

30 Business combinations (continued)

Provisional fair values for the assets and liabilities of these depots were used to calculate goodwill due to the proximity of the acquisition to 31 March 2008. Final valuation took place during the period to 17 February 2009 and did not result in any further fair value adjustments. Fair value adjustments principally comprise the recognition of two supply contracts as intangible assets along with the related deferred tax liabilities.

During 2008, the Group acquired the goodwill of a number of bottled milk buyers for cash consideration of £1.6 million resulting in goodwill of £1.6 million.

Included in goodwill for the above acquisitions are certain intangible assets that cannot be separately identified and measured due to their nature. These include acquired milk rounds lists and assembled workforces. Management believes that goodwill represents value to the Group for which the recognition of a discrete intangible asset is not permitted. The majority of the value was assessed to comprise synergy benefits expected to be achieved by merging the businesses acquired into the Group's existing operations.

The trade and assets acquired as a result of the above acquisitions were absorbed into the wider Dairies business within Dairy Crest Limited. As a result, disclosure of the profit for the year to 31 March is impracticable. Similarly, it is impracticable to disclose what Group profit and revenue from continuing operations would have been if the acquisition had occurred on 1 April 2007.

Certain fair value adjustments were made in relation to St Hubert in the period to December 2007. These comprised adjustments to property, plant and equipment, intangible assets and deferred tax and resulted in additional goodwill of £0.6 million being recognised.

31 Financial risk management objectives and policies

The objective of the treasury function, which is accountable to the Board, is to manage the Group's and Company's financial risk, secure cost-effective funding for the Group's operations and to minimise the effects of fluctuations in interest rates and exchange rates on the value of the Group's and Company's financial assets and liabilities, on reported profitability and on cash flows.

The Group's principal financial instruments comprise bank loans and overdrafts, loan notes, finance leases and cash and short-term deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

The Group also enters into derivative transactions; principally interest rate swaps, cross currency swaps and forward currency contracts. The purpose is to manage the interest rate and currency risks arising from the Group's operations and its sources of finance. It is, and has been throughout 2009 and 2008, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are liquidity risk, interest rate risk, foreign currency risk, price risk and credit risk. Information on how these risks arise is set out below, as are the objectives, policies and processes agreed by the Board for their management and the methods used to measure each risk. Derivative instruments are used to change the economic characteristics of financial instruments in accordance with the Group's treasury policies. The Group's accounting policies in relation to derivatives are set out in the Accounting Policies note.

Liquidity risk

The Group's objective is to ensure that forecast net borrowings, plus a reasonable operating headroom, are covered by committed facilities which mature at least 12 months after the year end. The maturity analysis of Group borrowings is set out in Note 20. At 31 March 2009 the Group's total credit facilities amounted to £669 million (2008: £632 million) excluding finance leases of £14 million (2008: £16 million) and the impact of cross-currency swaps on \$US and € loan notes of £32.1 million (2008: £(15.8) million). The facilities consist of:

2009

- a £85 million plus €175 million multi-currency revolving credit facility repayable at maturity in July 2013;
- a £100 million multi-currency revolving credit facility repayable at maturity in November 2011;
- Loan notes totalling £321 million repayable between April 2013 and April 2017.

2008

- a term loan of £25 million repayable in semi-annual instalments in June 2008 (£20 million) and December 2008 (£5 million);
- a £250 million multi-currency revolving credit facility repayable at maturity in June 2009;
- a £100 million multi-currency revolving credit facility repayable at maturity in November 2011;
- Loan notes totalling £257 million repayable between April 2013 and April 2017.

Undrawn revolving credit facilities at 31 March 2009 amounted to £127 million (2008: £150 million). This can be analysed as follows (see also Note 20):

94 Notes to the financial statements continued

31 Financial risk management objectives and policies (continued)

	2009 Drawn down £m	2009 Facility £m	2008 Drawn down £m	2008 Facility £m
June 2004 5-year multi-currency revolving credit facility	–	–	93.1	250.0
November 2006 5-year multi-currency revolving credit facility	100.0	100.0	106.7	100.0
July 2008 5-year multi-currency revolving credit facility	120.1	247.1	–	–
Total	220.1	347.1	199.8	350.0
Headroom		127.0		150.2
Cash and short term deposits		107.5		40.3
Effective headroom		234.5		190.5

The Group aims to mitigate liquidity risk by closely managing cash generation by its operating businesses and monitoring performance to budgets and forecasts. Capital investment is carefully controlled, with detailed authorisation limits in place up to Executive level and cash payback criteria considered as part of the investment appraisal process. Short-term and long-term cash and debt forecasts are constantly reviewed and there are regular treasury updates to the Executive highlighting facility headroom and net debt performance.

Day-to-day cash management utilises undrawn revolving credit facilities, overdraft facilities and occasionally short-term money market deposits if there is excess cash.

