

A: It feels like we're at the point where this is a new era for Dairy Crest. For the last 20 or so years we've been realigning this business, coming away from a supply-driven business to a consumer-driven business and this is the start of that journey.

We'll have a focused £0.5 billion or so turnover business, focused mainly on brands, brands such as Cathedral City. We'll concentrate on the things that have served us well - innovation, cost control. But importantly we've got some new initiatives. We've got the products that are about to come on the market from our factory down at Davidstow, demineralised whey and galacto-oligosaccharide, but that moves us into the emerging markets and the growing infant formula market.

Results – Mark Allen

Q: Looking at the sales of your four key brands, how would you describe these interim results?

A: I'm very pleased. We've maintained the level of our sales compared to last year and I think in the market we find ourselves in at the moment I think that's very good. A number of our competitors are achieving results nowhere near as good as that.

If I look at the four brands that we talk about individually, Cathedral City is a stunning performance. Year in, year out the brand continues to deliver. For the last couple of years I've talked about Cathedral City being in 50% of the homes of the country. It's now 58%. That's a real privilege. It's grown sales by around about 7% year on year.

If I look at FryLight, FryLight is an up and coming brand that we purchased a couple of years ago. It's now being purchased by around about 5 million homes and has got fabulous growth in the first half and we expect that to continue for the rest of this year.

The other two brands, Clover and Country Life, have had a more difficult first half, but there is some exciting news as to how we're going to deal with that in the second half. If I look at Clover firstly, Clover performed in line with the market, but the real focus for us is to make Clover a more natural brand. That resonates with consumers.

And what I mean by that is we've taken some time with our innovation colleagues to take out all the added ingredients that are in Clover and make it an absolutely natural product. We've just launched that. It's supported by quite a considerable advertising budget and we expect Clover to perform much better in the second half.

And then finally, if I come on to Country Life, Country Life is a brand that resonates with the British consumers and we probably stood back from that a little bit in the first half. What you'll see in the second half is a real focus on the Britishness of the brand and we think that will help our performance in the second half.

Q: And what progress have you made at your manufacturing sites over the first half?

A: I don't think it's just the first half. I think we've been working hard in our manufacturing sites over the last four or five years with investment, with a real focus on costs and a real drive for efficiency. If I look at our Cheese business, our Cheese business by most people's dimensions would be world-class. We think we've got a competitive advantage right the way through the supply chain.

And a good example of that would be that over the last four or five years we've reduced our packing costs at Nuneaton by around about 25%. That was based on an initial investment and the drive for efficiency that's followed that investment.

Now if I move to our Spreads business, which is the other big manufacturing location up at Kirkby, we've spent around about £30 million there over the last few years. We're starting to see some of the benefits of that investment coming through. What I'd like to see over the next two or three years is a similar performance as we've achieved at Nuneaton, where we really start to generate efficiencies based on the investment that we've made.

Q: You've invested heavily in the new whey and galacto-oligosaccharide facilities at the Davidstow creamery, but when are we going to see the impact from sales?

A: Well, we're making a lot of progress there. We're well down the commissioning route at the moment and we'll be sending galacto-oligosaccharide samples out to our potential customers really from the start of next week - very pleased about that.

As far as demineralised whey is concerned, we'll be doing the same thing towards the end of November. So we'll end up with some sales in this financial year in the final quarter. We'll get a full year of the benefits in the financial year 2016/2017.

Financials – Tom Atherton

Q: Take us through why you're saying your profits will be second-half weighted?

A: We highlighted earlier in the financial year that this year's profits would very much second-half weighted, so it's no surprise at all that profits in the first half of the year are below last year.

In our Cheese business, Cathedral City revenue and volumes were up, although we're selling cheese that was made a year ago and in that time we've seen huge deflation in input costs. Those cheaper costs are only going to flow through our P&L in the second half of the year. The evidence for this is on the balance sheet.

We've seen stocks fall by £15 million between the year end and September and it's those cheaper stocks that we're going to be selling through in the second half of the year.

Q: Exceptional costs also fell. Does this signal an end to restructuring?

