Company Review: First Milk

A guide to your milk buyer

February 2012

Agriculture & Horticulture DEVELOPMENT BOARD

DairyCo

First Milk
Company profile

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First Milk is a farmer owned co-operative with around 2,200 Members in 2010/11, which produced around 14% of Britain's milk in that period. The principal activity of the co-operative is the collection and marketing of milk, along with the manufacture of cheese and dairy ingredients.

The aim of the co-operative is to grow profits for the business in order to deliver long term sustainable returns to its producer Members. In its 2010/11 financial report, it has listed five areas of focus to achieve this aim:- to drive shareholder returns; to increase sales of branded products in order to grow margins; to exploit opportunities to improve its market, customer and product spread; to work to minimise its costs base and to build mutually beneficial partnerships within the dairy supply chain.

Activities during 2010 and 2011 that have supported these objectives include the launching of two major marketing campaigns to support growth of its Lake District Cheddar brand and the acquisition of Kingdom Cheese and Kingdom Dairies, providing it with access to new dairy market segments and customers. In September 2010 Arla entered into a deal with First Milk and Milk Link to become a shareholder in Westbury Dairies Limited, which will reduce First Milk's share of site costs.

First Milk has a goal to increase the proportion of its total business from international markets over the next 18 months from the current level of around 5-7% to 10%. The strategic partnerships it established with Eilers & Wheeler to export its cheddar, the acquisition of Kingdom Cheese with its established export clients and the joint venture with Fonterra to sell added-value whey products abroad are moves that may help the co-operative to achieve this target.

In April 2010, First Milk introduced market-related pricing schedules for its Members, linking prices paid to market returns on product markets. Milk prices[1] paid by the co-operative rose by more than the average increase over the 2010/11 milk year as the company realised improved returns for its milk and achieved reductions in its cost base.

As a company, First Milk faces competition from other raw milk brokers and, as many liquid milk processors are aiming to increase direct suppliers, may see the demand for brokered milk decline. In the Cheddar and soft cheese markets, First Milk will face competition from other cheese makers such as Milk Link, Lactalis and Dairy Crest; although competition from imports declined during the year as relatively better returns could be obtained from other markets. It will face competition on an international scale for Cheddar and whey products in its export markets, however its strategic partnerships with companies who have experience in these markets should provide some competitive advantage.

1 Based on the DairyCo standard litre

Current position

- First Milk is one of the largest milk buyers in GB in terms of the number of suppliers and volume of milk collected, although it has lost Members in the past two financial years.
- During the current milk year (2011/12), it has focused on increasing volumes and has recruited in the region of 150m litres of additional volume since April 2011.
- The co-operative has increased its range of products and market channels, which should enable it to benefit from a more broadly based business.
- It has strong historic links with the major liquid dairies to provide milk for balancing.
- It has reduced the amount of its milk that is directed towards lower value markets such as brokering and has increased its production of value-added dairy products from 28% to 30%.
- Lake District Cheddar grew to be the fourth largest brand in terms of value sales in the branded cheese market[2] in the period to October 2011.
- First Milk has exploited the strength of world commodity markets through its use of the International contract operated in partnership with Eilers & Wheeler.
- Its investments have been directed towards growing its brands, increasing efficiencies and expanding its product portfolio.
- It has reduced its share of the site costs of Westbury Dairies through the deal with Arla Foods to become a shareholder.
- Its financial position has improved as turnover increased and it has realised some improvements in cost control.
- Milk prices paid to producers have increased on the back of reductions of its cost base and the strength of world commodity markets. Although they remain in the bottom third of the DairyCo league table, Members have seen an above-average rise during the year.
- Will benefit from a capital gain of approximately £9.6m upon completion of the sale of its 10% shareholding in Robert Wiseman Dairies to Müller, strengthening its cash position.

Future challenges and opportunities:

- Its strategic partnerships with Eilers & Wheeler and Fonterra should allow it to take advantage of opportunities on world markets both for value-added and commodity products.
- May continue to face the risk of reduced milk supplies as Members are paid one of the lowest milk prices[3] and may look for alternative buyers, although the rate of resignations has dropped during 2011/12.
- The ability to efficiently use its production capacity would be impacted should it continue to

2 According to Kantar data for the 52-week period ending 2 October 2011.
3 As measured by the DairyCo standard litre.

lose volumes through reduced membership. This may also reduce available capital which could increase the cost of financing required investments.