Interest rate risk

The Group's exposure to the risk for changes in market interest rates relate primarily to the Group's long-term debt obligations with a floating interest rate.

The Group's policy is to manage its interest cost using a mix of fixed and variable rate debt. Specifically, to keep between one third and three quarters of its borrowings at fixed rates of interest. To manage this mix in a cost-efficient manner, the Group has issued fixed coupon loan notes and also enters into interest rate swaps on a portion of its floating bank borrowings, in which the Group agrees to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed-upon notional principal amount. These swaps are designated to hedge underlying debt interest cash flow obligations. At 31 March 2009, after taking into account the effect of interest rate swaps, approximately 73% of the Group's borrowings were at a fixed rate of interest (2008: 67%).

The Group's exposure to interest rate risk is shown (by way of a sensitivity analysis) in Note 32.

Foreign currency risk

The Group has invested in operations outside the UK and also buys and sells a small amount of goods in currencies other than Sterling. As a result the value of the Group's non-Sterling revenues, purchases, assets, liabilities and cash flows can be affected by movements in exchange rates – predominantly Euro/Sterling.

The Group mitigates the effect of its structural currency exposures by borrowing to some extent in the same functional currency as the foreign operation into which it invests. The foreign operations hedged in this way are St Hubert SAS (France) and Wexford Creamery Limited (Ireland); both are Euro-denominated subsidiaries. Our policy changed during the year ended 31 March 2009. Previously, 100% of overseas net assets were hedged but this proportion has been reduced in line with the Group's reduced levels of Euro-denominated borrowings. Our new policy is to hedge 100% of the inventories and tangible fixed assets and 33% of goodwill and intangible assets exposure (2008: 100% of net assets) of these subsidiaries through borrowings and/or cross-currency swaps in Euros. No hedging of earnings exposure is undertaken. At present, our only currency exposure is Euros. At 31 March 2009, all borrowings designated as a net investment hedge are done so on a pre-tax basis and no cross currency swaps are utilised as part of the hedging relationship. For part of the year ended 31 March 2008, cross-currency swaps were used as part of the designated hedge relationship and this and an element of Euro-denominated borrowings were designated as a post-tax hedge of the St Hubert net investment.

The majority of the Group's transactions are carried out in the relevant entity's functional currency and therefore transaction exposures are limited. This can be seen in Note 17 where the only significant non-Sterling debtors are in Euros and these predominantly relate to the functional currency of St Hubert and Wexford. The Group trades skimmed milk products and bulk butter mainly to customers in Europe and Central and South America. The Group also exports its own skimmed milk products, bulk butter and other branded products. The Group's policy requires foreign currency sales and purchases through Philpot Dairy Products Limited, a subsidiary company, to be hedged by foreign exchange contracts once the transaction is committed so that the margin on the transaction can be fixed. There are currently no sales between the UK business and St Hubert SAS.

Currency exposures on other transactions, such as certain capital expenditure denominated in a foreign currency, are hedged following approval of the project using forward foreign exchange contracts.

31 Financial risk management objectives and policies (continued)

In 2006, the Group issued loan notes denominated in \$US. At the same time, cross-currency swaps were implemented to hedge the interest and principal repayment cash flows. The principal amount and interest and principal payment dates on these swaps match those on the loan notes exactly and all swaps are with counterparties with strong credit ratings. There is no profit and loss exposure in relation to \$US debts as any retranslation impact on the profit and loss account is offset by recycling of amounts from the SORIE.

In 2009, the Group entered into cross-currency swaps on €75 million of its loan notes denominated in Euros in order to hedge the future interest and principal repayment cash flows. The principal amount and interest and principal payment dates on these swaps match those on the loan notes exactly and all swaps are with counterparties with strong credit ratings. There is no profit and loss exposure in relation to this €75 million of debt as any retranslation impact on the profit and loss account is offset by recycling of amounts from the SORIE.

Price risk

The Group is exposed to price risk related to certain commodities and their by-products used by the Group's businesses. The principal non-milk commodities that affect input prices for the Group are vegetable oils, gas, electricity, diesel, heavy fuel oil ('HFO') and crude oil by-products (used in packaging).

The Group monitors prices on an ongoing basis in order to assess the impact that movements have on profitability and to assess whether the amount of forward cover is appropriate. Vegetable oil contracts are usually structured such that between six and nine months purchases are at fixed prices. Energy is generally contracted one season in advance for both Summer and Winter energy but with some requirement contracted at more regular intervals. Diesel and HFO is not generally contracted at fixed prices although from time to time, forward contracts have been put in place to fix future prices.

The Group regularly reviews relevant commodity markets and levels of future cover. Fixed price contracts are only entered into with the approval of the Executive Directors.

Credit risk

It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. The Group only offers these terms to recognised, creditworthy third parties. In addition, receivables balances are monitored on an ongoing basis with the result that the Group's history of bad debt losses is not significant.

