

Chief Executive's Report

In an extremely challenging year for the dairy industry, the Group continued to make steady progress, delivering growth in targeted added value markets and increasing profits despite considerably higher energy and input costs. Dale Farm continued to strengthen its market position through ongoing improvements in performance and investment in brands, products and operational capabilities.

Results

During 2006-07, the Group further improved its financial performance, with profit before tax increasing by 15% to £3.08 million. Strong performances in consumer products and good cost management more than offset increased losses in powder and other commodities which were adversely affected by depressed markets, further cuts in EU support and increased costs, particularly for energy.

Overall Group turnover was 1% lower, at £292 million, with reductions in milk and dairy commodity prices outweighing the impact of the increased volumes of milk purchased and processed by the Group. Dale Farm turnover, however, increased by 4% to £140 million with consumer product sales turnover increasing by 5.5% to £94 million and ingredients sales turnover by 43% to £10 million. Commodity sales turnover continued to decline, mainly as a result of low market returns, and was down 7% on the previous year to £35 million.

Borrowings were generally lower throughout the year due to the tight control of working capital, as reflected in the lower interest costs of £0.84 million, which were down 7% on the previous year. The Group's net debt at the year end increased by £3.45 million to £17.92 million primarily due to a new loan obtained for the purchase of Dale Farm House and to additional cheese stocks resulting from a significant increase in production. The tax charge for the year at £691,000 was up £67,000 compared to 2005-06 due to the increase in profits; however no actual corporation tax was payable as these charges were deferred due to the timing differences in allowances received and tax payable.

The Group balance sheet value of total shareholders' funds increased by £3.6 million to £30.2 million. This was largely due to the benefit of the retained profits and a



reduction in the net pension deficit in the Nilgosc pension scheme, in which a small minority of current employees participate.

In keeping with the Group's ongoing objective of returning value to its farmer members, a distribution of £1.12 million was returned to shareholders (up 9% on the previous year) in the form of a 4.5% dividend and an allocation of bonus shares. The Group also repaid £0.534 million to shareholders leaving/retiring from the society.

Investment and Restructuring

A fundamental part of the Group's strategy of "growing in value" is to ensure that it is cost competitive in its target markets and that its products, facilities and performance are best in class. Core to delivering these objectives is the Group's ongoing capital investment programme. The overall capital expenditure in 2006-07 was £7.44 million, which included the purchase of Dale Farm House for approximately £3.0 million. The underlying spend in the Group's operations, principally



Dale Farm, was approximately £4.5 million, which was close to depreciation and as expected lower than the previous year's spend of nearly £6 million. In the year the Group received £1.027 million in Government and EU grants towards this expenditure.

While the investment in operations was spread throughout the Group a number of key projects were undertaken or completed during the year. At Dunmanbridge, the new centre of excellence for cheese processing and packaging and a new powder packing line were officially opened in December 2006. At the same time further investment to expand the cheese and whey processing capability was announced. The additional cheese making capacity was completed in early 2007, increasing the overall cheese production capacity at the site and allowing greater flexibility going forward to vary production between powder and cheese manufacture so as to maximise the returns from milk processed. At Kendal a new dry goods store was completed, the first phase of a planned improvement in the storage and distribution facilities at the site which now acts as a distribution hub for the Group's GB sales. This has improved materials handling and reduced costs by eliminating the need for outside storage. Construction on the second phase of this development, a new chill store for finished products, is planned to commence during 2008.

When the Group moved its Head Office and administration centre to its present location in Dale Farm House, it rented the office space needed on a long term lease with an option to buy at a fixed price within

the first 3 years. Following a favourable movement in the valuation of the property in the intervening period – the Group exercised its option to buy Dale Farm House towards the end of the 2006-07 financial year, at a price of approximately £3 million. Following the purchase of the property which was funded via a bank loan, the Group has leased the vacant ground floor of the building providing an income stream to offset the interest costs on the borrowing involved. Projections on the net cost of purchasing the building show considerable savings versus renting the office space, before allowing for any future appreciation in the value of the property.

The Group continued to streamline its operations in order to reduce cost and improve productivity. Despite an increase in the milk volumes collected by United and the growth in the throughput of Dale Farm, average numbers employed in the business fell from 860 to 803 people compared to previous year. During the year charges for exceptional items increased by £144,000 to £463,000, with a reduction of £466,000 in the profit realised on the disposal of assets more than offsetting a £322,000 reduction in redundancy costs compared to the previous year.

Markets and Sales

The CAP reform process continued during the year, with further cuts in intervention prices and export refunds, including the complete removal of all EU export subsidies on milk powders. The reduction in EU support together with adverse currency movements, particularly the weakening US dollar, led to a continued downward trend in dairy commodity returns, with bulk butter prices in particular dropping to record low levels. However toward the end of the year world demand for milk powder began to outstrip supply leading a recovery in global dairy commodity markets.

Throughout 2006-07 the Group continued with its long term focus on increasing sales of added value products especially in the GB and Rol markets. Sales in the company's own brands continued to show strong growth especially in the Loseley, Rowan Glen and Dale Farm brands helped by new product launches, improved distribution and increased marketing support. Dale Farm Ice Cream had a record year boosted by the excellent summer weather. Ingredients sales also showed strong growth with a number of new customers being

developed in mainland Europe. In overall terms Dale Farm's added value sales increased from 68% to 75% of total turnover; with commodity sales, which fell by 7% to £35 million largely due to lower returns, representing only 25% of total sales.

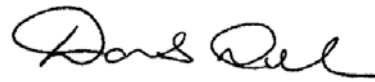
Outlook

The improvement in commodity markets evident at the end of 2006-07 has continued into the first quarter of 2007-08, with further significant improvements in powder prices leading a recovery in butter and cheese markets. These changes are being reflected in the auction prices for forward milk supplies and are expected to result in a substantial improvement in the milk prices paid to United members in the year ahead.

The recovery in dairy markets has so far been commodity led, leaving the average returns from consumer products well behind those available from bulk powder, butter and cheese. As a result of its ongoing investment in processing capability, Dale Farm is well placed to benefit from these improved commodity returns; however, the company will face considerable challenges in its consumer products

businesses where the increased costs for raw milk and other bulk commodity inputs are not yet being fully reflected in market realisations. It is expected that the premium in the returns from "added value" dairy markets versus the international commodity markets will normalise in the course of the next financial year. However until this happens consumer product margins will remain depressed.

In overall terms the increasing value in dairy products is welcome news for an industry which has seen a significant fall in underlying real prices over the last 10 years and will provide a much needed improvement in return on capital and the overall viability and sustainability of our co-op and its membership.



David Dobbin
Group Chief Executive

