Dairy Crest – Final Results 2016/17

Results – Mark Allen, Chief Executive

Q: How would you summarise Dairy Crest's full-year performance?

A: I'm pleased with the full-year performance. We've delivered profits in line with our expectations, but more importantly than that, there's a number of things that we said we'd do at the half year and we've delivered against them.

We said we'd get Cathedral City back in growth in the second half, and it is. We said we'd do well with Clover based on its naturalness position, and it has. Then, finally, we said we'd get our hit rate on demineralised whey up to 80%, and we have. I'm really pleased with it.

Q: Dairy prices increased during the year. How did that impact the business?

A: We got about 40% inflation in the cost of our milk. That is a challenge. But we've said many times in the past we can deal with inflation and deflation. That is based on the strength of the brands and the investment that we've put in them over many years.

Brands – Mark Allen, Chief Executive

Q: Cathedral City is still the UK's favourite cheese, but volumes are down 3%. What's the outlook for the brand?

A: We're in a very privileged position with Cathedral City. It is the nation's favourite brand. We're in nearly 60% of homes in the country. We said at the half year the first half had been quite challenging. We'd seen volumes decline by about 5%. We also said we'd get volume and growth in the second half, and we did.

Interestingly, that growth has continued and we've got a very strong first quarter of the new financial year that we've just entered. As I've said on many occasions, as long as we keep advertising the brand – which we will – and as long as we keep promoting it – which we will - and as long as we keep investing in innovation, which we will, the brand will continue to do well.

Q: The stand-out performer in your portfolio is Frylight, which continues to grow well ahead of the market. How have you achieved this and what's the scale of the opportunity?

A: We purchased Frylight some five or six years ago now and it was a tiny niche brand when we purchased it. Today it is in 23% of the homes in the UK. That is an incredible story. It is the number-one oil brand in the UK and, last year, grew by 20%. We have some new products coming onto the market. We've launched avocado recently and, before that, coconut. It is an exciting time for Frylight and we see that growth continuing over the next few years.

Q: What are the trends you’re seeing are in butters and spreads in the market at the moment?

A: Well, for many years we've been talking about butters strengthening and spreads declining. But we've seen more recently a little bit of a reverse in that. We've seen spreads starting to come back a little bit as the prices on butter have increased. So we're actually, in a unique position. We're one of the few companies that have got butters and spreads, so we can compete in both markets effectively.

Q: How has Clover performed?

A: Clover has been a star. For the last four or five years we've seen Clover growing in share. In the last couple in particular, where we've introduced the ‘naturalness’ side of the brand, it's done really well. During last year it grew volume by about 1% in a category that went back by 7%. And actually, it's in a great position, as we the decline on butter being taken up by a little bit of growth on spreads. So Clover is ideally positioned for the future.

Q: What about your other butter and spreads brands?

A: Well, funnily enough, the non-dairy brand, Vitalite, is doing very well, as is Willow. And Country Life has had a good performance as well. In a category that's had quite a lot of challenges, we've seen volumes about flat for the year. There's really two halves of that. The first half is spreadable, where we've seen very strong growth, and the second half is block butter, where we've seen decline in the first year based on the price of cream increasing. As that cream has increased, we've had to increase the prices of butter.

Q: Innovation has long been at the heart of your strategy. What new products have you launched this year and how have they impacted sales?

A: I'm really proud of our performance on innovation. We've been ahead of the pack for many years now. We've been delivering more innovation than our peers. Last year was no exception to that. From products that we've developed in the previous three years, 13% of our sales came from those products, and that's right across the piece.

We had innovation in Frylight, with the new avocado and coconut sprays. We had innovation in our spreads business, with the Clover all-natural product. We had innovation in cheese, with the new spreadable product. Innovation is the key to our strategy going forward, and long may that continue.

Functional Ingredients – Mark Allen, Chief Executive

Q: Give us an update on your Functional Ingredients division, beginning with demineralised whey?

A: I'm really pleased with the performance on demineralised whey. We said we'd hit 80% of that product meeting the infant formula grade during last financial year, and it did for the last couple of months. That's good news. I'm also pleased for a couple of other reasons. Firstly, the product that we're making has very good heat stability. What that means is it reacts really well when the temperatures are high. That's good for customers.

Then, secondly, our mineral content is very consistent and very stable. Again, that's good news for our customers.

Both of those will help us sell this product at a premium over time. We're starting to make sales now. We're making sales in Europe, in Australasia, and in China through our partners, Fonterra. And things are progressing pretty well.

Q: What about in galacto-oligosaccharide?

A: Galacto-oligosaccharide is doing really well. We're consistently hitting infant formula grade. We're starting to develop sales on a global basis with our partners, Fonterra, both here in Europe, in Australasia and in China. Importantly, we're continuing with the work on university trials with animal nutrition. We talked about that at the last results in November. But we've also since signed a partnership with DuPont that gives us access to trials on a more global basis in Europe et cetera. Those seem to be going well and we're still very excited about the possibilities for galacto-oligosaccharide going forward.

Q: How challenging is it to meet the required consistency in the production of infant grade formula?

A: It is challenging. We would it to be so. We always believe that one of the things that we have in our DNA is a consistent striving for quality in all the products that we make. We think, by having high benchmarks, we will have the best product available and, therefore, ultimately command a premium for that product.

Q: You mentioned Fonterra. How's that relationship progressing?

A: It's going well. They're a great partner. They're helping us technically. They help us with engineering. Most importantly, they are helping us with sales on a global basis.

Q: Tell us a little bit more about how you are investigating uses of galacto-oligosaccharide beyond baby formula.

A: We're looking at animal nutrition. We've got a range of trials, both university and field trials, with a number of partners, taking place at the moment. We're also starting to look at galacto-oligosaccharide as an ingredient in food as well. It's a naturally-occurring sugar and, therefore, has some benefits in that area.

Financials – Tom Atherton, Group FD

Q: Revenues declined slightly, but adjusted profits before tax were up 5%. How was that achieved?

A: You're right. Revenue did fall by 1% across the whole year, but in the second half of the year it actually grew by 4%, and we're taking some of that momentum into the new year. The other thing we had to deal with during the year was some significant cost inflation across butters and milk. The way we do that, is the way we always deal with these things, which is to focus on what's really important for this business.

That’s driving our brand performance through innovation, through marketing, making sure we've got the right commercial arrangements in place, making sure our supply chain is as efficient as it can be, and keeping an eye on costs. By doing all of that we were able to deliver profits that were 5% up, despite revenue coming off by 1%.

Q: How would you summarise financial performance over the year?

A: It was a strong year. We made some commitments at the half year, two of which Mark talked about earlier, which was the improvement in Cathedral City performance in the second half, but also hitting our infant formula grade demineralised whey by the year end. In addition, we committed to increased profits in the second half, which we did. We also said that net debt would come down during the second half of the year, which it did also. So that's a good performance and, more importantly, it gives us momentum as we go into the next year.

Q: As the business has been simplified, have you been able to take costs out through the year?

A: We always look to take costs out each and every year, whatever the size of the business has been, and that certainly is no different this year. So, yes, we've looked at costs across the supply chain and the overhead base corporately, and have taken costs out this year, and you can see that profits have benefitted from that. But we're not done. We're looking at our IT systems and trying to simplify those and replacing the core IT. That is going to deliver more savings over the next 18 months.

Q: Talk us through the £19.1m of exceptionals incurred over the year? And should we expect more in the coming year?

A: All of the exceptionals this year really relate to the commissioning at Davidstow, where we were finalising the demineralised whey and the GOS plants. It took us longer than we would have anticipated at the start of the year and it cost us more, but we have got to the place where that equipment is working in the way we expected it to work. We are delivering the hit rate on infant formula. And that won't repeat next year.

We will have exceptionals next year, but they are likely to be exceptional profits, and not losses, as well sell some of our old properties that we've previously closed.

Q: Net debt is up 9% to almost £250m. How comfortable are you with that number?

A: I want net debt lower and we are committed to making it lower. Our operating cash flow was quite good this year. It was £32.8m. That was over £50m better than a year ago. But we had three one-off items that went against us that we had to pay for. Firstly, we paid £28.5m back to Mueller in the final settlement of the dairies disposal from the year before.

Secondly, we had the exceptional costs that I mentioned earlier at Davidstow, but also some costs associated with that dairies sale.

Then, thirdly, the area we weren't expecting was the inflation we saw through the second half of the year across milk and butter.

Importantly, none of those three will repeat. We have sold the dairies business, the work at Davidstow is finished and the latest announcement on milk prices is down. That means that the cash we generate in the future will go towards reducing net debt.

Q: Let's turn to your current pension liability. What is the update there?

A: The accounting deficit on the balance sheet increased over the year. And that was really around bond yields globally falling. But the more important measure for us is the actuarial deficit. That is what drives how much money we have to put into the scheme. We are still in negotiation with the trustees, so there's no new news today on what that looks like. Until such time that we agree the latest schedule of contributions, we are governed by the one from 2013. That had us paying in contributions of £13m last year. This year it will be £17m. But it will be replaced by the new agreement shortly.

Q: How committed are you to maintaining a progressive dividend policy?

A: Very committed. We've increased our dividends each and every year since 2009 and we've done the same again this year. We have announced a final dividend of 16.3 pence, which is an increase of 2%. That still allows us to increase our earnings cover and, going forward, we remain committed to doing that. Everything we are trying to do as a company is to deliver an increased dividend for our shareholders. In the future that will be increasingly covered from a cash point of view as well as from an earnings point of view.

Outlook – Mark Allen, Chief Executive

Q: Since the disposal of the dairies business, Dairy Crest is smaller. It's more focused. So what's the plan? Are you looking to make acquisitions to build scale?

A: Smaller and more perfect, I would say. I think we are now in a really good place. We mare of a size that is very manageable. We have some very interesting positions in the products that we make, the brands and the added-value ingredients. I think that puts us in a really good place to move forward. We have said on many occasions, I've said on many occasions, that we'd always look for acquisitions, and we will continue to do that, but we will be careful. We will make sure that if we buy something, it is something that we can bring into this business to create value for our shareholders. I think that's really important. We will not acquire for acquisition's sake.

Q: What is your outlook for the year ahead?

A: Well, I think it's very promising. I think we have got Cathedral City in a great place. It started the new year really well. Clover, similarly, is in a great place. It started the new year really well. We've made some progress with Country Life. In the area that's the fastest growing and the most important - spreadable - we're doing particularly well. Frylight is the star of the show - continues to perform well. And we're making really good progress on the ingredients side of the business, so we're hitting our targets et cetera. I think it could be a good year for us.

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