



**OFGEM SEMINAR  
8<sup>TH</sup> SEPTEMBER 2006**

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**Purchasing Controller**

**DAIRY CREST**

**THE IMPACT OF RISING ENERGY COSTS**

# AGENDA

- A Profile of Dairy Crest
- Energy Market Prices
- Impact of Energy Costs on Manufacturing
- Options for Energy Procurement
- Energy Management



## A Profile Of Dairy Crest

DAIRY  
CREST

# A PROFILE OF DAIRY CREST

## A Leading Dairy Foods Company



Annual Turnover £1.5bn  
7,500 Employees  
19 Manufacturing Sites  
188 Household Depots

### Business Units

Dairies

Spreads

Cheese

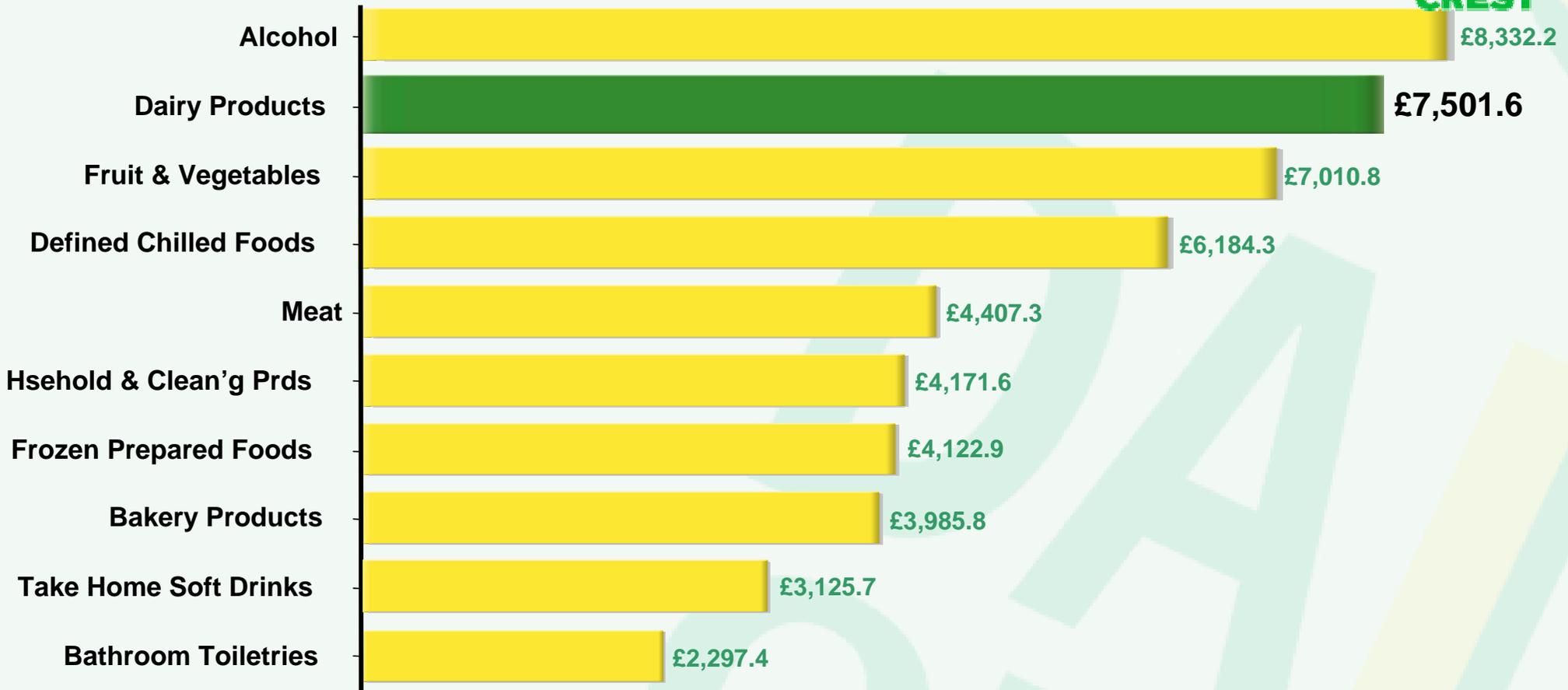
Yoplait DC

Household

Ingredients



# Dairy is BIG !



- The 2nd largest grocery category
- Consumers view dairy as a distinct “super” category
- With common issues & opportunities

Milk remains important to us and our customers



# Retailer Own Brand Milk

Milk has a retail value of **£2.5 Billion** and growing



In **7 out of 10** Shopping Baskets



Bought in **95.6%** of Households



Dairy Crest supply over **1 Billion** Litres of Milk a year



Bought on average **65** times per year

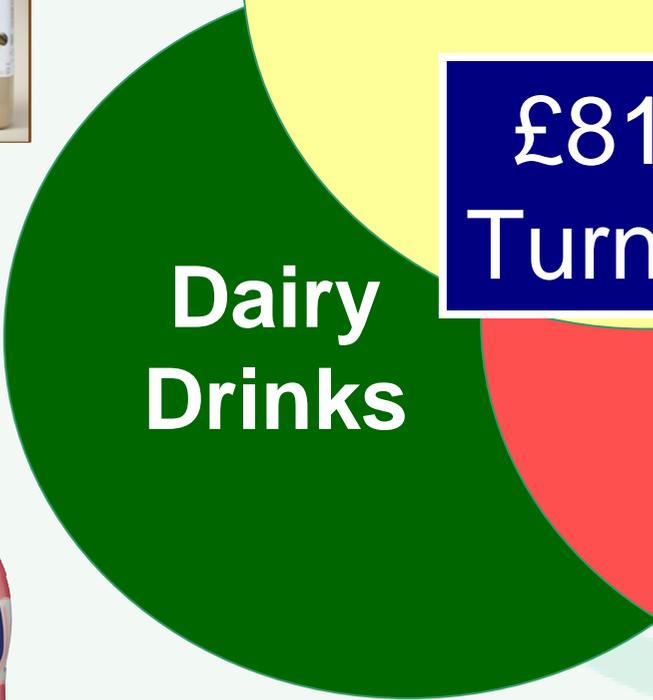


# The Dairy division More than Milk!

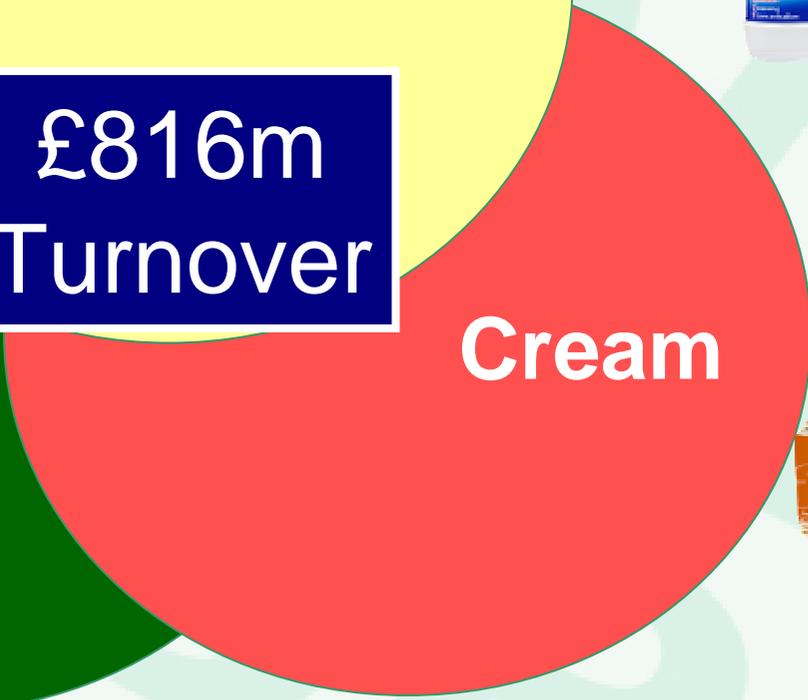


Milk

£816m  
Turnover



Dairy  
Drinks



Cream



# The Spreads Category Segmentation



TASTE

Cooking

Butter

Spreadables

Dairy Spreads

HEALTH

train

Low Fat

Functional

- £882m, +2%; DC £212.42m
- Marketing continues to focus on four key brands
- Simplified portfolio with fewer brands and sku's
- Brands with strong heritage



# A PROFILE OF DAIRY CREST

Our brands are getting bigger



Source: Dairy Crest Annual Sales Volumes (Country Life 100% since Sept 2004) – 1996/97 indexed to 100

# A PROFILE OF DAIRY CREST

Our brands are getting bigger



**£106m**

**bigger than**



**£66m**

**bigger than**



**£52m**

**bigger than**



**£41m**

**bigger than**



## Continued good growth in chilled yogurts and desserts market

- Brands continue to perform strongly with overall sales value up 11%
  - Petits Filous up 25%
  - Frubes up 34%
  - Wildlife up 6%
  - YOP up 13%
- Weight Watchers down 4% by value but held market share in 'Light'
- New product development in functional foods
  - Petits Filous Plus: probiotic yogurt drink for kids
- Closure of own label operations in June 2005



# Significant Investment driving Growth



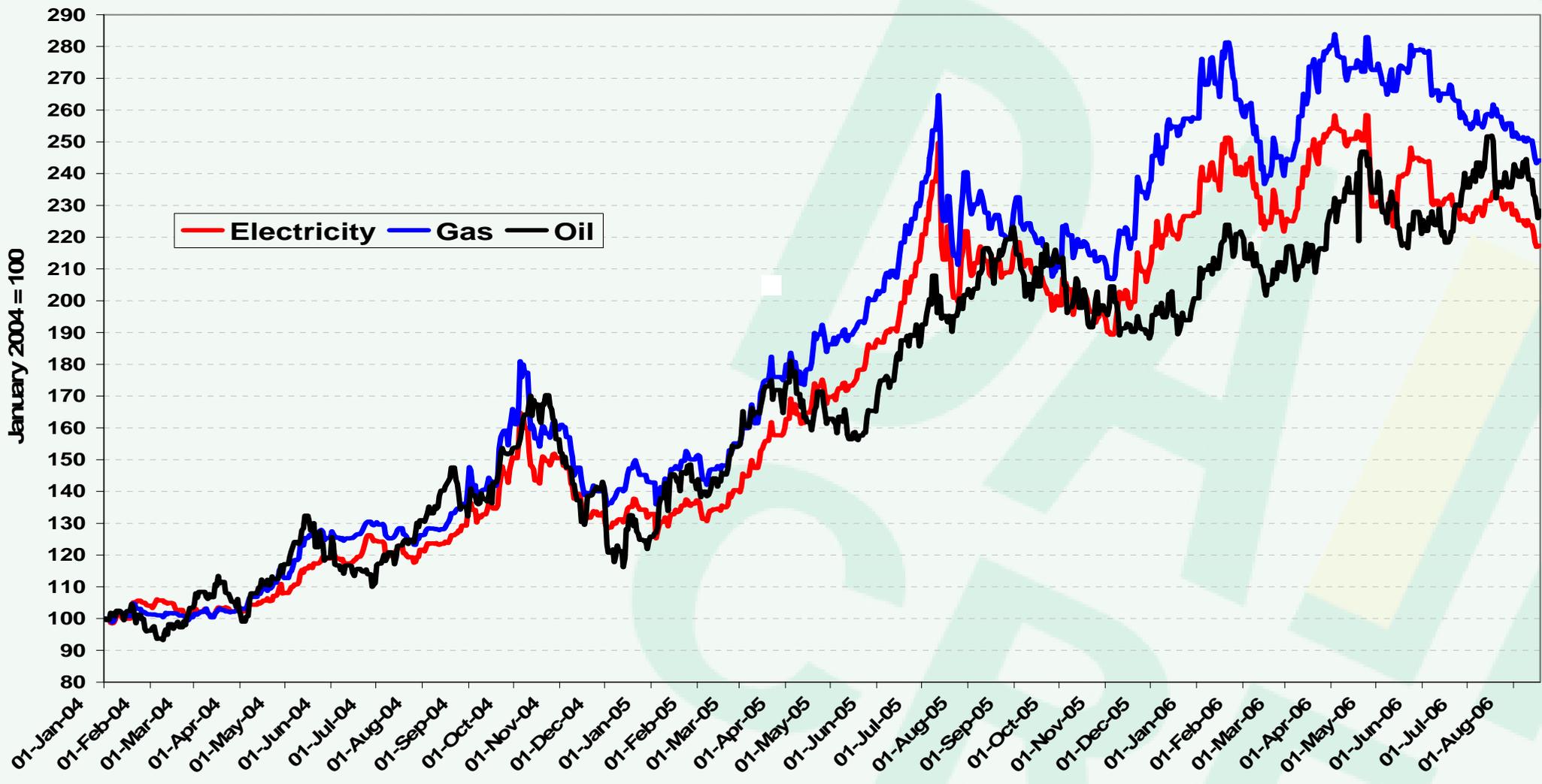
		05/06 (£m)	YOY% change
1.		67	(12)
2.		60	3
3.		52	34
4.		43	(20)
5.		26	24
6.		22	45
7.		19	24
8.	MARKS & SPENCER	18	72
9.		17	3
10.		16	(22)

**Now the 6th biggest food advertiser in the UK**

## Energy Market Prices

DAIRY CREST

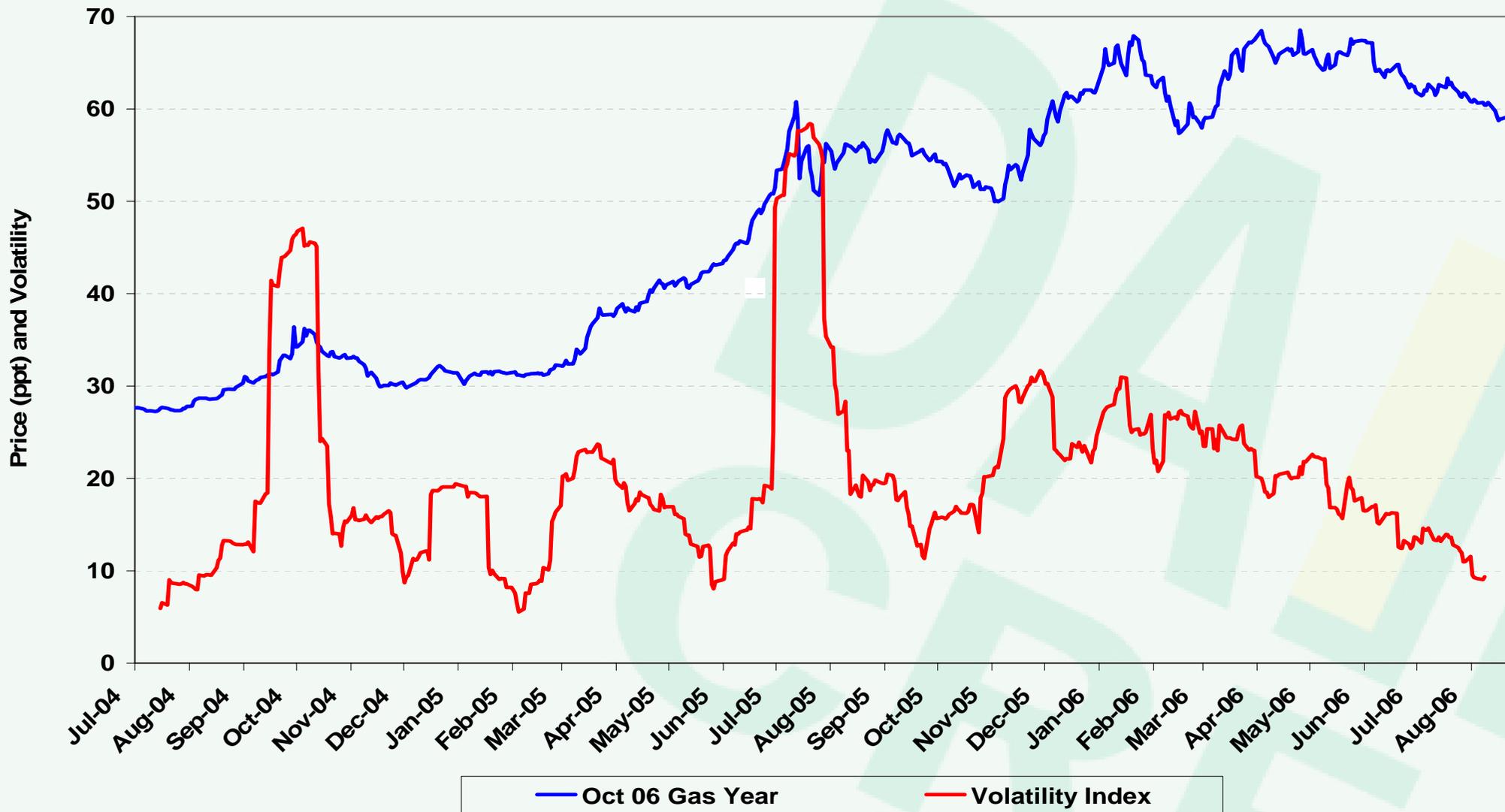
# UK Oil - Gas - Electricity





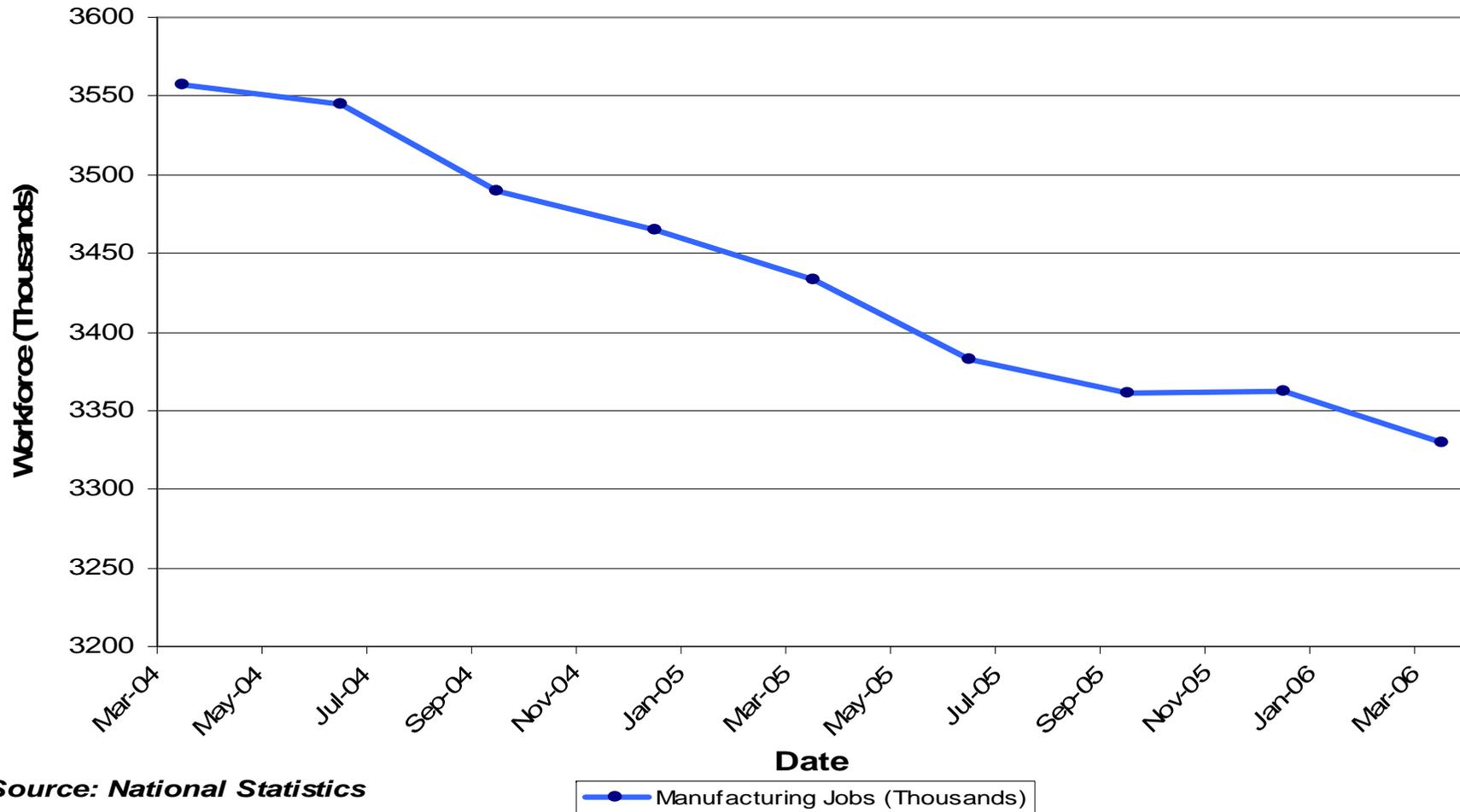
**DAIRY  
CREST**

# UK Natural Gas -Volatility Index



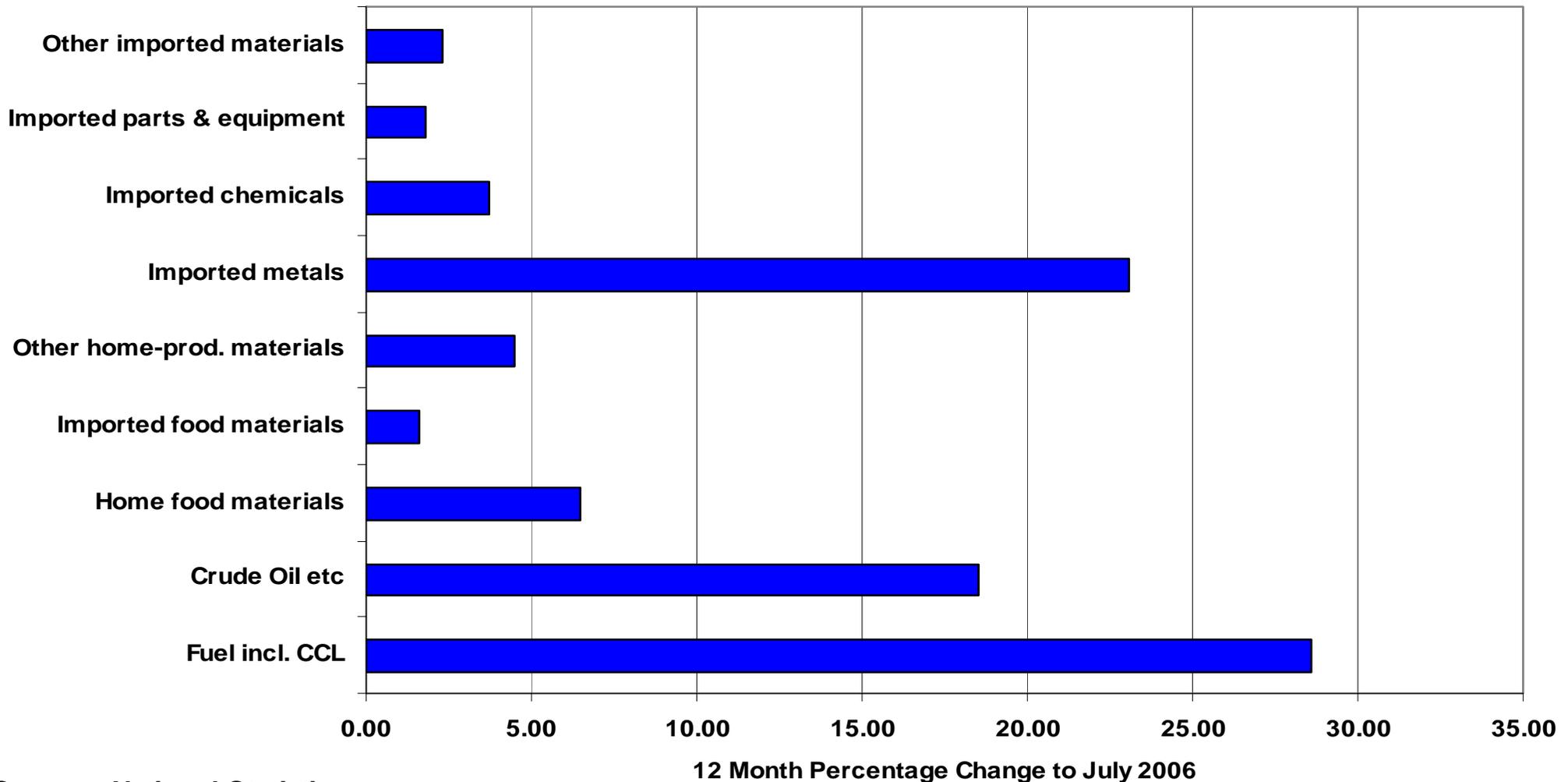
# **Impact of Energy Costs on Manufacturing**

# UK Workforce Jobs – Manufacturing March 2004 – March 2006



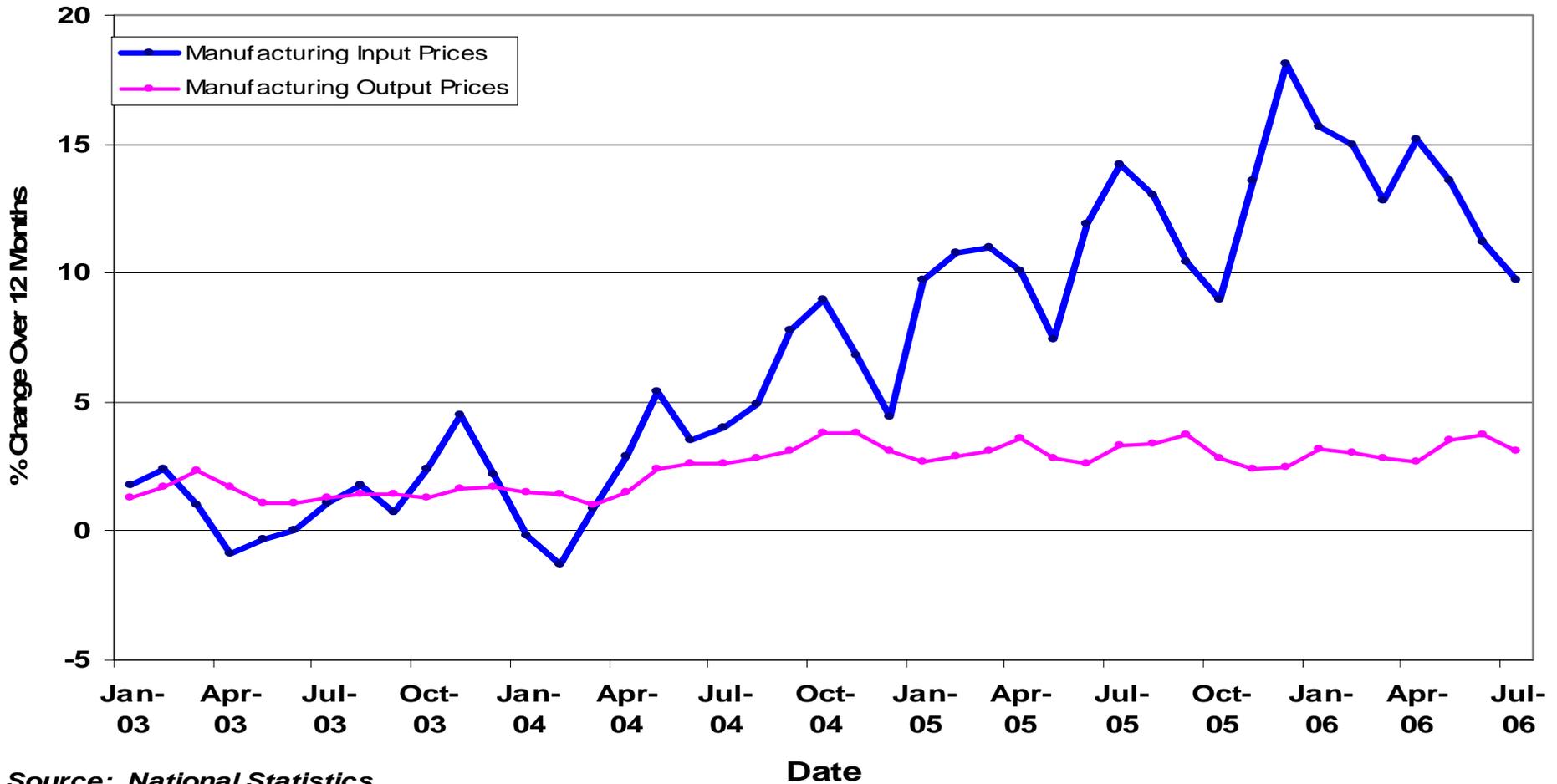
Source: National Statistics

# Input Prices 12 month % Change (All manufacturing = 9.7%)



Source: National Statistics

# All Manufacturing Industries – Input Prices vs. Output Prices (Jan 2003 – Jul 2006)



Source: National Statistics

# Energy Prices Hitting the Manufacturing Industry

- ❑ 100,000 fewer jobs than year earlier
- ❑ 250,000 jobs have been lost compared with 2 years ago
- ❑ Manufacturing Output Prices > 2.8%
- ❑ Manufacturing Input Prices > 9.7%

***Energy*** is the single largest contribution to Input Prices

***In the last 12 months we have seen:***

- ❑ 32% increase in Electricity
- ❑ 24.7% increase in Natural Gas (80% compared to 2 years ago)
- ❑ 18.5% increase in petroleum products

***CONCLUSION:*** *Manufacturers, rather than passing costs to the consumer, have absorbed them.*

# The Global Challenge

- The UK Market is increasingly impacted by global change
- Oil price and energy
- New suppliers from Europe and even further a-field
- Consumer trends increasingly being driven globally
- We all need to understand these influences and plan for them
- Examples:
  - Environment / Food Miles / Bio Diesel
  - Health
  - Convenience
  - Ethnic Foods
  - Global Brands

# The Global Challenge

## Market Conditions

- Dairy Crest
  - Highly competitive market
  - Energy increases
  - Tough retail environment
  - Competing against global companies
- Therefore we need to be smarter in procuring energy
  - Understand and evaluate energy markets
  - Develop key supplier partnerships
  - Clearly defined energy strategy
  - Implement energy management at sites



# Options for Energy Procurement

DRAFT

## Developing a Risk Management Strategy

### Annual Expenditure

- Gas           £5m
- Electricity £20m

### Objectives

- To Reduce/Manage Costs
- To Reduce Risk & Exposure

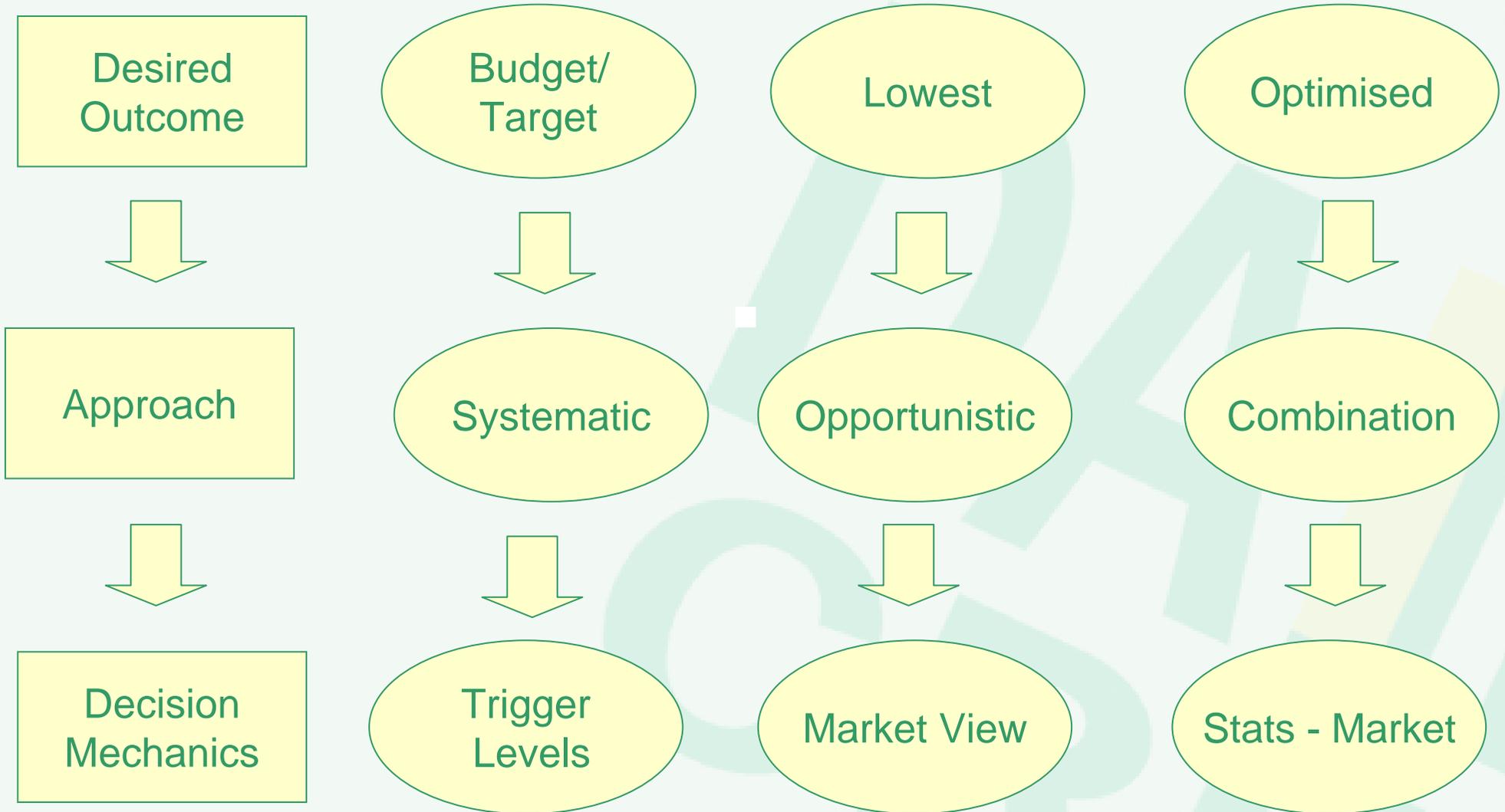
# Risk Profiles - Buying Strategies



	Budget	Priority	Opportunity	
High	<b>FINANCIAL CERTAINTY</b> Predominantly Fixed with limited Variable	<b>RISK WILLING</b> Predominantly Variable		
Low	<b>RISK AVERSE</b> Fixed Period Fixed Price	<b>FINANCIAL FLEXIBILITY</b> Balance of Fixed and Variable		
	Low	Ability to Pass Through Costs		High



# Pricing Approach



# The Flexible Contract



- ❑ The standard aggregated Contract is a buy-at-one-time (1 in 260 opportunity) Contract which aims to squeeze Supplier Margin by providing large Volumes to Supplier
  - **(BUT Supplier Margins provide very little Squeeze Room)**
- ❑ The flexible Contract provides multiple Opportunities to buy Tranches and fix Price when/if Market Dips (Margin Squeeze is a Bi-product)



# FLEXIBLE PURCHASING



# Buying Decision Triggers - Guide

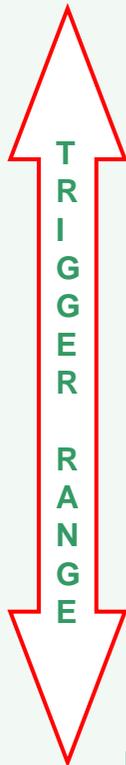


Low Risk / Budget Certainty

High Risk / Beat Market

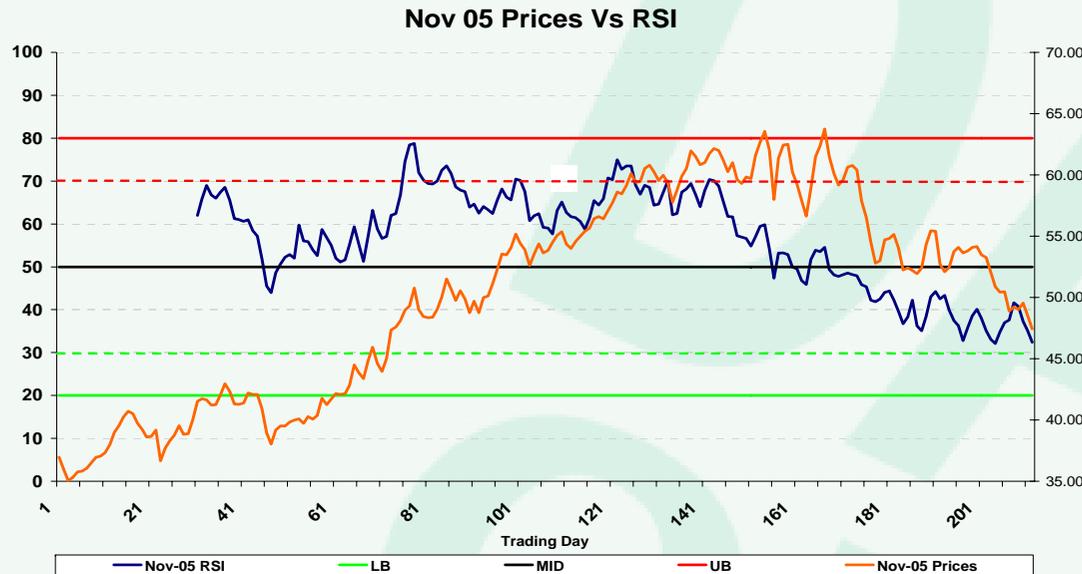
FUTURE

FUTURE



FORECAST

FORECAST



# Models and Techniques



## Standard Models Utilised

Technique	Application	Comment
Best Time to Buy	Policy Setting	Profile forward cover
Relative Strength Index	Futures Market	Indication of turning points
Seasonal Index	Far Curve	Removes seasonal element of price to identify underlying trend Reapply seasonality after market analysis
Linear Exponential Smoothing	Near Curve	Short term decisions to float or fix

# Relative Strength Index



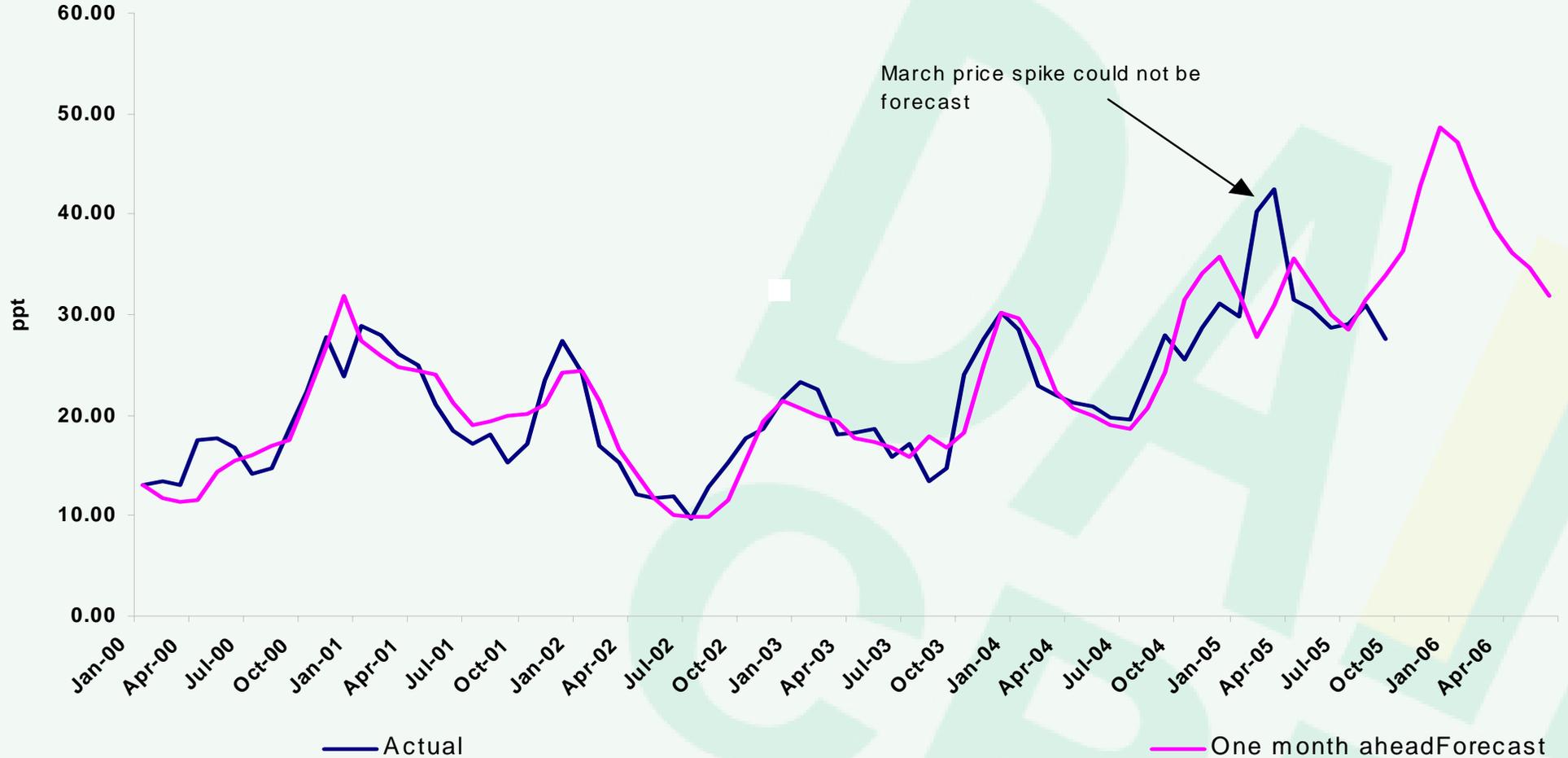
## Apr-06 RSI Vs Price



# Linear Exponential Smoothing



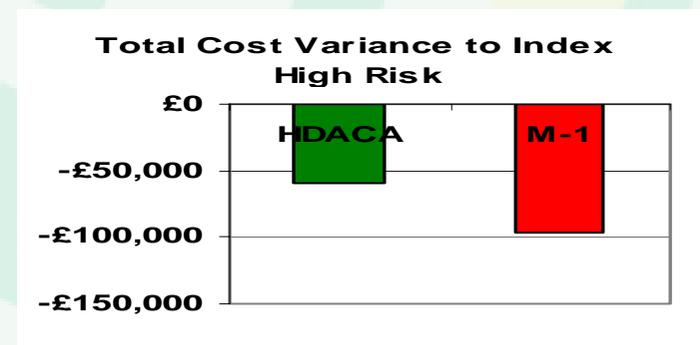
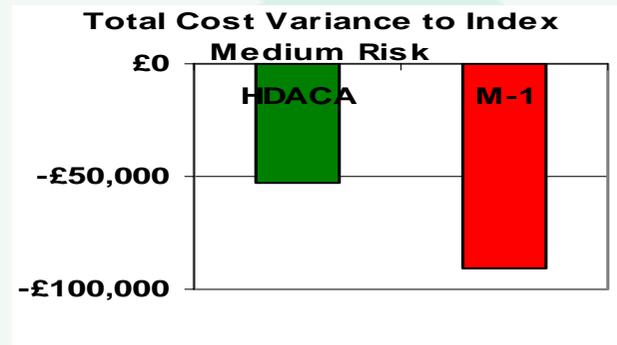
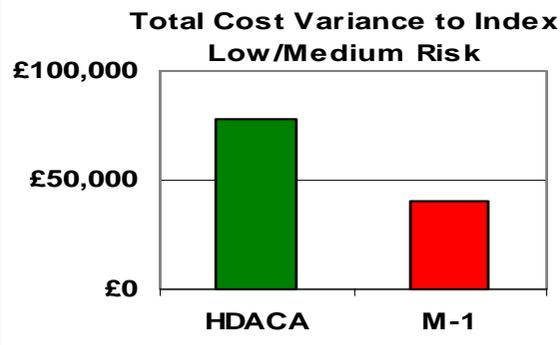
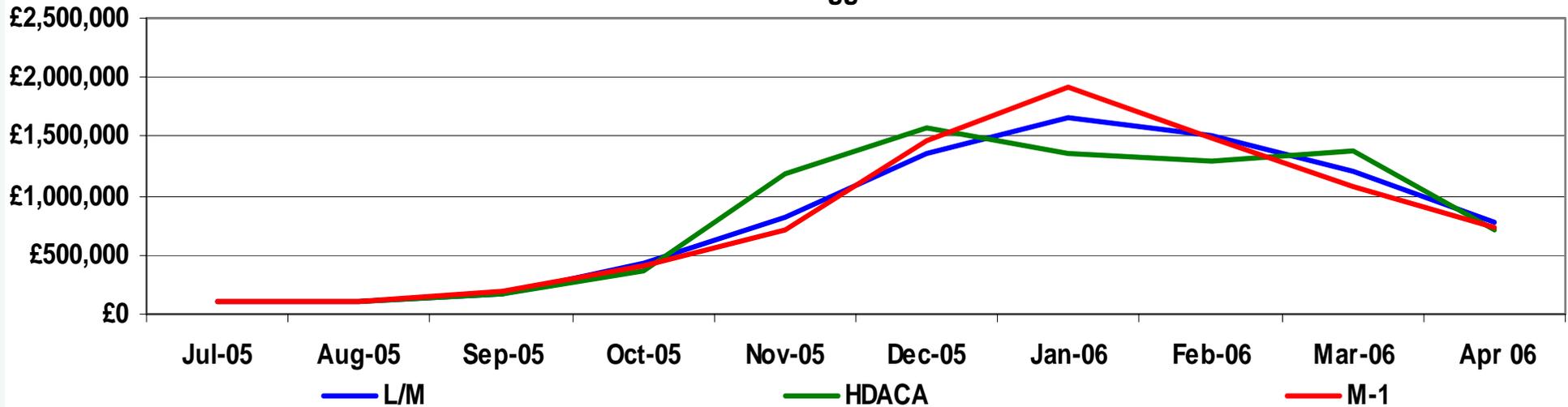
Day Ahead Gas Forecast



# SMART Gas Trigger Model Performance



Low / Medium Trigger Model Performance



# Market Related Pricing



<b>% of fixed and Market Related Pricing</b>			
<b>Year</b>	<b>Market</b>	<b>% Contracts Market Related</b>	<b>% Volume Market Related</b>
<b>2003</b>	<b>No alternative</b>	<b>0</b>	<b>0</b>
<b>2004</b>	<b>Introduction of Market Related</b>	<b>18</b>	<b>29</b>
<b>2005</b>	<b>Development of Market related</b>	<b>23</b>	<b>45</b>

# Conclusion

## Procurement Process for Energy

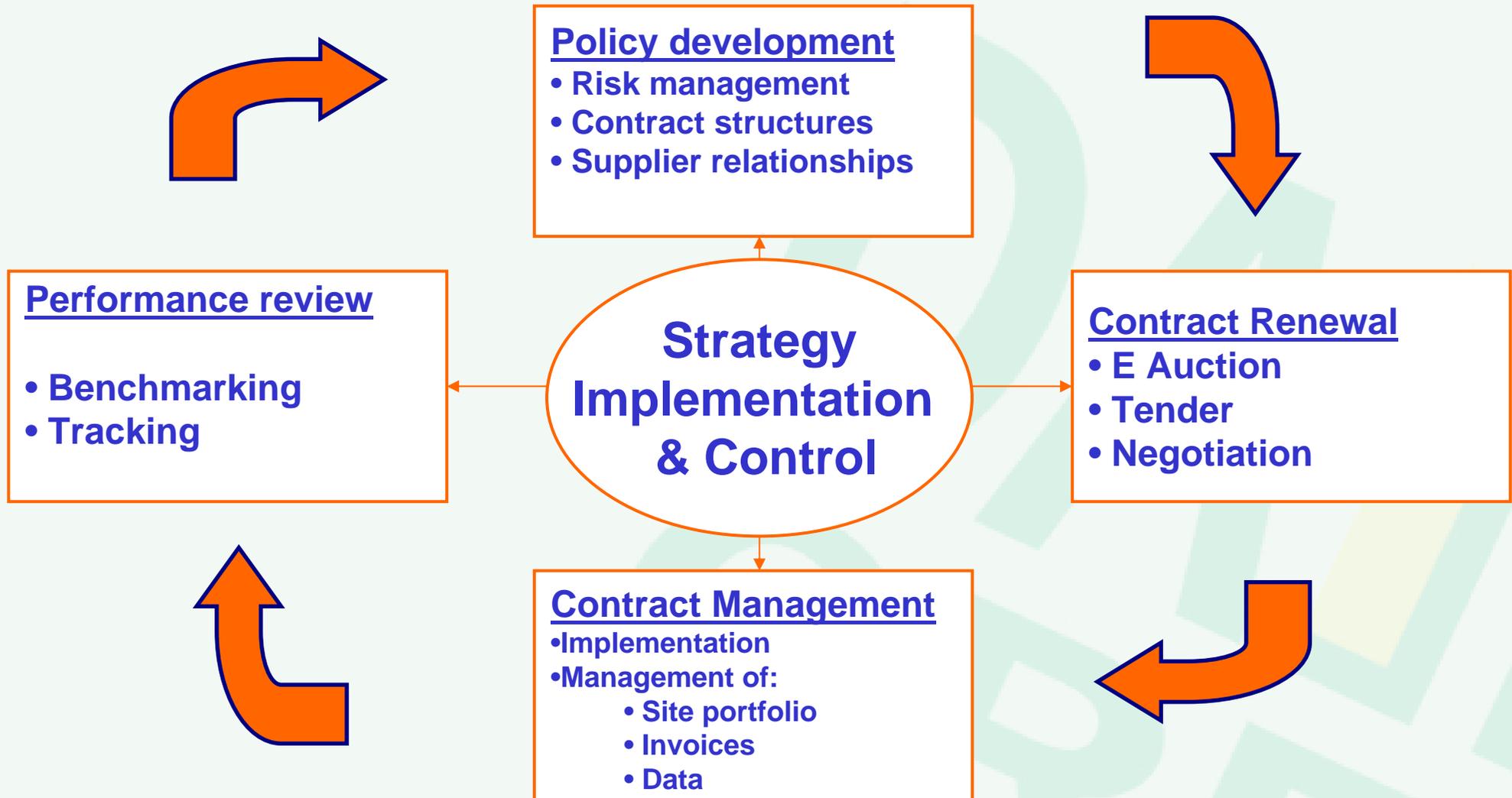


### ❖ Determine Company Policy with Board

- » Confirm Company Risk Profile
- » Agree Long Term Buying Strategy
- » Negotiate Margins and Select Supplier
- » Determine Use of Financial Tools
- » Put in place a Framework Agreement
- » Agree Appropriate Price Triggers
- » Purchase at opportune times

# Conclusion

## The Procurement Cycle





## Energy Management

DAIRY CREST

# DC Energy Policy



## Objective

To implement a formal energy management programme at all DC sites to reduce energy usage and carbon emissions

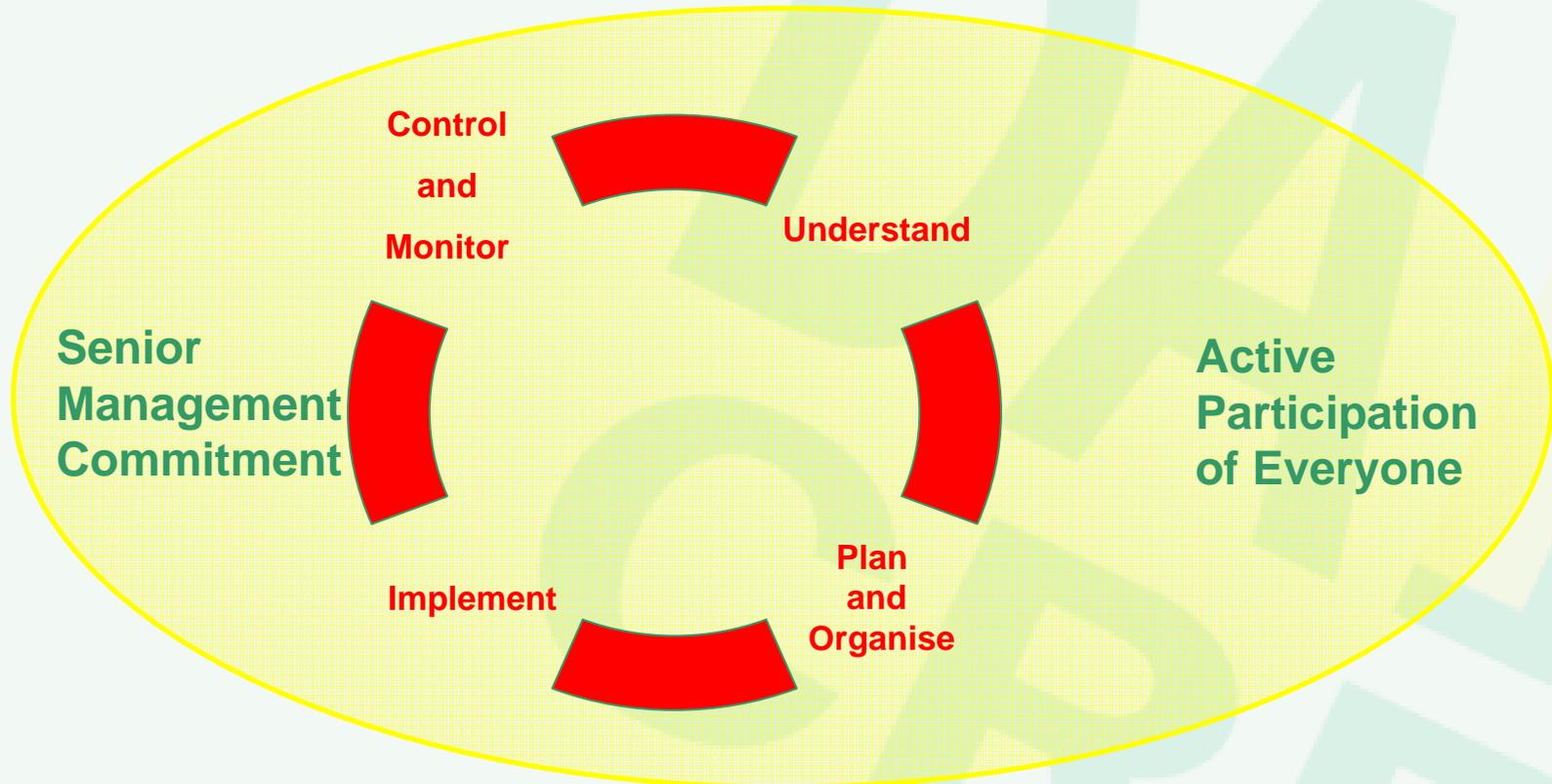
- Energy management and efficiency
- Maintenance and a cost model for benchmarking
- Best practice across all sites
- Waste Minimisation
- The feasibility of renewables

# DC Energy Policy

## Development & Implementation



Get Commitment → Understand → Plan and Organise → Implement → Control and Monitor



# DC Energy Policy Process



- Create a Group steering committee to set a strategic plan
- Implement meaningful KPIs and collect consistent site data to attack the drivers of energy and utility consumption
- Identify best practice using internal and external benchmarking
- Use this to indicate the most effective realisable improvements in performance
- Implement continuous monitoring and analysis of site performance
- Share best practice across the Group

# DC Energy Policy Process



Agree local energy policy and targets, endorsed by senior management and briefed to site

- Select Energy Consultant
- Roll out energy and utility management systems
- Develop a plan to implement sub-metering, to improve accountability and the understanding of consumption
- Develop a database of metering data to facilitate analysis
- Raise awareness of energy and utility efficiency through staff training, focusing on personal impact. Use free Carbon Trust resources including posters and information packs
- Involve staff through improvement groups to target local ideas that can be implemented by the group members
- Communicate the positive impact of initiatives regularly to staff

# DC Energy Policy Energy Management



## Implementation

- Projects and savings identified by Consultant are verified by sites
- Savings signed off by sites at monthly meeting
- Cost savings tracked by accountants to ensure Consultant delivers against targets
- A Champion on each site to be responsible for project implementation
- Project steering group meetings held in rotation at each site
- Project Champion(s) from site attend steering meeting when held at the site

# DC Energy Policy

## Waste Minimisation Programme



- Comprehensive energy and resource management solution
- Reduces operation costs and environmental impacts
- Yields substantial cost savings
- Environmental control & reporting significantly enhanced
- Utilises proven methodology
- Package of technical consulting and software tools
- Energy Software
  - energy and environmental tracking
  - improvement in initiative co-ordination
- Proven implementations

# DC Energy Policy

## Waste Minimisation Benefits



- Low risk investment
- Reduces management time
- Resource cost savings - scope to save
  - Energy 5% - 15%
  - Water 5% - 30%
  - Raw materials up to 1%
  - Packaging 5%
- Environmental compliance
  - ISO 14001 / EMS and PPC
  - Emissions reduction
  - Minimises risk

**Good for Business – Good for the Environment**