- Demand for brokered milk from major liquid processors may decline in the long term as they seek to increase the proportion of milk supplied from directly contracted farmers unless there is sufficient growth in market demand for milk and milk products.
- Maintaining long-term relationships with customers through competitive pricing and servicing will continue to be important in the near future.
- Further improvements in its financial performance will be important in ensuring continued access to long-term funding for capital investment.

Procurement analysis

Milk purchases

The table below gives details of First Milk's milk supply base for the 2010/11 milk year.

	Direct supplies		Total	Change from previous year
	Aligned	Non-aligned		
Million litres	45	1,580	1,625	-6.1%
Numbers	60	2,300	2,360	-6.0%

Source: First Milk

Membership in the co-operative fell during the year, declining by around 6% of which approximately half due to retirements. This had an impact on total milk purchases, which were down by approximately 105m litres (6.1%) compared to the previous year.

Recruitment

First Milk is actively recruiting new producers, either as Members, direct suppliers or on short term deals such as through its partnership with Eilers & Wheeler[4]. In the first six months of the 2011/12 milk year, in excess of 150m litres of new volume had been recruited. Approximately half of this volume was recruited on the Eilers & Wheeler contract, with the remaining roughly split between direct supply contracts and new Members.

When recruiting, First Milk's main criteria for selection is primarily size and location; farmers should supply a minimum of 1,000 litres per day and be located within its existing milk fields. The co-operative prefers autumn calvers as this reduces wide variations in available milk through the year. There are currently no restrictions on expansion from Members, with no plans to introduce volume restrictions in the future.

4 See Contracts section for further details.

Contracts

The table below summarises the main features of the supply pools operated by First Milk.

Milk pools	Liquid	Balancing Liquid†	Tesco	Highlands & Islands	Cheese††	Balancing Compositional
Million litres	910		45	50	620	
Producer numbers	1,300		60	55	945	
End use	Liquid		Liquid	Cheese	Cheese	Cheese and ingredients
Catchment area	Central Scotland, England and Wales		Wales	Highlands and Islands	Central Scotland, England and Wales	
Annual average price 2010/11*	23.19	23.59	26.93	23.53	23.01	22.72
Annual average price as of Sep 11*	27.62	27.33	29.92	28.30	27.13	27.14
Reasons for price changes	Market related		Promar cost tracker	Market related		

Source: AHDB/DairyCo estimates.
*Based on DairyCo standard litre (see www.dairyco.org.uk/datum for details). If contract is offered on a profile and variable/seasonal basis, the price based on profile payments is reported.
†New contract from September 2010 (annual average over 7 months); average may be slightly overestimated as it does not include seasonally lower spring prices.
††New contract from June 2010 (annual average over 10 months).

In April 2010, First Milk launched new contracts with pricing linked to market returns and accounting for haulage costs. For milk directed towards its cheese sites, a protein bonus applies. First Milk now offers distinct end-use linked contracts, one for cheese, one for liquid and one for balancing (either milk or cheese). The Highlands and Islands contract is effectively a cheese contract, with milk directed to a local creamery. Prices paid on this contract are slightly higher to account for differences in costs.

The redesigned contracts offer bigger bonuses for larger volumes, indicating that First Milk is looking to concentrate milk collections and lower costs. In addition to these market related contracts, there is a Tesco aligned contract for milk supplied to Tesco's stores in Wales, which operates in the same manner as other Tesco aligned contracts.

In April 2011, First Milk launched its International contract in partnership with Eilers & Wheeler. The contract was designed to recruit additional milk in order to take advantage of strong international commodity markets. Prices paid on the contract are linked to market returns for skimmed milk powder (SMP) and butter. First Milk manages the contracts and the processing of milk at Westbury, while Eilers & Wheeler use their expertise and established distribution network to market and sell the product. The margin made on the milk is returned to First Milk Members through dividend payments.

The Eilers & Wheeler contract, available to non-members on an evergreen contract, initially paid a price of 28.5ppl for milk supplied to the end of June 2011. The price is tracked and changes are based on Dutch market prices for SMP and butter. In addition to the base price, there is a volume bonus of 0.2ppl for each additional 1,000 litres per day starting at 8,000 litres per day to a maximum of 1.6ppl for any deliveries above 15,000 litres per day.

Price Review

Being a co-operative, Members receive returns in the form of the milk price combined with returns on Member capital. Farmgate prices are set by the First Milk board which has six farmer directors out of 11 board members in total, which gives farmer directors a majority of votes. Three of the farmer directors are elected with the other three selected on the basis of the skills and expertise they can offer to the management of the co-operative.

Since the re-alignment of its milk contracts, prices are directly linked to market returns in the various markets. Prices paid for milk have been driven up on the back of the continued strength of commodity markets throughout 2011. The cheese and compositional contracts have seen the largest net increase in price in the current milk year, with four price increases totalling 2.98 ppl and 2.97ppl respectively, including the most recent increase of 1.0ppl effective October 2011. The Highlands and Islands contract, which also supplies milk for cheese, has had price rises totalling 2.98ppl, while liquid milk contracts have increased by 2.9ppl since April 2011.

The Tesco aligned contract price changes on a six-monthly basis, in line with the Promar cost tracker. In April 2011, an extra increase of 1.28ppl was announced followed by an additional increase of 0.43ppl in October, bringing the total price increase on the Tesco contract for the current milk year to 1.71ppl.

Prices on all of First Milk's contracts have increased over the year, although they remain in the bottom part of the DairyCo league table. However, when comparing year-on-year changes in milk prices[5], First Milk has improved its position with prices on its cheese contracts increasing by just under 14% compared to the average increase of 12% on cheese contracts. For liquid milk, First Milk suppliers have seen average prices increase by over 11%[6] compared to an average increase of 9% on non-aligned liquid milk contracts.

In addition to the milk price paid, Members of the co-operative receive a return on their Member capital. A dividend of £1m was paid in January 2011, followed by a further £1m in July 2011, equating to return on capital of 6% for active and retired Members. In December 2011, First Milk announced its third return on Members' capital in 18 months, with Members receiving 3% on their capital, to be paid in January 2012.

Exit policy

Farmer Members are required to give 12 months notice to quit their contract, with three exit dates at the ends of March, September and December. Effectively this means there could be up to 18 months of notice required, although Members have the option to reduce the notice period to 6 months notice by paying 2% of the previous 12 months milk cheques. Exit periods for this are at the end of March and September. For the Eilers & Wheeler contract, the notice period to end the

5 Annual averages effective September 2011 from DairyCo league table. For consistency in reporting across major milk buyers, annual averages from September 2011 are used.

6 Not including prices paid for milk on the Tesco aligned contract.

contract is three months for both First Milk and the producers.

Farmers supplying First Milk as Members benefit from an evergreen contract meaning that First Milk cannot give notice to its Members unless they breach certain rules.

Supplier benefits

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First Milk operates a number of schemes aimed at helping its Members. The First Milk Farm Sustainability Programme aims at increasing efficiencies on farm and improving business practices through discussion groups, workshops and benchmarking. First Milk also operate in partnership with Anglia Farmers, the UK's largest agricultural purchasing group, to provide Members with the opportunity to source a large range of agricultural inputs, business products and services.

Highlights...

- First Milk introduced a market-related contract structure at the beginning of the 2010/11 milk year, linking prices paid for milk to returns from product markets.
- Milk supply has fallen in 2010/11 compared to the previous year, linked to a drop in Member numbers which were influenced by a high rate of retirements.
- Milk prices paid to Members have risen on all contracts through the year at a higher than average rate, with prices paid on cheese contracts seeing the largest year-on-year increase of almost 14% effective September 2011.
- First Milk is recruiting new producers, either as Members, direct suppliers or to supply on the Eilers & Wheeler International contract.
- Additional benefits offered through the Farm Sustainability programme and partnership with Anglia Farmers which helps Members to improve their business and reduce costs.

Production analysis

Product portfolio

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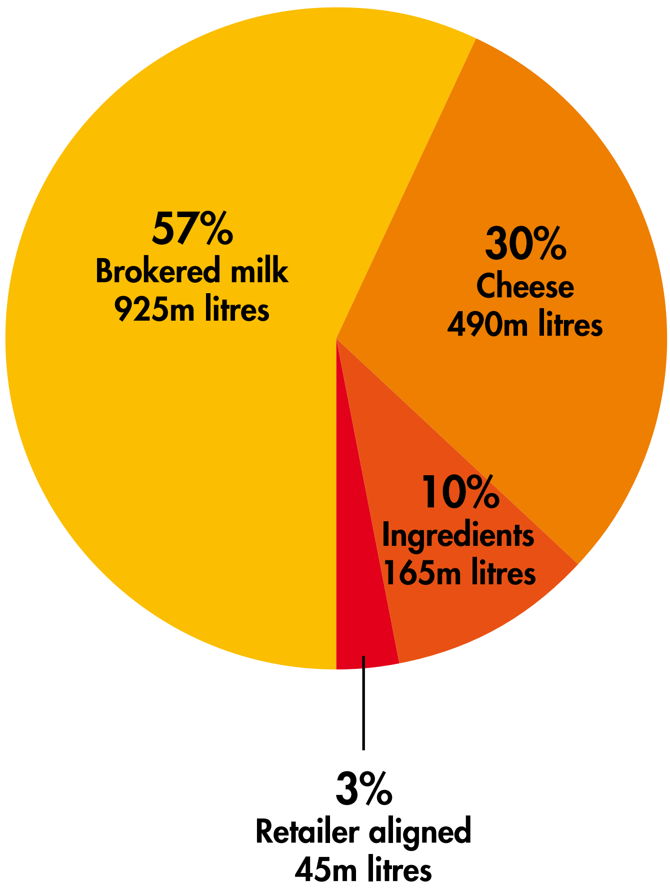
Total milk purchases 1,625m litres



There were no major changes in the utilisation of milk by First Milk between 2009/10 and 2010/11, although there was some growth in cheese production. The co-operative remains primarily a milk broker, with this accounting for approximately 57% of its milk pool, representing around 925m litres. It is also a major cheese processor, with 30% of its milk supply directed towards the production of 50,000 tonnes of cheese in 2010/11. The production of ingredients such as SMP and butter accounts for 10% of its milk with the remaining 3% sold to Tesco as liquid milk in its Welsh stores.

First Milk sell the whey from its Haverfordwest Creamery exclusively to the nutrition ingredients company Volac, while the whey from its Lake District Creamery will be marketed as high quality whey protein concentrate through Fonterra which should provide improved returns once the investment at the site becomes operational.

During the 2010/11 financial year, the co-operative entered into partnership with Eilers & Wheeler as its preferred partner for export sales of cheese and packet butter, with the intention that the partnership would allow First Milk to benefit from Eilers & Wheeler's strong links and experience in export markets.

Production facilities

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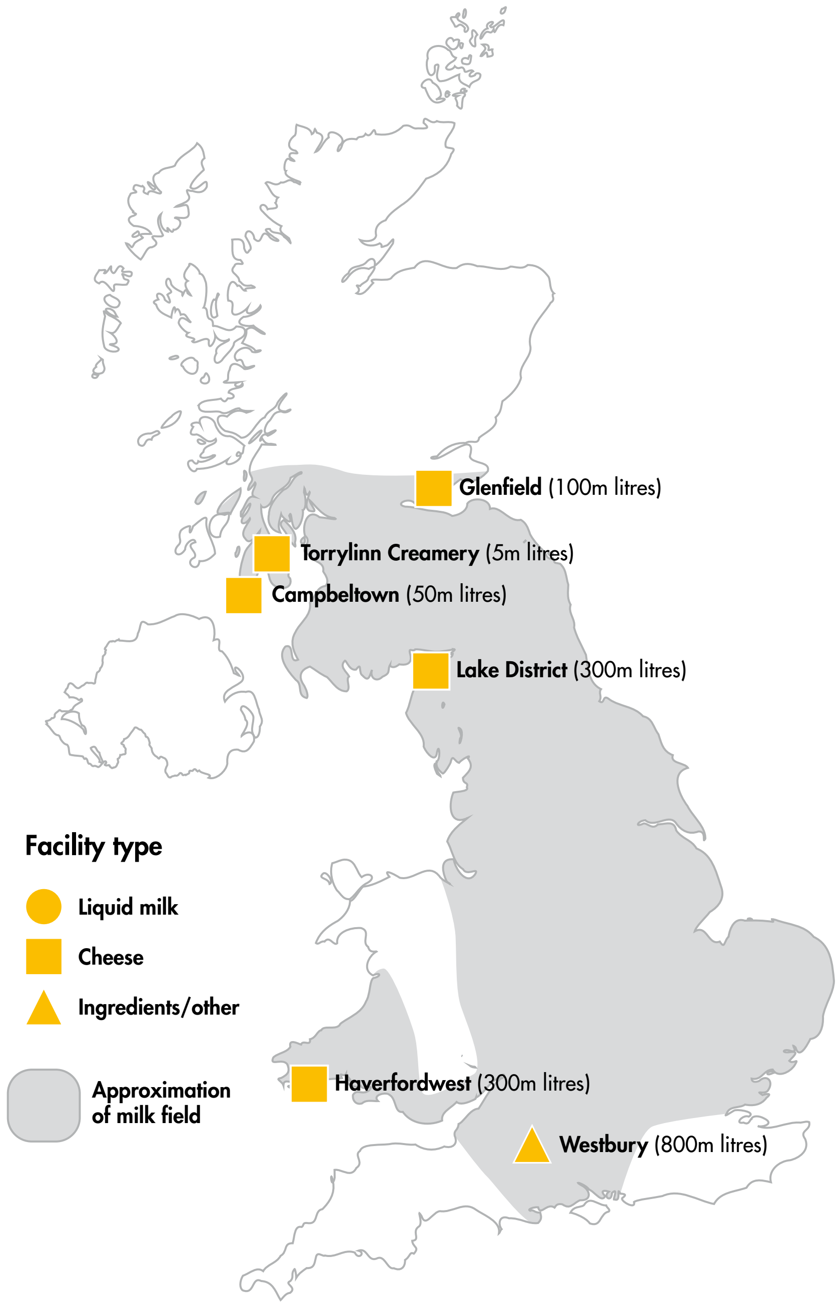

First Milk owns four creameries producing cheese and one factory processing ingredients, together with owning a share in the processing facility at Westbury Dairies. At each of the regional creameries, it produces both own-label and branded products. For example, its Scottish creameries produce its Scottish branded Cheddars (Scottish Pride, Mull of Kintyre and Isle of Arran), while the Haverfordwest creamery produces Pembrokeshire Cheddar, marketed primarily in Wales and the Lake District creamery produces its range of Lake District Cheddars.

In September 2010, First Milk and Milk Link agreed to the transfer of a minority shareholding of Westbury Dairies Limited to Arla Foods Limited, which will manage operations at the site. This has reduced First Milk's shareholding from 66% to 59% while Arla have an 11% shareholding.

In September 2011, First Milk entered into a joint venture with Fonterra, the New Zealand based dairy co-operative. The deal will see a joint investment to install a new dryer at its Lake District Creamery site at Aspatria which will allow for the production of premium whey proteins. It is anticipated that production will begin in spring 2012. The added-value whey product will then be marketed in European and world markets by Fonterra, a key supplier of dairy ingredients on international markets. The increased drying capacity at the facility will also provide First Milk with additional capacity to process cheese to support its strategy to have the Lake District Cheese brand move to the number three position in the GB branded Cheddar market.

Between 2011 and 2013, the Lake District Creamery at Aspatria will benefit from a total of £15m in investments, which will improve efficiency and increase its capacity to 35,000 tonnes of cheese production. Included in this total is the joint venture with Fonterra which see the installation of new whey-processing equipment capable of producing a whey protein concentrate, and allow for increased cheese production.

Plans to relocate its existing Campbeltown production site to a new facility, which were due to start during 2011, were dependant on the sale of the current site to Tesco. While Tesco have announced it no longer wishes to purchase the site, First Milk has been able to secure funding from the Scottish Government to redevelop its current site. The investment will allow for increased production and provide processing efficiencies which cannot currently be achieved.

In May 2011, the co-operative purchased Kingdom Dairies and Kingdom Cheese, who sell in the region of 10,000 tonnes of a mix of dairy products annually from production at its two adjacent sites in Fife, Scotland. Its range of products includes soft cheeses, cottage cheese, cream and mozzarella products which are sold to major retailers, foodservice, wholesalers and food manufacturers, both in the UK and abroad. The acquisition provides the company with opportunities to diversify its product and customer base. Having renamed the site Glenfield Dairy, First Milk has implemented a new production hall to support new business from October 2011 supplying five cottage cheese lines to Marks & Spencer.

Markets

Liquid milk

First Milk's main activity continues to be the brokering of milk to liquid processors. Recent years have seen a move by the major liquid processors to increase direct supplies, which presents a risk that demand for brokered milk may decline unless there is sufficient growth in market demand for milk. With growth in total demand for liquid milk in the domestic market currently at around 2%-3%, the opportunity to increase volume sales of liquid milk is limited.

During 2010 and 2011, there was intense competition between the three main liquid milk processors to maintain market shares of retail sales, which, along with increasing input prices, squeezed profit margins. This may have an impact on the price paid for brokered milk as processors will look to keep costs to a minimum. With First Milk improving its spread of production across product segments, it should be able to reduce this risk by moving milk to alternative markets to counterbalance any drop in demand by liquid processors or pressure to reduce selling prices.

Cheese

First Milk primarily produces own-label Cheddar cheese for the retail market, although its branded cheese production increased to around 18% of its total cheese output in the 2010/11 milk year on the back of strong growth in sales of its Lake District Cheese. The own-label segment of the Cheddar market[7] has grown by 6.1% in value terms and 5.8% in volume terms in the 52-week period ending 2 October 2011. Over the same period, branded Cheddars have also seen growth in value sales, although at a lower rate. Total expenditure on branded Cheddar at retail level increased by 5.5% year-on-year, driven by an increase in average selling price as volume sales remained static.

First Milk owns the Lake District, Pembrokeshire, Mull of Kintyre, Isle of Arran and Scottish Pride brands, all of which have seen increased volume sales. The co-operative has a target for Lake District Cheddar to become one of the country's top three Cheddar brands by 2013[8]. During the year ending 2 October 2011, the brand has seen sales almost double in terms of volume and value, resulting in the Lake District Cheddar range reaching a value of over £60m in retail sales[9]. Since its introduction four years ago, the brand has grown to become the fourth largest Cheddar brand at retail level[10].

To grow the brand, over £1m has been invested in a marketing campaign for Lake District Cheese to support market growth, including media advertising and on-pack campaigns. The product range was extended to include products such as grated Cheddar and individual portions and distribution networks have been developed to ensure that there are market outlets to support the increased production resulting from expansion at the Lake District creamery.

In addition to the extension of the Lake District brand portfolio, First Milk has developed its Dairy Maniacs brand of dairy products for young families. Its first product, Cheddar Stix, was launched during 2011 through a tie-up with the release of the movie *Kung Fu Panda 2* and was aimed at the growing kids' snack market. This is being followed up with a link to the *Puss in Boots* film.

Ingredients

Commodity markets, such as skimmed milk powder and butter, have continued to perform well during 2010 and 2011, providing First Milk with the opportunity to benefit from good returns from this segment of the market. Its partnership with Eilers & Wheeler to develop export sales of Cheddar and to exploit the buoyant powder and butter markets through its International contract should have improved the revenues generated from milk directed towards ingredients and commodity markets.

First Milk also process whey as a by-product of its cheese manufacturing activities. From the development of partnerships with Volac and Fonterra, the whey from its two largest creameries is now directed towards added-value markets providing the opportunity for improved returns for its milk. In a deal completed in 2010, all of the whey from its Haverfordwest site is sold to Volac, who manufacture and supply high performance nutrition products to the global market. The joint venture with Fonterra, established during 2011, will see the whey from cheese production at its Lake District Creamery directed towards added-value premium whey markets in Europe.

7 Not including 'value' own-label Cheddar.
8 As reported in its September 2010 trading update.
9 Figures from First Milk.
10 According to Kantar Worldpanel data for the 52-week period ending 2 October 2011.

Highlights...

- First Milk is the main milk broker in the country, selling mainly to Robert Wiseman, Dairy Crest and Nestlé. With many processors looking to increase the amount of milk sourced directly, First Milk risk seeing demand for brokered milk reduced in the long run.
- In the cheese market, First Milk sells mainly own-label cheese, which has seen an increase in market share at the expense of branded products. Its main cheddar brand has seen solid growth during the year, gaining market share.
- First Milk has benefited from increased use of Westbury to produce commodity ingredients for buoyant commodity markets. Has gained volumes through the use of purchasing agreements in partnership with Eilers & Wheeler.
- The joint venture with Fonterra will provide First Milk with an additional income stream from its whey and the potential to deliver improved returns to its Members.
- Will benefit from a £15m programme of investments at its Lake District Creamery which will increase capacity and support brand growth.
- First Milk intends to keep its business model unchanged and to keep about the same split between its main markets: 60% brokered milk, 30% cheese and 10% ingredients.
- The purchase of Kingdom Cheese and Kingdom Dairies (renamed Glenfield Dairy) expands First Milk's product range, customer base and distribution networks.

First Milk

Financial analysis

D. Headline figures

Headline financial figures and ratios have been calculated from the most recent full set of accounts for First Milk. Operating profit figures do not include gains or losses from exceptional items or non-recurring items. The definitions of the financial figures and ratios are available in the Appendix at the end of the report.

Operating profit...

104%

£11.2 million
year end 31/03/11

Profit before tax...

£6.9m

£7.2 million
year end 31/03/11

Member reserves...

11.2%

£50.8 million
year end 31/03/11

Cash flow...

Cash in: £30.3m

Cash out: £1.0m investments
£32.0m finance

£2.7m

from previous year

- Operating profit recorded a positive swing from the operating deficit reported in the previous year. The gain occurred despite reduced volumes, impacted both by reduced costs of sales and improved revenues on a pence per litre basis.
- The increase in total revenues in pence per litre terms indicates that First Milk were able to extract higher value for its milk, either through exploitation of strong commodity markets or better alignment of milk to higher margin products.
- Pre-tax profits increased by over 0.7ppl as revenues generated per litre of milk increased more than the costs of sales per litre.
- Equity has increased for the first time in three years - a result of increased retained earnings although Member loan capital has fallen by 3.5% due to the reduced number of Members.
- The reduction in Member loan capital due to reduced Member numbers may cause problems with access to investment funds in the future if the downward trend continues.

- First Milk has improved its net cash flow from operating activities by £25.3m compared to last year, driven by a reduction in stocks and improved operating revenue.
- The majority of First Milk's cash outflows were from financing activities; primarily due to the reduction of its revolving bank facilities, with net debt down £25m although cash available was down by £2.7m at the end of the year.

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Financial Ratios

Profitability ratios

Gross margin 5.3%

- Improved trading performance on previous year has increased ratio from 3.5% in 2009/10.
- The ratio remains low indicating that the company is not highly effective at turning raw milk into income although this has been improving over recent years.

Pre-tax profit margin 1.3%

- Has improved from 0.1% pre-tax profit margin in 2009/10.
- Indicates that the company is becoming more competitive but remains low, leaving tight margins to cover overheads and for investment.
- As a co-operative, aims to maximise milk price to Members which has the impact of increasing costs of sales, however, it needs to generate sufficient profits to maintain investment.

Return on capital employed (ROCE) 12.0%

- Up for second consecutive year, from a ROCE of -0.4% in previous year.*
- Reduced debt and improved earnings during the financial year have contributed to the improved return on capital.

* Calculated using operating profit (excluding exceptional items) which was negative in 2009/10 although First Milk reported a small pre-tax profit that year due to the sale of a portion of its shareholding in Robert Wiseman Dairies.

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Debt ratios

Quick ratio 0.9

- Has declined from 1.1 in previous year.
- Higher trade liabilities have contributed to reduced quick ratio, which may be due to higher milk costs during the year impacting trade payables.

Current ratio 2.0

- Has declined from ratio of 2.4 reported in 2009/10.
- The lower value of stock for the year, which has reduced net debt, along with an increase in trade creditors has influenced the ratio.
- Indicates that the company is liquid enough to cover current liabilities.

Gearing 45.7%

- Reduced from 60.7% in previous year.
- Is the lowest gearing figure for FM in five years, resulting from reduced debt and improved earnings during the financial year.
- May be slightly inflated as the co-operative classifies its revolving credit facility as a long term liability.
- Is comparable with industry averages.

Efficiency ratios

Debtor days 28.5

- Decreased from 31.2 days in last financial year.
- Indicates that FM may have improved on the rate of debt collection during the year on average.
- Impacted by improved turnover and reduced receivables.

Creditor days 27.9

- Has increased marginally from 26.4 days in 2009/10.
- Impacted by higher trade payables, which will have been influenced by higher milk prices.
- Including accruals (to account for unpaid milk purchases), creditor days stand at 35.5 days for 2010/11 (34.1 previous year).
- The ratio is in line with industry averages.

Return on total assets 7.1

- Return on assets has improved from -0.2 in the previous year.
- Improved earnings derived from its assets have moved the ratio into a positive position.
- Indicates that for every £1 in invested assets, earnings of £7.1 are generated.
- Is in line with similar companies.

The September 2011 trading update reported that while turnover was slightly down on the previous year (to end September 2010) operating profits were up by £0.9m. Pre-tax profits have remained static, net of £0.9m of dividends paid out to Members as a return on invested capital for the six months to end March 2011. Despite challenging economic conditions, First Milk has grown due to improved brand sales, reductions in its cost base and exploitation of buoyant international commodity markets.

Highlights...

- In 2010/11, First Milk improved its financial situation through enhanced earnings from commodity markets and improved production efficiencies, despite a decline in milk volumes handled.
- First Milk have reduced costs through the change of ownership share of Westbury and enhanced production efficiencies.
- Return on assets has improved during the year, indicating that more income has been generated from its assets, although the return on capital employed remains low.
- The business has improved its balance sheet position, with its improved gearing ratio arising from reduced debts.
- Will realise a capital gain of approximately £9.6m from the sale of its 10% shareholding in Robert Wiseman Dairies to Müller, improving its cash position.

Annex 1 - Financial ratio calculations.

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Financial headline figures and ratios	Calculation	Description	Interpretation
Operating Profit	Turnover less cost of sales (including overhead costs). NOT including exceptional or non-recurring items.	Profit after cost of sales and overhead expenses (not including exceptional items) but before interest and tax.	Indicates the efficiency to which a company generates profits from operating activities.
Pre-tax Profit	Profit before tax.	Profit after all costs, including finance costs, exceptional and non-recurring items, but before taxes and not accounting for actuarial gains/losses from pensions.	The profits available to be disbursed to shareholders or added to reserves (before tax).
Total Equity/ Member Reserves	Issued capital plus reserves and revenue reserves.	Shareholders or members' funds.	Needs to be examined in light of the direction of change over the past two to three years.
Gross margin	(Gross profit* (Turnover less cost of sales)/ Turnover) x 100	Shows how much it costs to get goods and services ready for sale.	Indicates the amount of money the company has available for overheads from its turnover.
Pre-tax profit margin	(Pre-tax Profit/Turnover) x 100	Shows how efficient the company is at generating profits from sales.	Indicates the amount of money the company has available for purposes of taxes and dividends, and also for re-investing in the company.
Return on capital employed (ROCE)	Operating profit (as above)/Capital Employed (equity** plus long term loans)	Measures performance as a whole, taking into account all sources of funding.	Considered a good measure of efficiency.
Quick Ratio	(Current Assets – Inventories)/Current Liabilities	Similar to Current Ratio but with stocks removed (stocks are traditionally less liquid).	As per Current Ratio. Can vary due to nature of inventories as some are more available for sale than other (i.e. butter v. Cheese).
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.
Gearing	Long term loans/Capital Employed (equity** plus long term loans)		
Debtor Days	Trade Receivables x 365/Turnover	Measures how long, on average, it takes for the company to collect its debts.	Generally should be lower than creditor days. If it is rising, raises questions about the company's ability to collect money and may induce cash flow problems.
Creditor Days	Trade Payables x 365/ Cost of Sales	Measures how long, on average, it takes for the company to pay its creditors.	Generally should be higher than debtor days.
Return on total assets	Operating profit x 100/ Fixed assets + Current assets	Measures how efficient the company is at generating revenues from its assets.	If there is a large gap between Return on assets and Return on capital employed, this can indicate that assets are run down. Should be assessed in terms of how it has changed over time; should be increasing as assets should not be held if they do not generate revenue. New assets will cause ratio to fluctuate.

* Not including distribution and administration costs
**For co-operatives, equity is equivalent to member reserves

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