A: We've only had one exceptional cost for our continuing business this year and that's the spend we're putting into place down in Davidstow to commission the demineralised whey and galacto-oligosaccharide plant. We spent £2.4 million in the first half and we'll spend about another £6 million in the second half of the year to take that project to completion.

Beyond that, we're a much simpler business - five operating sites well invested. We're not expecting material restructuring costs going forward. In fact, looking ahead we're likely to sell some of our previously-closed operating sites for a profit so we may even see some exceptional gains in the future.

Q: And turning to the sale of the Dairies business what are the key numbers?

A: Our Dairies business has had a very tough six months, along with the wider industry. Revenues are down over 20% and losses have widened from £4.4 million last year to over £20 million this year, as well as incurring exceptional costs. It's definitely the right thing to have sold this business.

We expect proceeds to be in the range of £40 million to £50 million and that's a good price for a business that's making losses on this scale. In the future we're left with properties that weren't included in the transaction that are worth in excess of £20 million and we'll be selling those through over the next couple of years.

Q: Net debt is up. What's behind this and where should we expect to see it at year end?

A: Net debt always increases in the first half of our financial year and that's because of the seasonality of milk supply. We buy more milk in the spring and that gets turned into butter, skimmed milk powder and cheese that's sold later in the year.

In fact, the increase this year of £43 million is lower than last year's £67 million. And our cash generated from operations was over £40 million better than last year and that's despite losses in Dairies of £20 million and heightened levels of capital expenditure of £35 million.

If you look ahead into the second half of the year both of those drags on cash are going to fall away. We'll complete the sale of our Dairies business in December. That will give us proceeds, but, more importantly, will stop some of those losses coming through.

And as we finish our Davidstow investment CapEx will return to below levels of depreciation, which in future years will be £20 million. All that put together means that we'll have a significant reduction in net debt in the second half.

Q: So what are your forecasts for net debt over the longer term?

A: In future years we expect net debt to come down. We have a simpler business that will generate more cash and have less restructurings and capital expenditure. I suppose that's borne out by our latest refinancing. We've signed a new facility last month for £240 million that reduces in three years' time to £160 million. If you like, that's a statement of intent about our drive to reduce levels of net debt in this business.

Q: And turning to your pension liability, what progress have you made?

A: The pension liability on our balance sheet has reduced by £8 million in the course of the half, down to £33 million. However, the more important deficit is the actuarial deficit which we are funding and that's calculated by reference to gilt yields, which have stayed very low. Our next tri-annual valuation is March 2016 and after that we'll agree a new schedule of contributions.

Since the half year, in order to sell the Dairies business, we have repurchased three properties from the pension scheme for £8.3 million. That will save us £2.8 million a year going forward in contributions. It's net cash neutral.

Q: And finally, update us on your dividend policy.

A: Our long-term dividend policy is a progressive one. That means we want to increase the dividend each and every year. We also need earnings cover of between 1.5 and 2.5 times. The sale of our Dairies business doesn't change that at all.

We've announced today a 2% increase in the interim dividend, to 6.1 pence, and we'd look to keep increasing that in future years. Personally, I'd like to see that better covered by cash as well as earnings.

Outlook – Mark Allen

Q: Completion of the sale of Müller is finally in sight. What's on the priority list for you in the second half?

A: Well, there are a number of things. Firstly, finishing the deal and making sure we don't get distracted by the completion. Secondly, carry on doing the things that we've done for many years; investing behind our brands; innovating behind our brands; promoting and advertising our brands; making sure we're cost-efficient; and making sure that we bring the new products - galacto-oligosaccharide and demineralised whey - on stream and they start to deliver benefits to the company in the final part of this year.

Q: And beyond this year? What's next for Dairy Crest?

A: I think this is perhaps the most exciting time the company has ever had. We are a smaller, more focused business, heavily dependent on our brands, which have performed very well over many years, with new and exciting opportunities in demineralised whey and galacto-oligosaccharide.

Those opportunities get us into emerging markets and in the fast-growing infant formula market as well. Increasingly we'll become more cash generative. That will underpin our dividend policy. It is a fantastic time to be associated with Dairy Crest.

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