

DAIRY CREST

GROUP PLC

[DCG:LN]

- Leader in the UK dairy sector demonstrating stable growth rates
- High investments and efficient cost control allow the Group to successfully operate in a tough economic environment



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by **VALUATION & RESEARCH SPECIALISTS (VRS)**

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DAIRY CREST GROUP PLC

Sector : Food

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Company Description:

Dairy Crest Group plc is a United Kingdom-based company engaged in the manufacture and trading of milk and dairy products. The group processes cheese, spreads, and fluid milk for consumers and provides ingredients to food manufacturers. The Group's products are sold throughout UK (about 90% of total turnover) under brands including Cathedral City, Clover, Davidstow, and Willow while the company exports in Europe, Canada, USA, Middle East and Asia.

Price (29/12/2009)	GBP	2.13
Shares Outstanding		133 mn
MktCap (in GBP mn)		283

Source: Company data & VRS Projections

Share Price Graph (GBP, 5-year)



Key Investment Points

- ⊙ Dairy Crest Group plc (DCG or the Group) **derives the bulk of its revenues from the UK economy**, which is a healthy and steadily growing economy. The **UK dairy sector** which DCG operates in, is a large in size and defensive market where growth rates are not as high as in other economic sectors, however they are relatively stable.
- ⊙ **Historically, the Group's financial performance is positive with an upward trend in revenue and profit generation.** DCG also proceeded with significant investments in the past to boost growth.
- ⊙ With **its peer group, DCG compares satisfactory** in terms of profitability, liquidity and capital structure ratios, however it performs worse in terms of working capital cycle.
- ⊙ The Group's **historic performance within its sector** implies that **revenue and profit generation is sustainable in the future however with certain volatility in its pattern due to economic cycles** such as the current one, which points to a financial and broader economic crisis. It would be also important for DCG to improve its working capital cycle in view of the credit conditions expected to appear in the near future.
- ⊙ We adopted a **conservative scenario** with regard to the DCG's future performance, in view of the tough economic conditions expected to persist **in the next 2 years, and an optimistic scenario after that period.**
- ⊙ In terms of weighted average valuation based on 4 different approaches, **DCG stock "deserves" a fair value which is slightly above its current market capitalization in the stock market.** The valuation outcome is in line with the Group's financial performance and overall market conditions prevailing at this period of time.

Please see important disclosure and disclaimer statements at the end of this report

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Dairy Crest Group Plc (DCG) Profile

Dairy Crest Group Plc (DCG or the Group) is a United Kingdom-based company engaged in the manufacture and trading of milk and dairy products. The group processes cheese, spreads, and fluid milk for consumers and provides ingredients to food manufacturers. The Group's products are sold throughout UK (about 90% of total turnover) under brands including Cathedral City, Clover, Davidstow, and Willow, while the Group exports in Europe, Canada, USA, Middle East and Asia. Dairy Crest operates in two divisions:

1. Foods division, including a) Spreads, b) Cheese and c) Fresh dairy products;
2. Dairies division, including a) Liquid products b) Household products and c) Ingredients.

Through a joint venture with Yoplait's French parent company Sodial, Dairy Crest sells yogurt and desserts. DCG expanded production operations internationally by acquiring in January 2007 the French company St Hubert with sales in French and Italy.

Dairy Crest produces and markets a wide range of fresh milk and cream products. It sells milk and cream to key retailers. At present it supplies over 20% of all milk sold in the major supermarket chains. Dairy Crest supplies milk and cream to major restaurants and food service customers. It also offers home delivery of milk and dairy products, delivering to 1.1 million households, with 350 million bottles of milk a year.

UK Economy – General Overview

Most of Dairy Crest Group's products are considered to be a household basic and target the whole of UK population, which during the mid-2007 accounted for 60,975,000. The UK economic environment where DCG operates (about 90% of turnover derives from UK) has the following characteristics:

- GDP growth is projected to slow from 3% in 2007 to approximately 1% in 2008 and possibly turn negative in 2009 as the effects of the global credit turmoil has put the UK as well as most economies of the world into recession.
- During the last 10 years, UK real GDP per capita grew by 27% (data for 1997-2007, Source: HM Treasury), which was more than in any other G7 country.
- Consumer spending growth is also expected to turn negative in 2009 as well as inflation rate that will be affected by lower demand.
- According to the National Statistics, the UK Consumer Prices Index (CPI), annual inflation was 4.1% in November, down from 4.5% in October 2008, while the Retail Prices Index (RPI) inflation slowed to 3.0% in November, down from 4.2% in October 2008.
- The functional and presentational currency of Dairy Crest Group plc and its UK subsidiaries is pound sterling (GBP). The functional currency of Wexford Creamery Limited and St Hubert SAS, subsidiary companies incorporated in Ireland and France respectively, is the Euro. The Wexford business, based in Ireland, generates the majority of its revenue from sales into the UK in GBP currency. The St Hubert business, based in French, generates the majority of its revenue from sales in France and Italy in EUR currency. Dairy Crest also exports ingredients and finished goods mostly in EUR currency. The EUR / GBP exchange rate currently stands at 1 EUR = 0.94 GBP.

The UK Government's long term goal is to secure and maintain macroeconomic stability in order to promote a strong economy.

Dairy Market in the UK

The dairy industry is vital to the UK economy; milk and dairy products account for about 10% of UK consumer expenditure on food items. During the last decade, the consumption of dairy products in UK has declined in volume but increased in value terms. Average liquid milk consumption for 2007 stood at 1,575mls per person per week - 2.4% lower than the data for the 2006 year, while the average spending increased to 93 Pence per person per week from 90 last year. The table below analyses the trend of dairy market in UK over the last 3 years.

Table 1.1: Trend of Dairy Market in UK

	Average purchase per person per week			pence/person/week			
	Unit	1998	2006	2007	1998	2006	2007
Liquid Whole milk	ml	678	477	420	34	27	25
Semi-skimmed milk	ml	969	974	982	49	54	58
Fully skimmed milk	ml	165	163	173	8	9	10
Total Liquid Milk	ml	1.812	1.614	1.575	91	90	93
Total Cheese	g	103	116	119	51	64	68
Cream	ml	21	22	21	6	6	6
Yogurt & Fromage Frais	ml	143	204	196	30	44	44
Condensed or evaporated milk	eq ml	22	18	18	1	1	1
UHT milk	ml	13	11	11	1	1	1
Dairy desserts - not frozen	ml	31	41	40	10	13	14
Butter	g	36	40	41	11	12	14

Source: DEFRA, the Department for Environment, Food and Rural Affairs

The UK market for milk and dairy products grew by 13.8% between 2003 and 2007, from £6.56bn to an estimated £7.46bn. The dairy category is made up of six sub-categories, all of which are important, showing growth. The milk category is worth £3bn, cheese and chilled yogurts & desserts are £2bn each, butters & spreads are £975m, cream is £231m and fresh flavored milk is

£48m. (Source: TNS Worldpanel 2008, Research and Markets study, Executive Summary 2008).

Liquid milk sales accounts for 40% of the total dairy market, with semi-skimmed products absorbing the majority stake of this category. However, the future trend differentiates the market towards local, organic and filtered milks of higher value added and higher prices, outpacing the decline in sales volumes. Although there are more than 100 dairy processors in the UK, seven major milk processors account for more than 90% of the UK's liquid milk supply. They sell bottled milk to the main grocery retailers, food service companies and for doorstep delivery by the milkman.

(Source: Research and Markets study executive summary, 2008).

During the last 5 years, cheese sales have seen consistent growth, aided by the introduction of new varieties, as well as new formats driving development, reduced-fat cheeses, organic options and regional products. EU cheese consumption is predominantly in hard and semi hard cheese. Average EU cheese consumption is 18.9 kg/capita while in UK it is 10.2 kg/capita.

Yogurts sector is continuously increasing as they have become part of a positive health and diet food profile. According to DEFRA, the world market is growing at 5.2% to 14.5 million tones in EU.

Current butter consumption per capita is highest in the EU at 4.7kg/capita (UK has seen 6% growth to 3.6 kg/capita due to market segmentation and product development).

The milk and dairy products market has been driven by trends evident in the wider food market. Health remains a major consideration and activity has focused on the introduction of a number of new products, as well as the re-launch of established products with improved health profiles. Functional products offering additional health benefits also continue to make gains. Furthermore, as consumers are taking a greater interest in product provenance, attention has been focused on organic and regional products.

Competitors

The most important competitors of Dairy Crest in UK are presented below:

Arla Foods UK Leeds, United Kingdom

Arla's products include milk, butter, cheese, yogurt, and cream. The company's distribution unit collects the raw milk, and delivers processed milk and milk products to supermarkets. The company also sells bulk dairy ingredients to food manufacturers. It is a subsidiary of Denmark's Arla Foods.

First Milk Paisley, Scotland

First Milk Limited packs the collective power of more than 2,500 UK dairy farmer members. It has three divisions: milk operations; a cheese company; and ingredients production. Its members produce approximately 16% of all Great Britain's milk and its cheese company supplies a number of leading retailers with own label cheese.

Robert Wiseman Dairies Glasgow, United Kingdom (listed on London)

As one of the UK's leading milk processors, the company receives raw milk from dairy producers and then turns it into saleable fresh, flavored, and extended-shelf-life milk. The company provides branded and private-label fresh milk from its five dairies and 15 depots to supermarkets in England, Scotland, and Wales. It also offers home delivery.

Westbury Dairies Limited Westbury, England

Westbury Dairies is the result of three cooperatives. The company is a joint venture between three of the UK's largest dairy cooperatives: Dairy Farmers of Britain, First Milk, and Milk Link. Westbury Dairies was set up to process their farmer-members' steady supply of milk at what is now one of the largest single dairy site in the UK. From the raw milk, it produces cream, milk powder, butter, and milk concentrate (used to make yogurt) for the food manufacturing industry.

[Please note that in financial analysis and tables to be followed, the year denoted refers to the annual period ending at the end of March of each year. For example, "2008" or "03/2008" implies the financial year April 2007 – March 2008.]

Historic Financial Performance and Position of the Group

The analysis of Dairy Crest's financial performance over the last 4 years follows the examination of the economic environment it operates in. It is noted that the Company changed its accounting reporting to IFRS (International Financial Reporting Standards) from UK GAAP in fiscal 2005.

The current analysis uses the published annual reports of Dairy Crest for the fiscal years 2005, 2006, 2007 and 2008. It deals with the most important accounts of Income Statement, Balance Sheet and Cash Flow Statement of the Company.

Income Statement

(in GBP million)	03 / 2005	03 / 2006	03 / 2007	03 / 2008
Net Sales	1,261	1,161	1,309	1,570
y-o-y Change. %	-0.8%	-7.9%	12.8%	19.9%
Cost of Sales	928	843	909	1,131
% of Turnover	73.6%	72.6%	69.4%	72.1%
y-o-y Change %		-9.2%	7.8%	24.5%
Other operating income / expense	5	8	7	13
Operating Expenses	254	280	341	377
% of Turnover	20.1%	24.1%	26.0%	24.0%
y-o-y Change %		10.3%	21.5%	10.8%
Depreciation	0	0	0	0
% of Turnover	0.0%	0.0%	0.0%	0.0%
Operating Income (Expense)	84	46	67	74
% of Turnover	6.7%	3.9%	5.1%	4.7%
y-o-y Change %		-45.7%	46.7%	11.2%
Financial expense	-16	-17	-19	-26
Other financial results & j-v income	3	10	17	18
Net Results Before Taxes	70.2	38.4	64.6	66.0
EBT Margin	5.6%	3.3%	4.9%	4.2%
y-o-y Change %		-45.3%	68.2%	2.2%
Income Tax	19	6	11	13
Effective Tax Rate	26.5%	14.6%	17.5%	18.9%
Net Results After Taxes	51.6	34.8	49.2	54.7
EAT Margin	4.1%	3.0%	3.8%	3.5%
y-o-y Change %		-32.6%	41.4%	11.2%
Net Results (a.t.&m.i.)	51.1	33.8	49.0	54.4
Net Margin	4.1%	2.9%	3.7%	3.5%
y-o-y Change %		-33.9%	45.0%	11.0%

Source: Company Accounts.

Balance Sheet

(in GBP million)	03 / 2005	03 / 2006	03 / 2007	03 / 2008
Assets				
Net Intangible Assets	110	136	435	485
Net Tangible Assets	317	330	329	327
Investments in Associates	5	4	4	5
Other L-term assets	0	0	2	34
Total Non-Current Assets	433	470	770	852
% Total Assets	57.21%	57.32%	69.95%	68.76%
Inventories	173	193	148	160
Trade Receivables	106	128	144	166
Other Receivables	18	15	14	20
Cash in bank and at hand	27	15	25	41
Total Current Assets	324	350	331	387
% Total Assets	42.79%	42.68%	30.05%	31.24%
Equity & Liabilities				
Equity	31	31	33	33
Share Premium	28	29	67	70
Reserves	151	187	239	279
Minority Interest	10	11	4	5
Total Equity	221	258	343	388
% Total Equity & Liabilities	29.15%	31.46%	31.18%	31.30%
L-Term Bank Loans	234	254	348	474
Provisions for Staff Retirement	103	62	0	2
Deferred income	11	10	10	9
Other long term debts	0	14	82	96
Total L-Term Liabilities	349	340	440	582
Suppliers	72	93	70	92
Banks	20	41	122	29
Taxes-duties	19	7	5	14
Other Payables	77	81	120	133
Total Current Liabilities	188	222	317	269
Total Liabilities	536	562	757	851
% Total Equity & Liabilities	70.85%	68.54%	68.82%	68.70%

Source: Company Accounts.

Cash Flow Statement

(in GBP million)	03 / 2005	03 / 2006	03 / 2007	03 / 2008
Net Income	52	35	49	55
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	-83	45	-37	40
<u>Change in:</u>				
(-) Trade Debtors	-1	22	16	22
(-) Inventory	-16	20	-45	12
(-) Other Receivables	-6	-3	-1	6
(+) Trade Creditors	-10	21	-23	22
(+) Liabilities for taxes	6	-12	-2	10
(+) Other Short - term liabilities	-4	5	39	13
Net cash provided by operating activities	-18	54	56	99
Cash Flows from Investing Activities				
(-) Intangible Assets	-13	29	302	61
(-) Tangible Assets	-64	54	-41	27
(-) Other long - term receivables	2	-1	1	34
(+) Other Long - term liabilities	71	-28	6	15
Net cash provided (used) in investing activities	147	-109	-263	-106
Cash Flows from Financing Activities				
Increase in Share Capital	0	0	2	0
Increase in Share Premium Account	3	1	38	4
Net Change in Reserves	-81	2	25	8
Change in Long - Term Debt	-58	20	94	127
Change in Short - Term Debt	17	21	81	-93
Dividends	-1	0	22	23
Net Cash Flow from Financing	-118	42	217	23
Cash at Beginning	17	27	15	25
Change in Cash	11	-13	10	16
Cash at End	27	15	25	41

Source: Company Accounts.

Comments of Peer Group Selection

Dairy Crest Group is compared with 3 London Stock Exchange listed companies:

- a. Robert Wiseman Dairies (the fiscal year ends on March 31st)
- b. Northern Foods (the fiscal year ends on March 31st)
- c. Premier Foods (the fiscal year ends on December 31st)

From the three above companies only Robert Wiseman is fully comparable based on size and scope with Dairy Crest. Most of the DCG's direct competitors in UK are dairy farmer co-operatives, non-listed, reporting their accounts under UK GAAP, making comparison inefficient.

Dairy Crest Group and the first two companies are part of the 'FTSE 250 food producers' category of London Stock Exchange while Premier Foods is part of the 'FTSE All Shares food producers' category.

All companies operate in the broader food grocery sector that is estimated at GBP 89 billion. DCG is one of the largest food grocery categories worth GBP 8 billion (~9% of total).

The current analysis utilizes the consolidated accounts, as reported at the annual report of each company.

Analyzing the Profitability of DCG

The profitability of DCG is best described by the operating and net profit margins as well as the ROE & ROA ratios. At the table below, the progress of these ratios during the last 4 years is presented.

DCG Ratios Evolution

Profitability	03 / 2005	03 / 2006	03 / 2007	03 / 2008
(in GBP million)				
Sales	1,261	1,161	1,309	1,570
EBIT	84	46	67	74
Net Income	51	34	49	54
Shareholder's Equity (excl. minorities)	211	247	339	383
Total Assets	757	820	1,100	1,239
ROE (Net Income / Equity)	24.2%	13.7%	14.5%	14.2%
ROA (EBIT/Assets)	11.1%	5.6%	6.1%	6.0%
Gross Margin	26.4%	27.4%	30.6%	27.9%
OPEX / Sales	20.1%	24.1%	26.0%	24.0%
EBIT Margin	6.7%	3.9%	5.1%	4.7%
Net Profit margin	4.1%	2.9%	3.7%	3.5%

Source: Company Accounts.

Over the last 4 years, the Company reported continuous growth on sales, except for 2006, when the Company sold its retailer brand cheese operations, affecting its turnover, in order to focus on higher margin operations. This was evidenced, since, from fiscal 2006 and on, gross margin improved from 26.4% in fiscal 2005 to 27.9% in fiscal 2008.

However, operating expenses increased significantly as a percent of sales from 20% in fiscal 2006 to 24% in fiscal 2008. The increase was mostly attributed to the distribution (increase of oil prices and transportation costs) and promotion expenses (higher advertisement and promotion spending).

As a result of the above, operating margins reduced to 4.7% in fiscal 2008 from 6.7% in fiscal 2005 affected positively (by +1.5%) by improved gross margins and higher one off operating income and negatively (by -3.9%) by higher operating expenses.

ROE is calculated by dividing net income by shareholder's equity (net of minority rights). The Company reported strong net profit for the fiscal 2005 resulting to a high ROE of 24.2%. In fiscal 2006 net income fell, while shareholder's equity increased by the amount of retained earnings reducing ROE to 13.7%. During the fiscal 2007, the Group proceeded to a share capital increase by GBP 39 mn increasing total equity and thus affecting ROE negatively. However, the strong net income for the fiscal 2007 outpaced the total equity increase and drove ROE higher to 14.5%. The level of ROE remained almost stable for the fiscal 2008, affected positively by higher income while total equity increased by the amount of retained earnings.

ROA is calculated by dividing operating profit (EBIT) by total assets. This ratio is high for the fiscal 2005, but declines significantly in the next 3 years. This is attributed to strong investments that increased assets, without being fully utilized yet. However, the level of ROA (6% in fiscal 2008) stands above the average effective interest rate that is calculated at 4.8% (Euros) and 5.8% (Sterling), assuming that the firm earns more on its money than it pays out to creditors. The surplus earnings are available to the firm's owners, leaving ROE on high levels. During the last 4 years the Company is increasing its bank debt and this appears to have made a positive contribution to the firm's ROE.

Comparing Dairy Crest Profitability Ratios with the Peer Group

	03 / 2006	03 / 2007	03 / 2008	03 / 2006	03 / 2007	03 / 2008
	ROE (Net Income / Equity)			EBIT Margin		
Dairy Crest	13.7%	14.5%	14.2%	3.9%	5.1%	4.7%
Robert Wiseman	15.5%	17.3%	13.8%	4.8%	5.9%	4.4%
Northern Foods	10.6%	23.1%	20.9%	6.0%	4.5%	4.7%
Premier Foods	-281.1% ¹	11.2%	-5.8% ²	12.1%	10.2%	3.4%
	ROA (EBIT/Assets)			Net Profit margin		
Dairy Crest	5.6%	6.1%	6.0%	2.9%	3.7%	3.5%
Robert Wiseman	13.0%	14.7%	10.8%	3.2%	4.0%	2.7%
Northern Foods	5.5%	6.8%	6.4%	1.9%	3.2%	3.7%
Premier Foods	11.0%	6.8%	1.9%	6.4%	5.4%	-3.8%
	Gross Margin			OPEX / Sales		
Dairy Crest	27.4%	30.6%	27.9%	24.1%	26.0%	24.0%
Robert Wiseman	24.4%	25.9%	23.6%	19.8%	20.2%	19.4%
Northern Foods	23.5%	20.0%	20.8%	17.9%	16.0%	16.3%
Premier Foods	26.1%	27.5%	30.2%	14.7%	16.6%	27.0%

Source: Company Accounts.

Although Dairy Crest retains the highest gross margin of the peer group during the examined period, the high operating expenses affect operating profits, with EBIT margin standing on the average of the peer group over time. Net profit margins of Dairy Crest stand on the average of the peer group despite the fact that it pays the highest interest expenses (it also has higher bank loans) from the first two companies. Bottom line results of Dairy Crest are positively affected by the financial income (mostly from dividends generated from joint ventures).

Dairy Crest turns capital into profits as efficiently as its competitors, since the ROE ratio stands on average level compared to its peers over time. In addition, Dairy Crest has managed to retain a light fluctuation of ROE over time compared to its peers, implying management's policy for consistency over time (this could be possible a commitment to shareholders).

With respect to ROA, the ratio level for Dairy Crest stands below the peer group, assuming that it manages its assets less effectively. However, Dairy

Crest is carrying out strong investments in fixed assets, the effect of which has not been fully utilized on historical basis.

Analyzing the Liquidity of the Company

According to “Bodie–Kane–Marcus: Investments” book, the liquidity of the company is best measured by the liquidity ratios, which include the current ratio, quick ratio, and interest coverage ratio. Liquidity ratios attempt to measure a company's ability to pay off its short-term debt obligations.

At the table below, the evolution of these ratios for Dairy Crest Group during the last 4 years is presented.

DCG Ratios Evolution

	03 / 2005	03 / 2006	03 / 2007	03 / 2008
Liquidity Ratios				
	(in GBP million)			
Current Assets	324	350	331	387
Receivables	106	128	144	166
Cash	27	15	25	41
Current Liabilities	188	222	317	269
EBIT	84	46	67	74
Interest Expense	16	17	19	26
Current Ratio (current assets / current liabilities)	1.7	1.6	1.0	1.4
Quick ratio (Cash + receivables) / current liabilities	0.7	0.6	0.5	0.8
Interest coverage ratio EBIT/interest expense	5.1	2.7	3.5	2.8

Source: Company Accounts.

The Dairy Crest Group retains healthy liquidity ratios over the last 4 years with the level of current ratio standing well above 1x (except for fiscal 2007) implying that it has the ability to avoid insolvency in the short run, since it can pay off its current liabilities by liquidating its current assets. The ideal level stands at approximately 1.5-2x, with Dairy Crest's ratio standing close to 1.5x.

The quick ratio shows that DCG is carrying heavy inventory as part of its

current assets, since the liquidation of receivables and the cash can pay off only part of current liabilities. However, this ratio improves significantly in fiscal 2008 (stood at 0.8x whereas a suitable ratio would be close to 1).

Furthermore, the interest coverage ratio implies that the operating profits of the Group can cover at least 2.8 times (for the fiscal 2008) its annual interest obligations.

Comparing Dairy Crest Liquidity Ratios with the Peer Group

	03 / 2006	03 / 2007	03 / 2008
Current Ratio			
Dairy Crest	1.57	1.04	1.44
Robert Wiseman	0.76	0.73	0.70
Northern Foods	1.15	0.95	1.09
Premier Foods	1.07	0.92	0.80
Quick ratio			
Dairy Crest	0.64	0.53	0.77
Robert Wiseman	0.66	0.64	0.62
Northern Foods	0.88	0.74	0.87
Premier Foods	0.67	0.56	0.52
Interest coverage ratio			
Dairy Crest	2.73	3.48	2.84
Robert Wiseman	33.49	30.66	12.09
Northern Foods	1.49	0.67	0.76
Premier Foods	1.85	1.73	0.43

Source: Company Accounts.

Dairy Crest's current ratio stands well above the average of the peer group during the last 3 years, implying that it can better pay off its current liabilities by liquidating its current assets. However, approximately 50% of Dairy Crest's current assets account for inventories leaving quick ratio on the average level of the peer group. Overall, Dairy Crest is well positioned with regard to these ratios.

In addition, the Group is well positioned with regard to interest coverage ratio. Robert Wiseman's ratio is significantly higher since it has almost no interest bearing debt.

Analyzing the Asset Management of the Company

In order to measure how efficiently Dairy Crest is managing its assets, the 'inventory turnover', 'receivable days' and 'payable days' ratios are calculated. In addition the 'fixed assets turnover' ratio is measured in order to see how efficiently the company uses its fixed assets. For the calculation of these ratios, the average of the beginning and end-of-year balance sheet figures is taken into account.

DCG Ratios Evolution

Asset Management Ratios	3 / 2005	03 / 2006	03 / 2007	03 / 2008
(in GBP million)				
Net Sales	1.261	1.161	1.309	1.570
Cost of Sales	928	843	909	1.131
Inventories	173	193	148	160
Trade Receivables	106	128	144	166
Suppliers	72	93	70	92
Inventory Turnover Days (1)	67.9	79.1	68.3	49.5
Receivable Days (2)	30.8	36.8	37.9	36.1
Payable Days (3)	28.4	35.8	32.8	26.2
Cash Cycle Days (1+2-3)	70.3	80.1	73.4	59.4
Sales / Fixed Assets (times)	2.9	2.6	2.1	1.9

Source: Company Accounts.

Inventories represent stock of ready made goods or raw materials that are needed to be kept in order to be able to meet the orders of clients. The Group retains a high inventory turnover ratio given the industry it operates. However, it drops over time showing management's efforts to follow a stricter policy on inventories their turnover speed.

The Group's management has loosened its policy with regard to receivables, with the collection period for the last 3 fiscal years accounting for 36-38 days, from 31 days in fiscal 2005. Trade receivables are non interest bearing, and thus any increase is financed by short term bank debt affecting the Group's profitability (interest expense is not 'transferred' to clients'). DCG has a policy to retain receivable days close to 37-40 days on average. This policy

could be part a promotion strategy to attract new or retain current clients (maintain loyal customers).

Payables turnover ratio remains close to 26-30 days as part of DCG's policy over the last 4 years (except fiscal 2006). This means that the Group settles its suppliers in about 30 days. The ideal for a company is payable days to be more than the receivable days. For Dairy Crest it is lower compared to receivables days implying that it should find cash to cover the difference.

This is more evidenced when calculating the cash cycle days that results to 59.4 days in fiscal 2008 (improved over time). Cash cycle looks at the cash movements from the purchase of inventories up to when the customers settle their balances. A longer cash cycle ties up a bigger investment in working capital. In the past, Dairy Crest had a long cash cycle but it managed to improve it, changing its policy to reduce spending on working capital.

The fixed assets turnover ratio, which measures how productively the firm is managing its fixed assets to generate sales, indicates a slow down. This is due to the Group's strong investment program over the last 3 years that has not been fully utilized yet.

Comparing Dairy Crest Asset Management Ratios with the Peer Group

	03 / 2006	03 / 2007	03 / 2008	03 / 2006	03 / 2007	03 / 2008
	Inventory Turnover			Payable Days		
Dairy Crest	79.1	68.3	49.5	35.8	32.8	26.2
Robert Wiseman	6.0	5.7	5.3	55.6	56.7	52.9
Northern Foods	38.6	29.7	23.0	127.8	108.1	92.5
Premier Foods	56.2	55.2	38.2	104.4	90.5	83.3
	Receivable Days			Cash Cycle		
Dairy Crest	36.8	37.9	36.1	80.1	73.4	59.4
Robert Wiseman	28.6	28.2	27.1	-21.0	-22.8	-20.5
Northern Foods	74.2	59.5	44.2	-15.0	-18.9	-25.3
Premier Foods	63.0	58.4	40.6	14.8	23.1	-4.5
	Sales / Fixed Assets					
Dairy Crest	2.6	2.1	1.9			
Robert Wiseman	3.7	3.6	3.6			
Northern Foods	1.4	1.8	2.2			
Premier Foods	1.3	1.1	1.0			

Source: Company Accounts.

Dairy Crest inventory days stand significantly higher compared to the peer group under examination, while receivable days remain close to the average levels of the peer group. On the contrary, payable days stand lower compared to the peer group. Overall, the cash cycle of DCG is much higher compared to the peer group, with all the other companies reporting a negative cash cycle implying that the working capital is increasing the cash flow of these firms.

With regard to the fixed assets turnover ratio, the DCG's ratio stands on the average of the peer group. However, Dairy Crest is the company that has undertaken the largest investment in fixed assets during the last 3 years, implying that future comparison could be in favor of the company.

Concluding, Dairy Crest is in the worst position compared to the companies of the peer group. However, it is making efforts to improve its asset management (it is observed by the improvement of the relative ratios) which will turn in favor of its cash flow.

Analyzing the Capital Structure of the Company

The capital structure refers to the way a firm finances its assets through some combination of equity or debt. The ratios that will be used to measure this combination is 'debt to equity', 'bank debt to equity', 'short term bank debt to equity' and 'long term bank debt to equity' ratios.

DCG Ratios Evolution

Capital Structure Ratios	3 / 2005	03 / 2006	03 / 2007	03 / 2008
(in GBP million)				
Shareholder's Equity	211	247	339	383
Total Liabilities	536	562	757	851
Total Bank Debt	255	295	470	504
Short Term Bank Debt	20	41	122	29
Long Term Bank Debt	234	254	348	474
Total Debt / Shareholder's Equity	2.5	2.3	2.2	2.2
Total Bank Debt / Sharehold. Equity	1.2	1.2	1.4	1.3
S-Term Banks / Shareholders Equity	0.1	0.2	0.4	0.1
L-Term Banks / Shareholders Equity	1.1	1.0	1.0	1.2

Source: Company Accounts.

The growth of Dairy Crest is capital-intensive and is financed by both debt and equity. It has increased its total debt over the last 4 years mostly by rising bank debt in order to perform its investments in fixed assets (directly buyout or through acquisition of companies). In addition, it has increased its share capital by issuing new shares in fiscal 2007 and fiscal 2008. The increase of both was proportionally near, for equity and debt. As a result the debt / equity ratio has remained close to 2.2-2.5x level, while the bank debt / equity ratio has remained close to the area of 1.2-1.4x level. The Group's policy is to retain these levels in order sustain its growth through new investments and at the same time keep satisfied both shareholders and debtors (banks and suppliers). It is important to point that earnings increase by a greater amount than the debt cost (interest), as we have already seen from the ROA ratio (it stands above the average effective interest rate that is calculated at 4.8% (Euros) and 5.8% (Sterling), assuming that the firm earns more on its money than it pays out to creditors). This condition benefits shareholders as more

earnings are available for distribution.

It is positive that the majority of bank debt is long term since it reduces the risk exposure of the Group. The majority of long term debt finances fixed asset investment (long term assets), which when they are utilized are expected to repay the debt and generate profits, which is the case for Dairy Crest. DCG has increased significantly its long term bank debt improving its cash flow that covers part of its working capital needs resulting to lower short term bank debt (it is issued mostly to cover working capital requirements). The ratio bank debt / equity is high but it is justified as the Group is capital-intensive targeting growth by expanding operations beyond the UK market.

Comparing Dairy Crest Capital Structure Ratios with the Peer Group

	03 / 2006	03 / 2007	03 / 2008
Total Debt / Shareholder's Equity			
Dairy Crest	2.3	2.2	2.2
Robert Wiseman	0.8	0.7	1.1
Northern Foods	5.1	3.9	3.1
Premier Foods	-48.9	2.1	1.8
Total Bank Debt / Shareholder's Equity			
Dairy Crest	1.2	1.4	1.3
Robert Wiseman	0.1	0.1	0.3
Northern Foods	2.7	1.9	1.6
Premier Foods	-32.6	1.4	1.1
S-Term Banks / Shareholder's Equity			
Dairy Crest	0.2	0.4	0.1
Robert Wiseman	0.0	0.1	0.3
Northern Foods	2.7	1.8	1.6
Premier Foods	-30.6	1.1	1.0
L-Term Banks / Shareholder's Equity			
Dairy Crest	1.1	1.0	1.0
Robert Wiseman	0.02	0.01	0.03
Northern Foods	0.01	0.00	0.00
Premier Foods	-2.1	0.3	0.1

Source: Company Accounts.

The average level of total debt / equity ratio of the peer group under examination stand above 2x over the last 3 years, while the bank debt / equity above 1x implying that they are capital intensive companies.

Dairy Crest's capital structure stands at the average level of the peer group. However, Northern Foods and Premier Foods appear to have higher short term debt / equity ratio and this means that are more exposed in risk than Dairy Crest. The shareholders of the three mentioned companies prefer to expand operations with maximum of external funding in order to take lesser risk of their investment.

On the contrary, Robert Wiseman's capital structure policy is to expand business utilizing its own capital, avoiding risky exposure making its financial position highly solvent.

Analyzing the Investment Ratios of the Company

The most important investment ratios are the market–book-value ratio (P/BV) and the price–earnings ratio (P/E).

DCG Ratios Evolution

Investment Ratios	3 / 2005	03 / 2006	03 / 2007	03 / 2008
Share Price (in GBp as of 29/12/2008)	213			
Avg share price (in GBp, fiscal ending March 31st)	392.8	489.4	572.7	626.6
Basic number of shares (in million)	123.4	124.8	127.2	132.3
Diluted number of shares (in million)	124.6	125.2	128.3	133.3
Shareholder's Equity (in GBP million)	211	247	339	383
Net Earnings (in GBP million)	51.1	33.8	49.0	54.4
Basic earnings per share (GPX)	41.4	27.1	38.5	41.1
Diluted earnings per share (GPX)	41.0	27.0	38.2	40.8
P / EPS (basic, price as of 31/12/2008)	5.1x	7.9x	5.6x	5.2x
P / EPS (basic, on average fiscal stock price)	9.5x	18.1x	14.9x	15.2x
P / Book value (basic, price as of 31/12/2008)	1.2x	1.1x	0.8x	0.7x
P / BV (basic, on average fiscal stock price)	2.3x	2.5x	2.1x	2.2x

Source: Company Accounts.

DCG's earnings per share remain close to the GBp 40 region over the last 4 years, implying the management's commitment to produce solid profitability for its shareholders.

This EPS level results to a P/E ratio of 5.3-5.5x based on price as of December 31st 2008. This ratio implies that current stock price accounts for 5.2 times the fiscal 2008 earnings of the Group. So, if an investor had bought the stock on December 31st 2008, and the Group maintains current earnings level in the future, these earnings will cover the stock price investment in 5.2 years.

However, the stock price on December 31st 2008 was significantly lower compared to the average levels during the previous fiscal years. This is due to the global economic turmoil during the last 6 month period that has affected stock prices. The stock price is currently considered to be cheaper compared to past levels (based on average prices) assuming that as soon as the global economy stabilizes and DCG retains its strength to maintain profits, the stock will climb to higher levels.

The same case approximately is in effect with P/BV. The stock price reduction has affected the ratio's level, which currently stands below 1x. This means that the market capitalization of the Group is lower than its book value, implying that under certain circumstances the liquidation of DCG will result to higher value than current market value.

Comparing Dairy Crest Investment Ratios with the Peer Group

(prices as of 31/12/2008)	03 / 2006	03 / 2007	03 / 2008
Basic earnings per share (GPX)			
Dairy Crest	27.1	38.5	41.1
Robert Wiseman	25.4	33.4	26.8
Northern Foods	3.3	5.7	7.1
Premier Foods	11.9	12.7	-4.6
Price / Earnings per share (basic)			
Dairy Crest	7.9	5.6	5.2
Robert Wiseman	11.8	8.9	11.1
Northern Foods	17.2	10.0	8.2
Premier Foods	2.6	2.4	-6.6
Price / Book value (basic)			
Dairy Crest	1.1	0.8	0.7
Robert Wiseman	1.8	1.5	1.5
Northern Foods	1.8	2.3	1.7
Premier Foods	-5.3	0.2	0.2

Source: Company Accounts, Bloomberg, Reuters.

Dairy Crest has the highest earnings per share and the lowest P/E and P/BV compared to the peer group under examination. This indicates that the stock is undervalued compared to its peer group and appears more attractive.

However, the DCG's exposure on debt could be the reason why Dairy Crest stock price fell more than the direct competitor Robert Wiseman. A more risky stock is more vulnerable to price fluctuations (high risk - high return).

Overall, it is better to examine the expected P/E and P/BV ratios before proceeding to any conclusions. When we buy a stock, the investment is made for future results, while past results are just an indicator for the company's commitment to successful business. Dairy Crest has shown such a commitment historically, producing solid profits and strong EPS.

Dividend Policy

The dividend policy of Dairy Crest is examined by calculating the dividend per share, the dividend payout ratio and the dividend yield.

DCG Dividend Evolution

	3 / 2005	03 / 2006	03 / 2007	03 / 2008
Dividend Policy				
Share Price (in GBp as of 31/12/2008)	213			
Avg share price (in GBp, fiscal ending March 31st)	392.8	489.4	572.7	626.6
Net Earnings (in GBP mn)	51.1	33.8	49.0	54.4
Total Dividend (in GBP mn)	24.9	26.9	30.2	32.3
S-Term Bank debt	20.3	41	122	29.3
L-Term Bank Debt	234.4	253.9	347.8	474.4
Dividend per share (in GPX)	20.2	21.5	22.9	24.4
Dividend Payout Ratio	48.7%	79.6%	61.6%	59.4%
Dividend Yield (on avg price)	5.1%	4.4%	4.0%	3.9%
Dividend Yield (on current price)	9.5%	10.1%	10.8%	11.5%

Source: Company Accounts, Bloomberg, Reuters.

Dairy Crest maintains a favorable dividend policy for its shareholders, with payout ratio standing above 50% of net earnings while the dividend per share is steadily increasing although the dividend yield (based on average share price for the fiscal in reference) is reducing year-on-year, given an increasing share price. Dairy Crest dividend yield and payout ratio stands above global industry average, which stands at 1.38% and 29.4% respectively (Source: Reuters).

The Group is trying to maintain a dividend yield close to the area of 4-5%, as part of its policy to retain the attractiveness of the stock. At the same time, it has increased the bank debt significantly as part of its investment program. The debt increase might affect future dividends in the case that it should be forced to retain more earnings in total equity and reduce the bank debt / equity ratio.

Valuation of the Group

Having analyzed Dairy Crest Group (DCG) in terms of historical financial performance within its sector and broader economic environment, we attempt to draw financial projections based on the latest evidence of the Group's financial position and strategic objectives. By drawing projections we formulate the Group's future earnings and dividends performance, which are essential factors in completing the valuation exercise.

There are several valuation approaches, each with a different theoretical basis that can be used in order to estimate DCG's fair value. Thus we choose to apply the following valuation methodologies:

- a. Net Asset Value (Book Value)
- b. Dividend Model
- c. DCF – based Valuation
- d. Peer Group Valuation
- e. Comparative Valuation

Financial Projections for DCG

In order to draw our financial projections, we need to put in retrospect DCG's interim performance in the financial year April 2008 – March 2009, and also to take into consideration the management's guidance and equity research analysts' consensus for the current year's performance. Please note that current year which ends in March 2009, will be the first projected year in our valuation model.

DCG's Interim Financial Performance in the Current Year

Overall, the Group's performance in the first half (April – September 2008) was robust despite a challenging economic environment and tough credit conditions in the market. According to the management, the most important business highlights and recent developments can be described as follows:

- Key brands continued to make an excellent progress in the first half;
- Profits and cash flows were in line with management's expectations (higher input costs were successfully translated into price increases whereas the cost savings program continued);
- The management successfully renegotiated the group's syndicated debt facilities.

Table 3.1: Consolidated Income Statement for the Interim Period

Year ended 31 March 2008 £m	Half year ended 30 September 2008			Half year ended 30 September 2007		
	Before exceptional items £m	Exceptional items £m	Total £m	Before exceptional items £m	Exceptional items £m	Total £m
1,509.7	808.2	-	808.2	761.4	-	761.4
(1,508.6)	(769.6)	(5.5)	(775.1)	(727.0)	(9.1)	(736.1)
13.0	3.2	-	3.2	3.7	6.7	10.4
74.4	41.8	(5.5)	36.3	38.1	(2.4)	35.7
(26.2)	(14.3)	-	(14.3)	(13.0)	-	(13.0)
10.1	3.4	-	3.4	4.8	-	4.8
7.7	3.0	-	3.0	3.1	-	3.1
65.0	33.9	(5.5)	28.4	33.0	(2.4)	30.6
(12.5)	(8.1)	(13.8)	(21.9)	(6.4)	2.7	(3.7)
53.5	25.8	(19.3)	6.5	26.6	0.3	26.9
1.2	-	-	-	-	-	-
54.7	25.8	(19.3)	6.5	26.6	0.3	26.9
54.4	25.6	(19.3)	6.3	26.6	0.3	26.9
0.3	0.2	-	0.2	-	-	-
54.7	25.8	(19.3)	6.5	26.6	0.3	26.9
40.2	Earnings per share - continuing operations					
39.9	Basic earnings per share from continuing operations (p)					20.3
	Diluted earnings per share from continuing operations (p)					20.2
57.1	Adjusted basic earnings per share from continuing operations (p)*					22.2
56.7	Adjusted diluted earnings per share from continuing operations (p)*					22.0
41.1	Earnings per share					
40.8	Basic earnings per share on profit for the period (p)					20.3
	Diluted earnings per share on profit for the period (p)					20.2

*Adjusted earnings per share calculations exclude exceptional items and amortisation of acquired intangibles.

Source: DCG Interim Report 2008.

Management's Guidance

The management has already proceeded with a profit warning regarding the financial results of the year April 2008 – March 2009. Specifically, the information disclosed concerned the following key factors:

- Rising milk costs due to weak supply in the market;
- Weaker returns in the dairy ingredients markets;
- Tough budgeting ability due to the current volatile economic cycle;
- 10% earnings before taxes (EBT) deterioration in the current as compared to the previous financial year;
- Net debt was expected to fall from its end-September level of £490.6m to £470m-£480m by March (its debt is now expected to total £500m at the financial year end due to the pound's fall);
- Ratio of net debt to earnings before interest, tax, depreciation and amortization at 3.25x for the current financial year (the covenant allows the ratio to go up to 3.5).

Equity Analysts' Consensus

As of December 2008, equity analysts have not fully revised and updated their research reports on DCG. Apart from a report issued in December by JP Morgan, it seems that there is limited updated coverage on the stock. In a research note published in November, the analyst mentioned that "...the consensus expectations do not completely reflect the effect of increased farm gate prices on the company's cheese and powder segments..." As a result "...Dairy Crest is likely to witness depressed earnings in F2H09 and FY10..." the analyst says.

In another research note of Financial Times was mentioned "...Dairy Crest's ability to generate strong volume growth from such brands even as prices are rising is commendable. It also means that the troubles of the liquid milk business, which affect the whole sector, are cushioned. Even so, the outlook for the second half is slightly less positive than previously and while analysts are not cutting forecasts yet there is more chance that they will later. With pre-tax profits currently expected about £101m, and earnings per share of about 56.5p, the price/earnings ratio is a modest 6.9 while the yield is not

much lower. With the debt refinanced in good time, the dividend looks more than safe making for a defensive investment in these turbulent markets...". Of course whether DCG will be a safe investment is to be proved, however its nature of business offers a cushion to a potential investor, provided that the Group will avoid any significant earnings deterioration amid the current crisis.

Financial Projections

[Please note that in all financial tables to be followed, the year denoted refers to the annual period ending at the end of March of this year. For example, "2009 implies" the financial year April 2008 – March 2009.]

Below we present the major assumptions of our model's projections:

- We assume that current as well as next financial year will be tough ones due to the ongoing financial crisis that will affect demand. However, given the Group's defensive business activity, we tend to believe that from the period April 2010 – March 2011 and onwards, DCG's financial performance in terms of profitability will start showing signs of recovery, also due to a possible turnaround of the current sluggish economic cycle;
- For the next 2-3 years, we project a rather rigid cost structure that will not allow for any gross profit margin improvement. Already the signs of the interim results and the management's guidance point to rising production costs due to the market supply and demand forces for milk;
- For 2008-09, we forecast a -higher than the management expects- drop for earnings before taxes and an even sharper drop for net profit (after taxes) mainly due to an exceptional tax expense (which also affects the DCF model). However we anticipate the profit recovery to accelerate starting from 2010-11;
- We have also taken into consideration the fact that Dairy Crest has moved to reduce the risk in its finances by swapping some of its euro-denominated debt into sterling. In addition, the recent fall in the pound against the euro has pushed up the Group's euro-denominated debt in sterling terms, and a further slide in the exchange rate may lead to a breach in the Group's covenants in the future. However it is difficult to project future trends in the international currency market. Thus we have estimated the DCG' gross long-term debt at a range of GBP 450-480 million over the next 5 years, close to management's guidance, taking also into consideration the recent renegotiation of the loans' terms. In

addition, a possible maturity in the Group's investment plan in the following years may allow for a slowly declining level of debt.

The 5-y financial projections are depicted in the following tables:

Projected Consolidated Income Statement (in GBP million)

		2009 E	2010 E	2011 E	2012 E	2013 E
Turnover		1,650	1,700	1,825	2,050	2,350
	y-o-y Change. %	5.1%	3.0%	7.4%	12.3%	14.6%
Cost of Sales		1,188	1,233	1,314	1,445	1,633
	% of Turnover	72.0%	72.5%	72.0%	70.5%	69.5%
	y-o-y Change. %	5.0%	3.7%	6.6%	10.0%	13.0%
Other operating income / expense		5	5	5	5	5
Operating Expenses		396	412	438	497	588
	% of Turnover	24.0%	24.3%	24.0%	24.3%	25.0%
	y-o-y Change. %	5.0%	4.1%	6.2%	13.5%	18.2%
EBITDA		71	60	78	113	134
EBITDA Margin		4.3%	3.5%	4.3%	5.5%	5.7%
	y-o-y Change. %	-4.6%	-15.1%	29.5%	44.4%	19.2%
Depreciation		0	0	0	0	0
	% of Turnover	0.0%	0.0%	0.0%	0.0%	0.0%
EBIT		71	60	78	113	134
	% of Turnover	4.3%	3.5%	4.3%	5.5%	5.7%
	y-o-y Change. %	-4.6%	-15.1%	29.5%	44.4%	19.2%
Net Financial Results		-15	-15	-14	-14	-12
Net Results Before Taxes		56	46	64	99	123
EBT Margin		3.4%	2.7%	3.5%	4.8%	5.2%
	y-o-y Change. %	-14.7%	-18.8%	39.5%	55.3%	23.8%
Tax income		28	9	13	20	25
	Effective Tax Rate	50.0%	20.0%	20.0%	20.0%	20.0%
Net Results After Taxes		28	37	51	79	98
EAT Margin		1.7%	2.2%	2.8%	3.9%	4.2%
	y-o-y Change. %	-48.5%	29.9%	39.5%	55.3%	23.8%
Net Results (a.t.&m.i.)		28	36	51	79	98
Net Margin		1.7%	2.1%	2.8%	3.8%	4.2%
	y-o-y Change %	-48.5%	29.9%	39.5%	55.3%	23.8%

Source: VRS Assumptions, Estimates & Projections.

Projected Consolidated Balance Sheet (in GBP million)

	2009 E	2010 E	2011 E	2012 E	2013 E
Assets					
Net Intangible Assets	497	506	515	525	535
Net Tangible Assets	360	396	436	479	527
Investments in Associates	5	5	5	5	5
Other L-term assets	35	37	39	41	43
Total Non-Current Assets	898	945	995	1,050	1,110
% Total Assets	70.44%	72.91%	74.14%	73.34%	73.09%
Inventories	146	135	137	150	143
Trade Receivables	172	182	175	197	225
Other Receivables	21	22	23	24	26
Cash in bank and at hand	37	12	12	10	15
Total Current Assets	377	351	347	382	409
% Total Assets	29.56%	27.09%	25.86%	26.66%	26.91%
Total Assets	1,275	1,296	1,342	1,432	1,519
Equity & Liabilities					
Equity	33	33	33	33	33
Share Premium	70	70	70	70	70
Reserves	296	318	348	395	454
Minorities	5	5	5	6	6
Total Equity	405	427	457	505	564
% Total Equity & Liabilities	31.74%	32.92%	34.06%	35.25%	37.11%
L-Term Bank Loans	480	470	450	450	450
Provisions for Staff Retirement	0	0	0	0	0
Deferred income	9	9	9	9	9
Other long term debts	99	102	105	108	112
Total L-Term Liabilities	588	581	564	567	571
Suppliers	104	118	126	147	175
Banks	15	15	30	35	20
Taxes-duties	23	7	10	16	20
Other Payables	140	147	155	162	170
Total Current Liabilities	282	288	321	360	385
Total Liabilities	870	869	885	927	955
% Total Equity & Liabilities	68.26%	67.08%	65.94%	64.75%	62.89%
Total Equity & Liabilities	1,275	1,296	1,342	1,432	1,519

Source: VRS Assumptions, Estimates & Projections.

Projected Financial Ratios

	2009 E	2010 E	2011 E	2012 E	2013 E
Profit Margin					
Gross Margin	28.00%	27.50%	28.00%	29.50%	30.50%
EBITDA Margin	4.30%	3.54%	4.27%	5.49%	5.71%
EBIT Margin	4.30%	3.54%	4.27%	5.49%	5.71%
Net Profit margin	1.70%	2.14%	2.78%	3.85%	4.15%
Profitability					
ROIC	3.1%	4.0%	5.4%	8.1%	9.6%
ROA	2.2%	2.8%	3.8%	5.7%	6.6%
ROE	7.2%	8.9%	11.6%	16.6%	18.5%
Activity					
Stock Days	45	40	38	38	32
Debtors Days	38	39	35	35	35
Creditors Days	32	35	35	37	39
Capital Structure					
Total Debt/ Total Equity	2.15	2.04	1.94	1.84	1.69
Bank Loans/ Total Equity	1.26	1.17	1.08	0.99	0.86
Interest Coverage	2.21	1.91	2.50	3.57	4.39

Source: VRS Assumptions, Estimates & Projections.

Net Asset Value (Book Value)

The account denoted as “Shareholders’ Funds” on the right hand side of a company’s balance sheet is the “Net Asset Value” equaling with the difference between the value of the assets and the value of liabilities. This approach is also used or at least “exploited” by the so-called asset strippers who buy companies for their assets, sell those assets and by repaying all liabilities, are left with an amount of money that exceeds the original acquisition cost. Such transactions are financially sound when the acquired company’s market capitalization in the stock market is –for various reasons– lower than its book value depicted in the balance sheet.

As of March 2008 (the ending period of the latest available full historic financial year), DCG's total assets stood at GBP 1,238 million with total liabilities at GBP 851 million. Thus, the Company's Net Asset Value had settled at GBP 387 million before minority interest and GBP 382 million after minorities.

Dividend Model

The Dividend Discount Model is based on the projected dividends for the 5-year (explicit) period and for the infinity (implicit) period which are discounted to the present. Having extracted our projections for DCG's future earnings and dividend policy, we only need to discount the dividends into present values and then by adding those values we end up with the fair value of the company or the fair value per share. An important assumption is this approach is the dividend payout ratio which has been set at 40% lower than the previous years. This is due to the current tough economic conditions, which imply the need of Dairy Crest to retain a larger proportion of its earnings as a cushion against budgeting and investment needs in the future. The discounting factors are based on the cost of equity of 8.20% (risk free rate of 3.2%, beta at 1.25x and risk premium at 4.0%).

Table 3.6: Dividend Discount Model and Calculation of Cost of Capital

	<u>1st Projected</u> <u>Year</u>							Dividend Growth Rate	Terminal Value End of Period
	2007	2008	2009 E	2010 E	2011 E	2012 E	2013 E		
Dividend per Share (in GBP)	0.23	0.24	0.08	0.11	0.15	0.24	0.29	1.00%	4.12
Required Return / Cost of Equity	8.20%	8.20%	8.20%	8.20%	8.20%	8.20%	8.20%	↑ ↓ 4.49%	
Present Values (in EUR)			0.078	0.093	0.120	0.173	0.198		
Dividend Growth Rate (2007 - 2013 CAGR)									
Implied Value per Share (Target Price) (in GBP)									3.438
Current Share Price (in GBP)									2.130
Upside Potential									61.43%

Source: VRS Assumptions, Estimates & Projections.

DCF – based Valuation

By projecting the DCG's operating profits, and then adjusting for taxes, depreciation, capital expenditures and working capital, we end up with the future free cash flows to the firm. Discounting those cash flows with the weighted average cost of capital (the interest rate that weighs both own capital and debt employed by the company), we end up with DCG' enterprise value, also known as EV that equals with equity value (or market capitalization) plus debt minus cash.

Applying the above assumptions and factors, the fair value (EV minus debt plus cash) for DCG settles at GBP 240 million or GBP 1.804 per share. The following important assumptions have been made in the DCF model:

- Infinity weighted average cost of capital at 7.0 % (based on a 40% debt to equity ratio with cost of equity and cost of debt assumed at 8.2% and 6.5% respectively – for conservative purposes, cost of debt is assumed higher than current interest rates applied on DCG's loans),
- Cost of equity is based on risk free rate of 3.20% (the 10-year UK bond yield), risk premium of 4% and beta of 1.25x (source: Reuters),
- Infinity Sales Growth of 1%,
- Infinity EBIT Margin of 5%.

The model's assumptions relate also to the following conditions:

- Profitability improves in the following 5 years;
- DCG applies an efficient financial policy in terms of investments and working capital cycle.

It is evident that the Dairy Crest Group's DCF-based valuation may improve if the following conditions are satisfied by the Company's management:

- Higher operating profit margins;
- More efficient cash cycle management;
- Greater control on cost structure without jeopardizing profitability ratios;
- A better tax management.

Table 3.6: Discounted Cash Flow (DCF) Model

in GBP mn	2009 E	2010 E	2011 E	2012 E	2013 E	L-Term Assumptions
ASSUMPTIONS						
Growth Rate (Sales)	5.1%	3.0%	7.4%	12.3%	14.6%	1.1%
EBIT Margin	4.3%	3.5%	4.3%	5.5%	5.7%	5.0%
Tax Rate	50.0%	20.0%	20.0%	20.0%	20.0%	20.0%
Working Capital (% of sales)	-2.0%	-0.4%	-1.2%	0.1%	-0.7%	2.0%
Capex (% of sales)	4.0%	4.0%	4.0%	3.9%	3.8%	3.8%
Cost of Capital	5.4%	6.6%	6.6%	6.7%	6.8%	7.0%
Depreciation (% of sales)	1.3%	1.3%	1.4%	1.4%	1.3%	3.8%
CASH FLOW STATEMENT (GBP mn)						
Turnover	1,650	1,700	1,825	2,050	2,350	2,375
EBIT	71	60	78	113	134	119
Less: Adjusted Tax	36	12	16	23	27	24
Adjusted Operating Profit	36	48	62	90	107	95
Plus: Depreciation	21	23	25	28	30	89
Operating Cash Flow	56	71	87	118	138	184
Less: Change in Working Capital	-33	-6	-22	3	-17	48
Less: Capex	66	68	74	81	88	89
Cash Flow to the Firm (FCFF)	24	10	35	35	67	48
Discount Factor	0.95	0.88	0.82	0.77	0.72	0.71
Present Value of Cash Flows	23	9	29	27	48	
Accumulated Present Value	23	31	60	87	135	
Residual Value						802
Present Value of Residual Value						572
VALUATION						
Enterprise Value	707					
% Residual Value of Total	80.9%					
Less: Net Debt	467					
Value of firm (in GBP mn)	240					
Outstanding # of shares (000)	133					
Value of share (in £)	1.804					
Value of share (in €)	1.917					
WACC CALCULATION						
						Risk Free Rate
						3.2%
						Beta Factor
						1.3
						Market risk Premium
						4.0%
						Cost of Equity
						8.2%
						Debt / Debt + Equity
						40.0%
						Cost of Debt
						6.5%
						Tax Rate
						20.0%
						Weighted Average Cost of Capital
						7.0%

Source: VRS Assumptions, Estimates & Projections.

The following table presents the sensitivity analysis on the DCF model showing the valuation of the Company (in GBP) based on different growth rates and different values for weighted average cost of capital (WACC).

Table 3.7: Sensitivity Analysis based on the (DCF) Model

		WACC				
		5.0%	6.0%	7.0%	8.0%	9.0%
GROWTH	0.07%	2.62	1.97	1.15	0.54	0.08
	0.57%	3.80	2.40	1.45	0.76	0.25
	1.07%	4.63	2.92	1.80	1.02	0.44
	1.57%	5.71	3.57	2.22	1.31	0.65
	2.07%	7.16	4.37	2.73	1.65	0.89

Source: VRS Assumptions, Estimates & Projections, Bloomberg, Reuters.

It is important to note that the higher the implicit growth rate for a given weighted average cost of capital implies a higher value for Dairy Crest. On the other hand the importance of WACC is equally strong. For a given implicit growth rate, the lower the WACC, the higher the valuation evolves.

Peer Group Valuation

At this stage, we attempt to value DCG based on a peer group consisting of companies with similar or broadly relevant activities as it is not feasible to spot fully comparable listed companies from the UK food sector. The peer group valuation is based on the two major valuation ratios followed by analysts and investors alike: the price earnings ratio and the price to book value ratio.

Table 3.8: Peer Group Comparison

Stock	Country	Market Cap GBP mn	P/E '08-'09 (times)	P/BV '08-'09 (times)
Premier Foods	UK	240.71	1.93	0.20
Northern Foods	UK	294.34	8.17	1.78
Wiseman Dairies	UK	213.31	9.17	1.48
Dairy Crest Group	UK	283.43	10.12	0.71
Total Market Cap		1,031.79		
			P/E 2009 (times)	P/BV 2009 (times)
Peer Group Avg (times)			6.42	1.15
Market Cap Weighted Average (times)			7.46	1.06
Implied Target Price (Weighted) (in GBP)			1.57	3.17

Source: VRS Assumptions, Estimates & Projections, Bloomberg, Reuters.

From the above table, we draw the conclusion that DCG is more attractive than its peer group in terms of the price to book value ratio, whereas it is more expensive than the average in terms of the price to earnings ratio. Please note that book value is calculated net of minorities whereas earnings are after taxes and minorities.

Weighted Average Valuation

Based on the weighted average valuation that weighs 5 different valuation approaches (net asset value, dividend discount model, discounted cash flows, P/E and P/BV), the DCG stock settles at a fair value of GBP 2.35 per share implying an upside potential of 10.39%. The following table presents the constituents of the weighted average valuation approach and their weights.

Table 3.9: Weighted Average Valuation

Valuation Method		Weight	Price	Value Equivalent	Price Adjusted	Value Equivalent
		%	in GBP	in GBP mn	in GBP	in GBP mn
NAV	Average	20%	2.875	382.60	0.575	76.52
DCF	Average	40%	1.804	240.03	0.722	96.01
Peer Group	P/E	15%	1.57	208.83	0.235	31.32
	P/BV	15%	3.17	421.74	0.475	63.26
DDM	Average	10%	3.44	457.52	0.344	45.75
Total Weight		100%		Fair Value	2.351	312.87
Current Price					2.130	
Upside / Downside Potential					10.39%	

Source: VRS Assumptions, Estimates & Projections, Bloomberg, Reuters.

Note: We consider DCF and NAV as the most important valuation approaches, thus attaching weights of 40% and 20% respectively. Peer group valuation is weighted for 30% and DDM for 10%.

Share Price Performance

During the period 2004 – mid 2007, DCG stock performed on an upward trend reflecting the Group's healthy fundamentals. Since the start of the credit crisis however, right after the share price exceeded 700 p, the DCG stock has plunged quite significantly, dropping even below 200 p at the end of 2008. Especially during the last months of 2008, the stock's volatility surged with the share price posting some of biggest daily drops over the past 10-11 years.

DCG's Share Price over the Last 5 Years



Source: Digital Look.

The following table presents Dairy Crest Group's major valuation ratios.

Table 3.10: DCG's Major Valuation Ratios (Projected)

	2009 E	2010 E	2011 E	2012 E	2013 E
P/E	10.12	7.79	5.58	3.59	2.90
P/BV	0.71	0.67	0.63	0.57	0.51
EV/EBITDA	10.56	12.70	9.75	6.81	5.57
D/Y	3.95%	5.13%	7.16%	11.13%	13.78%

Source: VRS Assumptions, Estimates & Projections, Bloomberg, Reuters.

Conclusions on DCG's Analysis & Valuation

By performing the historic financial analysis and valuation of Dairy Crest Group Plc, we are in a position to draw useful conclusions about its financial status and sustainability in future. Below, the major conclusions are underlined:

- DCG derives the bulk of its revenues from the UK economy, which is a healthy and steadily growing economy.
- The UK dairy sector which DCG operates in, is a large in size and defensive market where growth rates are not as high as in other economic sectors, however they are relatively stable.
- Historically, the Group's financial performance is positive with an upward trend in revenue and profit generation. DCG also proceeded with significant investments in the past to boost growth.
- With its peer group, DCG compares satisfactory in terms of profitability, liquidity and capital structure ratios, however it performs worse in terms of working capital cycle.
- The Group's historic performance within its sector implies that revenue and profit generation is sustainable in the future however with certain volatility in its pattern due to economic cycles such as the current one, which points to a financial and broader economic crisis. It would be also important for DCG to improve its working capital cycle in view of the credit conditions expected to appear in the near future.
- We adopted a conservative scenario with regard to the DCG's future performance, in view of the tough economic conditions expected to persist in the next 2 years, and an optimistic scenario after that period.
- In terms of weighted average valuation based on 4 different approaches, DCG stock "deserves" a fair value which is slightly above its current market capitalization in the stock market. The valuation outcome is in line with the Group's financial performance and overall market conditions prevailing at this time.

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Notes

Notes

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- Interest rates

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