The Household doorstep business trades with individuals and receives cash payments on a weekly basis. Cash and debt management is a crucial part of this business and cash collection and balances due are closely monitored to ensure write-downs are minimised.

Debtor days outstanding are closely monitored throughout the year and action is taken promptly where payment terms have been breached.

With respect to credit risk arising from the other financial assets of the Group, which comprise cash and cash equivalents, trade and other debtors (excludes prepayments) and certain derivative instruments, the Group's exposure to credit risk arises from default of the counterparty. The maximum exposure for the Group is equal to the carrying amount of these financial assets of £279.6 million (2008: £219.7 million). There are no significant concentrations of credit risk.

All borrowings are through banks with long-term credit ratings of A or above. Funds temporarily surplus to business requirements are invested overnight through deposit accounts with mainstream UK commercial banks with a credit rating of AA or better. The Group currently has no requirement to place deposits for a longer period, accordingly counterparty risk is considered to be acceptable. Derivative financial instruments are contracted with a range of banks with long-term credit ratings of A or above to avoid excessive concentration of financial instruments with one counterparty.

Capital management

The primary objective of the Group's capital management is to ensure that it maintains an appropriate level of gearing in order to support its business and maximise shareholder value. In addition, the Group monitors its forecast net debt to EBITDA ratios in order that they are comfortably within its banking covenant requirements. The maximum net debt to EBITDA ratio for the purposes of bank covenants is 3.5 times.

The Group monitors its capital structure and makes adjustments to it in the light of changes in economic conditions or changes in Group structure. Possible mechanisms for changing capital structure include adjusting the level of dividends, issuance of new shares or returning capital to shareholders. No significant changes in capital structure have been implemented in the year ended 31 March 2009 or 2008 and there have been no changes in the objectives, policies and procedures during the last two years.

96 Notes to the financial statements continued

31 Financial risk management objectives and policies (continued)

The Group monitors capital using a gearing ratio, which is net debt divided by shareholders' funds. The definition of net debt is included in Note 34. The gearing ratio at March 2009 and 2008 can be analysed as follows:

	2009	2008
	£m	£m
Net debt	415.8	474.8
Shareholders' funds	357.0	387.7
Gearing ratio	116%	122%

Dividends

Details of dividends paid and proposed during the year are given in Note 7. The dividend policy is to maintain a stable dividend policy whilst maintaining an appropriate level of dividend cover. Total dividends paid and proposed in the year ended 31 March 2009 of 20.1 pence represents a decrease of 17.6% (2008: 24.4 pence and 6.6% growth).

32 Financial instruments

An explanation of the Group's financial instrument risk management objectives, policies and strategies is set out in the discussion of Treasury policies in Note 31.

Consolidated**Interest rate maturity profile of financial assets and liabilities**

The following table sets out the carrying amount, by maturity of the Group's financial assets and liabilities that are exposed to interest rate risk. No other financial assets and liabilities, other than those shown below, are exposed directly to interest rate risk.

At 31 March 2009	< 1 year	>1 <2 years	>2 <3 years	>3 <4 years	>4 <5 years	> 5 years	Total
	£m	£m	£m	£m	£m	£m	£m
Fixed rate							
Bank loans*	–	–	–	–	(68.5)	–	(68.5)
Loan notes*	–	–	–	–	(75.3)	(246.2)	(321.5)
Finance leases	(2.0)	(2.2)	(2.5)	(2.7)	(2.9)	(1.5)	(13.8)
Forward currency contracts	1.3	–	–	–	–	–	1.3
Interest rate swaps	–	–	(4.1)	–	–	–	(4.1)
Cross currency swaps	–	–	–	–	16.1	23.4	39.5
Floating rate							
Cash at bank and in hand	107.5	–	–	–	–	–	107.5
Overdrafts	–	–	–	–	–	–	–
Bank loans	–	–	(100.0)	–	(51.6)	–	(151.6)
At 31 March 2008							
Fixed rate							
Bank loans*	–	–	–	(59.0)	–	–	(59.0)
Loan notes*	–	–	–	–	–	(256.8)	(256.8)
Finance leases	(2.5)	(2.0)	(2.2)	(2.5)	(2.7)	(4.4)	(16.3)
Forward currency contracts	0.7	–	–	–	–	–	0.7
Interest rate swaps	–	–	–	(0.1)	–	–	(0.1)
Cross currency swaps	–	–	–	–	–	(3.9)	(3.9)
Floating rate							
Cash at bank and in hand	40.3	–	–	–	–	–	40.3
Overdrafts	(1.4)	–	–	–	–	–	(1.4)
Bank loans	(25.0)	(93.1)	–	(47.7)	–	–	(165.8)

*Classified as fixed rate after taking into account the effect of interest rate swaps.

Interest on financial instruments classified as floating rate is repriced at intervals of less than one year. Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument.