



Executive Summary

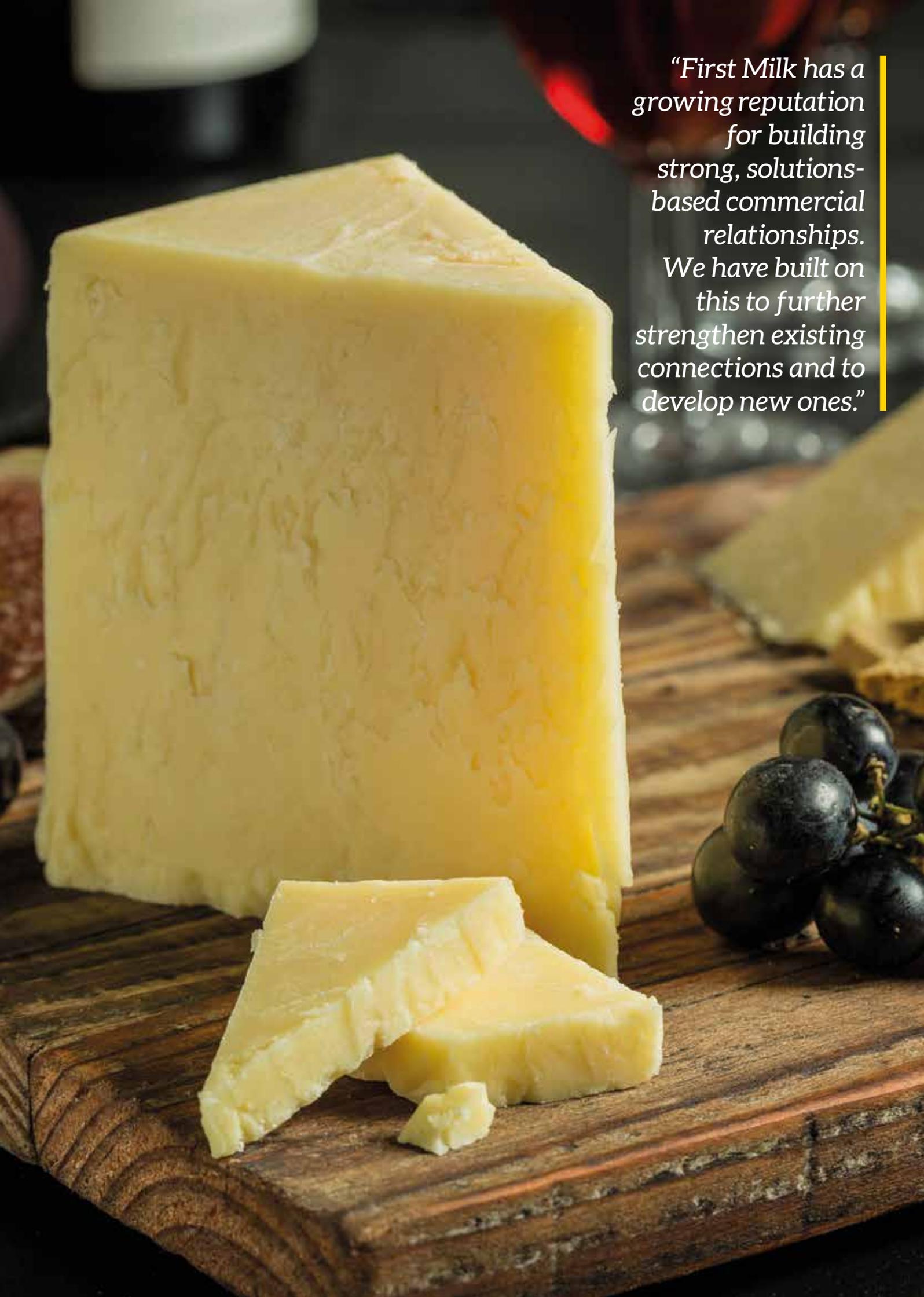
Review of the Year 2017/2018





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“First Milk has a growing reputation for building strong, solutions-based commercial relationships. We have built on this to further strengthen existing connections and to develop new ones.”

Financial highlights

	2018	2017
Group turnover	£252.7m	£206.5m
Operating profit (before exceptional items)	£6.6m	£11.7m
Net profit for the year	£3.2m	£6.0m
Net bank borrowings	£44.9m	£38.6m
Capital investment across all our sites	£3.2m	£3.8m
Total group capital and reserves	£27.4m	£22.0m



Chairman's statement

Clive Sharpe



Introduction

After a number of years of considerable change at First Milk, I am pleased to be able to report another year of solid progress, as we deliver profit in line with our plans for the year ended 31 March 2018.

The last twelve months have seen an adjustment in focus as we have concentrated on getting the business fit for future growth. We have a clear strategy in place to grow our cheese business and develop our fresh milk business that provides milk sourcing services through long-term customer partnerships.

As a farmer-owned co-operative, we are committed to ensuring that everything we do adds value to our members – today and in the future.

Governance

During the year, I was delighted to welcome Shelagh Hancock as our new Chief Executive, and Greg Jardine, who joined the Board as Chief Financial Officer, having previously been our Commercial Director.

I would like to record my thanks to Owen Shearer, who stood down as Group Finance Director and left the business at the end of September. Owen played a key role in the re-financing of First Milk and I'd like to thank him for his commitment and contribution to the business.

During the period we also said goodbye to Nigel Evans, our long-standing Vice Chairman and Farmer Director who, after seven years, stood down from the Board. Nigel's commitment, energy and drive were fundamental to the business during this time and I'd like to thank him for his considerable contribution.

As a farmer-owned co-operative we have clear governance procedures for our farmer director selection process. The selection of a new farmer director is overseen by a Nominations Committee of the Board, comprising the chair of the Nomination and Remuneration Committee, Carl Ravenhall, along with another farmer director and two Council members. This ensures that member views are represented throughout the process.

As a result of a selection process Robert Craig was chosen and joined the Board as the new farmer director, and existing farmer director, Jim Baird, was appointed as Vice-Chairman.

There were also Member Council elections during the year, which saw three Council positions becoming vacant – Scott Calderwood and Willie Purdie by rotation, with Robert Craig standing down from Council as a result of his appointment to the Board as a Farmer Director. There were four candidates who put themselves forward for election.

The result of the election was that Scott and Willie were re-elected for a further term, being joined by new Council member, David Walker.

Our seven-strong Member Council continues to work effectively with independent Member Council Chairman, Séan Rickard, to oversee the strategy of the business and represent farmer members in discussions with the Board and Executive.

The Council acts as the interface between the membership and the Board and provides input into a range of policy development areas, including in the last year the changes to our milk price schedules.

Over the last twelve months the Council members have also led a series of 'farmhouse meetings' with our members across the country, which has helped to improve member engagement. The Council has also been involved in the establishment of a Communications Group, along with Board and Staff members, to drive our communications activity across the business.

I particularly value the contribution the Council brings, which ensures that First Milk delivers for our members, and would like to take this opportunity to thank them for their hard work and commitment, much of which goes on behind the scenes, but which contributes so much to the development of First Milk.

As you know I informed the Board earlier this year of my intention to step down as Chairman. It has been a great pleasure to chair the Board over the last two and a half years and through a period of major strategic and structural change.

I am delighted to be handing over on 1 August to Chris Thomas, who has been appointed as your new Chairman following an extensive selection process and recommendation from the Nominations Committee.

Outlook

The last year has been a perfect demonstration of the external challenges that will continue to face the dairy sector – adverse weather, volatile pricing and uncertainty as a result of Brexit. We recognise that these events impact our members' farm businesses as well as First Milk, as it makes it very difficult to predict how dairy markets will develop. Yet, despite these challenges, First Milk is increasingly well-placed to deliver long-term prosperity to our members.

I would like to take this opportunity to thank our staff, Board, Council and, above all, our members, for their hard work and commitment during the last year.



CEO's statement

Shelagh Hancock



The last year has seen us concentrate on strengthening and developing customer relationships, improving the operational efficiency of the business, growing our processing capacity and reducing costs. Critically, we have done this whilst putting our farmer members back at the heart of our business, through improved focus on member engagement and communication.

Strengthening our customer relationships

First Milk has a growing reputation for building strong, solutions-based commercial relationships and over the last twelve months we have built on this foundation to further strengthen existing connections and to develop new ones.

Cheese business

Our biggest customer is Ornu, which supplies more than 40% of the hard cheese sold in British retailers and is the largest buyer of British cheese in the UK. We have a long-term contract to supply Ornu, and they buy the majority of the cheese we produce.

One example of our close relationship with Ornu is that during the last twelve months we have worked with them and their customer, Tesco, in successfully implementing the Tesco Cheese Group among our members surrounding our Haverfordwest Creamery. Tesco has a long track record of working with British dairy farmers and we were delighted to work collaboratively to create a strategic supply chain for them for British cheddar.

In recent months, we have also been pleased to support Ornu in securing new cheese business with Sainsbury's. This is a testament to the credibility of our business as part of their supply chain to their retail customers. As a result of this development, I am delighted that First Milk will be the primary supplier of this cheese for Sainsbury's. First Milk's role in supplying cheese for this contract is a fantastic endorsement of our members and processing sites.

As well as the success of our relationship with Ornu, we continue to develop our wider commercial relationships. Notably, the development of our export cheese sales through our partners, which sees us now distribute cheese to more than 15 countries, including the Netherlands, Saudi Arabia, South Africa, Australia, Japan and the USA.

When it comes to our branded cheese, we have made good progress in growing sales of our Mull of Kintyre

and Isle of Arran brands, driven largely through new product development and brand promotion. However, following a strategic review of our branded cheese business and after careful consideration, post-year end (in April 2018) we announced that we would be offering our Scottish cheese businesses at Campbeltown and Arran for sale as they are not core to First Milk's strategic direction. At the time of writing, we are focused on finding a potential buyer for this part of the business, to secure its long-term future.

Fresh milk business

We have also further developed our commercial activities around fresh milk sourcing, broadening our strategic customer base and growing our milk sales volumes.

A key strategic partnership is with Nestlé, one of the world's largest food and beverage companies. We have been working with them for more than 13 years and, as Nestlé's single largest UK supplier, we operate a dedicated farmer supply group to provide milk into Girvan for chocolate crumb manufacturing and into Dalston for the production of the Nescafé cappuccino ranges. During the last year, we have worked closely with Nestlé to implement a performance scorecard focused on sustainability and animal welfare on farm, helping them drive their vision of supporting farmers and the environment. We also completed the two-year Next Generation programme with Nestlé, which saw young farmer members of First Milk taking part in a unique development programme to broaden their understanding of the industry and the supply chain they are part of. It was a fantastic recognition of our commitment to our long-term partnership when Nestlé awarded First Milk 'Best Strategic Partnership Award' in February 2018.

Strengthening our operational performance

Since joining the business in April 2017, a major focus has been to drive operational efficiency and productivity at our sites, to ensure we can deliver more from less.

This has involved us restructuring our Lake District and Haverfordwest Creameries during the period to address day-to-day operational performance and ensure that the sites produce consistent, good quality cheese in the future, whilst concentrating on high productivity and factory optimisation. To deliver this

we have changed working patterns at the sites and, regrettably, this did impact on some of our colleagues – something that is never easy. These changes were essential, however, to put the business on a sound footing for future growth.

We exited from Westbury Dairies Limited at the end of December 2017 as planned. This means that we now need to balance our own milk supply, which is part of the reason for increasing the processing capacity at our key sites at Lake District Creamery and Haverfordwest.

As well as providing adequate balancing capacity, these developments mean that we are now consistently processing more milk, to produce higher volumes of high quality cheese, whilst operating at a lower cost base. This has helped us deliver a positive impact on relative milk price performance for our members in the period.

What is critical is that we are not only producing cheese at lower cost, but we are also maintaining the high quality that our sites are known for. To that end, I was delighted when the quality of our cheese was recognised with success at the Nantwich International Cheese Show 2017, where we won numerous awards for all our sites, and at the 2017 World Cheese Awards, where we came away with a total of eight awards, including two gold, two silver and four bronze.

Strengthening our culture and our people

No business can succeed without good people and the right culture. During the last twelve months, I have made some changes to strengthen our management team and have restructured various functions to develop the capabilities and expertise of our people.

We have also focused on developing the right mindset and ways of working, implementing a new style of problem-solving to improve business processes. Our 'continuous improvement' approach has been fundamental to the delivery of performance improvements across the organisation via enhanced productivity, quality and reduced waste.

After a period of considerable change at First Milk over recent years, it has been essential to re-focus the team and plan for the future, as we build and grow the business. As such, we have concentrated on clarifying our vision, so that we all have a common view of the future and the values by which we will operate.

This is absolutely critical, as having a clear direction helps drive strategic decision-making, as well as the way we operate day-to-day. Of course, you cannot change the culture of a business overnight, but we are now working hard to embed the new approach across our teams, working to do things better every day.

Our vision...



We'll deliver it by...



Delivering competitive total returns to our farmer members



Working as one team, with a relentless focus on efficiency and quality



Putting customers at the heart of our business, creating value through strong, long-term partnerships

Our values...



Fairness and integrity



Better every day



Right first time



I would like to take this opportunity to highlight the important contribution that all our staff have made during the year and thank them for their hard work and commitment.

Strengthening membership engagement

At the start of the year we undertook a member survey to understand how our members felt about First Milk. This highlighted that members felt strongly that it was important to them to be part of a farmer-owned co-operative but outlined some areas for improvement in terms of member communication and involvement. We have worked hard to address these concerns through the year, introducing six-monthly member meeting roadshows and improved newsletters and correspondence. Meanwhile, our membership team has implemented a new approach to day-to-day member relations, as well as annual Farm Business Reviews so that every member has the opportunity each year for a detailed discussion about their farm and their plans for the future and how they can maximise returns from membership of First Milk.

On top of this, we've developed our responsible sourcing strategy – something that is key to customers and to ensuring we have a sustainable supply of milk for the future – and we've launched a national 'Next Generation' programme to engage with young people associated with our members' farms to understand better what they want from First Milk in the future and to help broaden their knowledge and share best practice.

First Milk is set on a clear path for growth and as we build our customer relationships and processing capacity we need more milk to satisfy our requirements. As such, over the last year we have made some significant changes to the way we pay members.

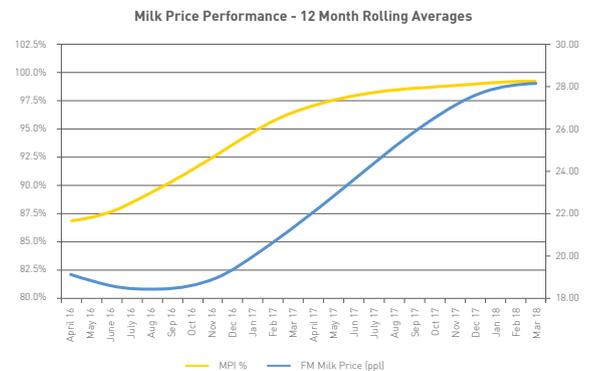
In September 2017 we discontinued A&B pricing and introduced a production bonus – both of these moves were to incentivise milk volume growth from existing members to meet our growing demand – there are no restrictions on those members that want to grow their businesses. As well as encouraging additional production from existing members to ensure we can deliver our growth aspirations, we have also launched proactive recruitment activity to grow our volume. This is already delivering results, with additional volume coming through the year from new members and suppliers.

Post-year end we have rationalised and simplified our regional pool pricing so that members are paid on just two schedules – liquid and manufacturing – with prices harmonised across the country on a liquid standard litre basis ensuring that all returns generated are distributed across all members who, through their capital contributions, have invested in the development of First Milk.



When it comes to absolute milk price during the year, it has been another period of volatility on world dairy commodity markets. This remains difficult to manage for our members and we have worked hard to minimise the impact on member prices and remain completely focused on maximising returns.

Critically, our relative milk price index (MPI), which tracks our milk price against our competitors, has continued to improve through the year as a result of improved business performance.



Building for the future

Looking forward, we are clearly focused on building the business for the future. Close, strong relationships right through the supply chain will be key and all parts of the supply chain will have to optimise efficiency – both financial and physical – to survive and flourish. We are focused on building strong long-term relationships with both our farmer members and our customers, and developing our business to ensure that we have the scale to be relevant yet personal, the commercial ability to deliver value and the agility to be flexible.

I am pleased that demand from our customers continues to grow and, post year-end, we have started a major capital expenditure programme at Haverfordwest Creamery, which will see us invest around £6.5m over the next two years. To take advantage of the increased demand and

production capacity that we are creating, we are focused on encouraging our members to produce more milk and on recruiting additional milk supply.

Yes, the dairy market remains volatile and, as a result, challenging. Yes, Brexit and all the changes that may bring lead to additional uncertainty. But, as a result of developments undertaken in the last twelve months, and with a clear vision for growth for the future, I am confident that we are well-placed to move forward with our goal of working together to deliver prosperity for our members.

I'd like to take this opportunity to thank my Board colleagues, Member Council, senior management and staff and our members for all their support in the last twelve months and I look forward to working together to deliver our plans for the future.

CFO's statement

Greg Jardine



During the last year we have continued to make progress in strengthening and growing the business and I am pleased to report a good financial performance in line with expectations for the year ended 31 March 2018. Our turnover increased, our balance sheet has strengthened and the business had a positive cash inflow.

Turnover

Turnover increased by 22% to £252.7m. This was driven by a combination of new business growth, higher cheese and brokred milk selling prices and higher returns from whey.

Profitability

Our operating profit was £6.6m – lower than last year but in line with our budgets and expectations. Our strategic objective is to maximise the return of value to members, through the milk price, whilst retaining sufficient profits to meet our business obligations and commitments. Profit comparisons year on year therefore need to be considered in conjunction with relative improvements in milk price returned to members, as highlighted in the improvement in the 12 month rolling averages Milk Price Index (MPI). The reduction in profit in 2018 is a direct consequence of improving our relative milk price.

Member Investment

During the year members contributed a further £2.1m to the business through the retention of 0.5 pence per litre until they reach their capital targets. At the end of the year Member Capital stood at £75.5m.

Capital Investment

Capital investment continued at all sites with £3.2m invested (2017: £3.8m) in various projects to improve efficiency, as well as the first stage of a £6.5m investment at Haverfordwest. Over the next two years our capital investment programme will continue at our Haverfordwest Creamery on new silos, buildings, pasteurisers and milk separators, heat recovery equipment as well as cheese-making equipment and whey-handling facilities. This will deliver energy and cost savings as well as improving productivity, releasing additional processing capacity.

Balance sheet, cash flow and net debt

The Group's balance sheet continues to strengthen, with net asset growth of £5.4m to £27.4m through a combination of a reduction in the pension deficit, continued investment in our processing, and the continued profitable and cash generative growth of the business.

Meanwhile, as a result of the increase in the value of cheese stocks (due to the price of milk used to produce the cheese), our working capital requirements increased, resulting in our net debt increasing by £6.3m to £44.9m at 31st March 2018. Our stock-holding volume remains broadly flat year-on-year with controls in place to ensure we only carry the necessary level of stocks to fulfil our sales needs.

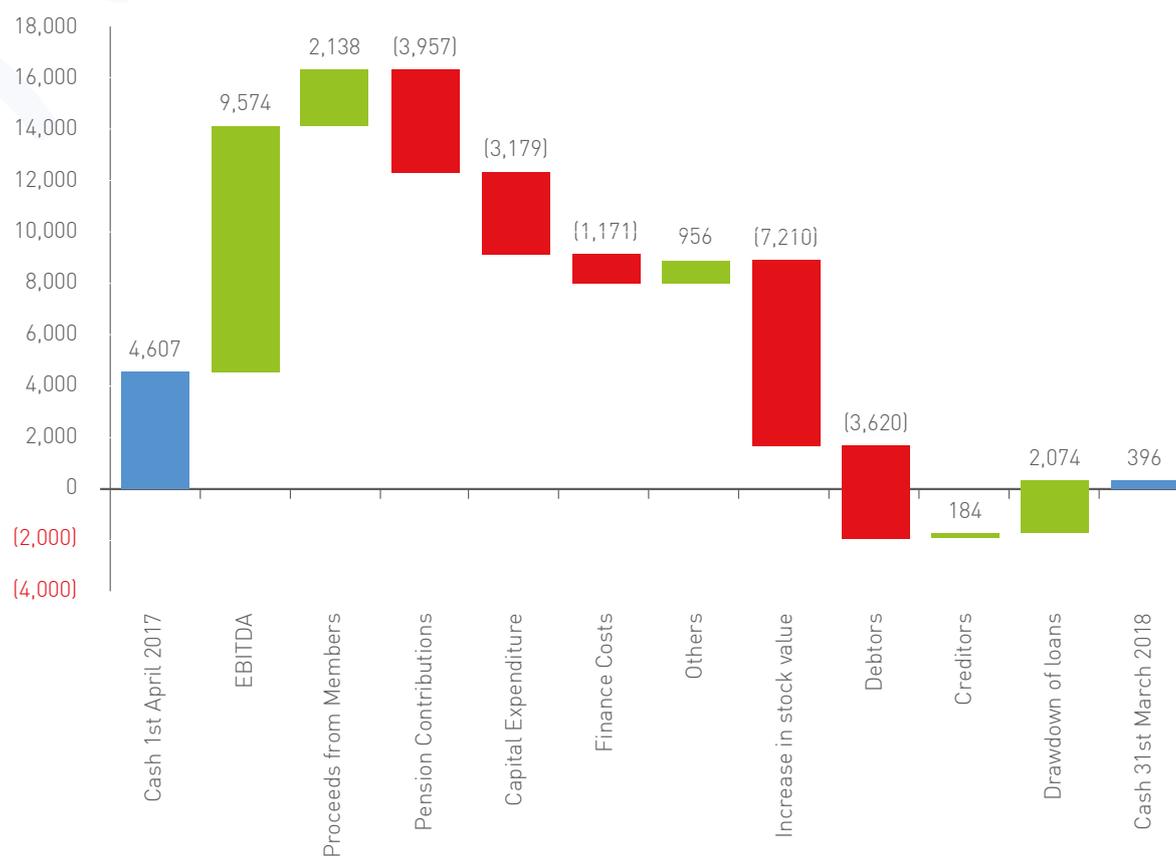
The cash earnings (EBITDA) of £9.6m together with £2.1m from member capital proceeds generated enough cash to allow us to service our various commitments.

Cash is required on an annual basis to make payment towards the pension deficit reduction agreements, invest at our creameries and pay bank interest. The net inflow before working capital requirements was £4.4m.

Working capital consumed £10.6m during the year. £7.2m was required as a result of higher stock holding value and a further £3.6m due to increased debtors.

During the year we drew down £2.1m from our loan facilities, which accompanied by a reduction in cash balances, led to a £6.3m increase in net debt during the year, in line with expectations.

Cash flow for year ended 31 March 2018



Interest

Net finance charges, totalling £2.1m, comprised of £1.2m relating to the Wells Fargo debt facility, £0.2m of bank arrangement fees and £0.7m of finance costs associated with the pension deficit. The facility in place with Wells Fargo since February 2017 terms are improved compared to the previous facility resulting in a £1.1m reduction in interest paid in the year.

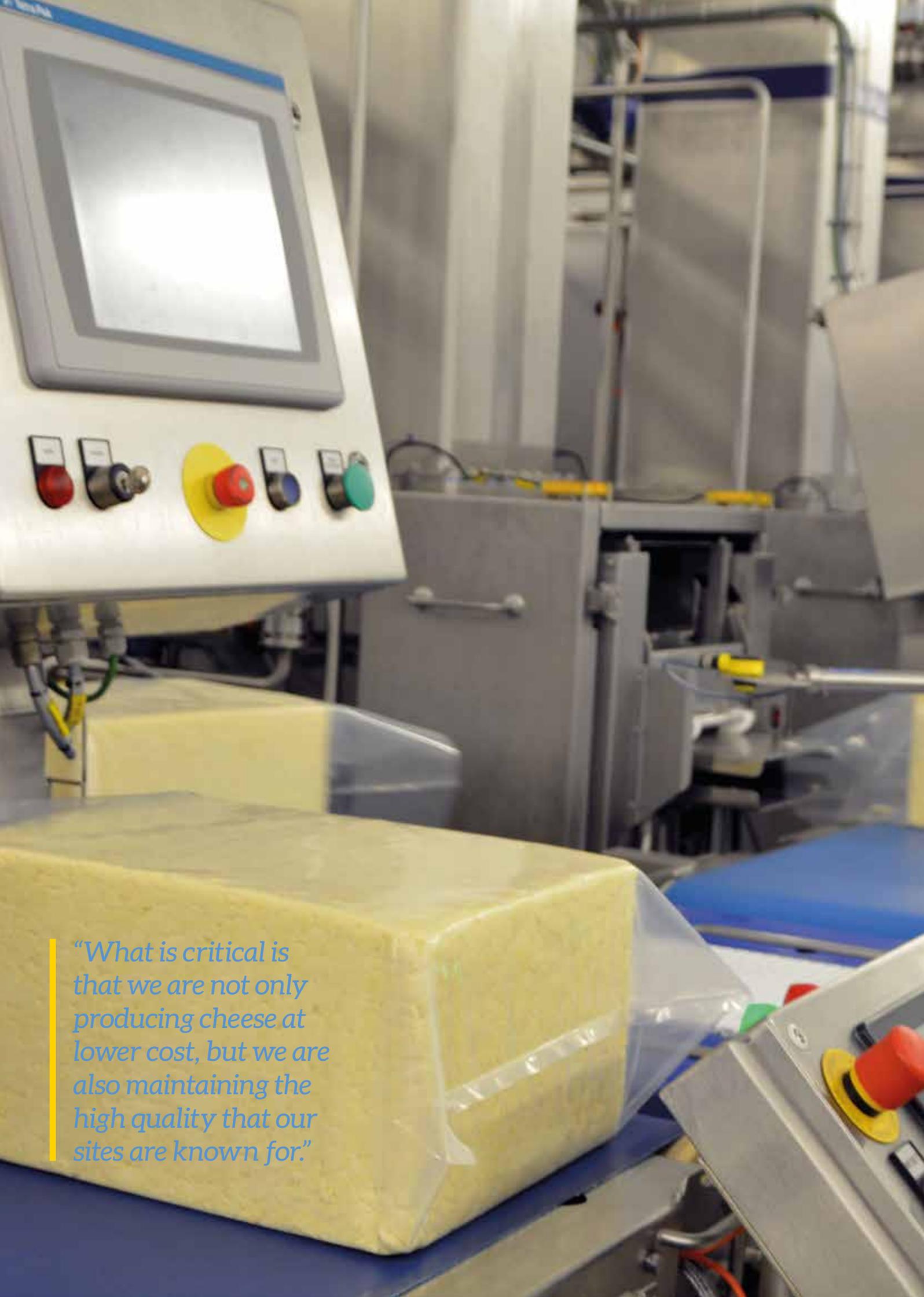
The constituent elements of the interest charge comprised:

	2018 Group (£m)	2017 Group (£m)
Bank loans, overdrafts and revolving facilities	1.2	2.3
Bank arrangement fees	0.2	0.3
Pension scheme net finance costs	0.7	0.9
Total Finance Costs	2.1	3.5

Pensions

We operate a defined contribution scheme with Standard Life for current employees, company contributions are charged to the Profit and Loss Account in year.

In addition, First Milk Limited operates the Scottish Milk Limited Retirement Benefits Plan, and also participates in The Milk Pension Fund, an industry scheme in which all participating employers report only their share of assets, liabilities and obligations while legally holding joint and several liabilities for the scheme as a whole. Both schemes are closed to accrual of benefits. During the year our total pension liabilities (net of deferred tax assets) fell from £11.3m to £8.1m. The contributions to the defined contribution scheme charged to the profit and loss account in the year ended 31 March 2018 were £0.7m (2017: £0.9m).



“What is critical is that we are not only producing cheese at lower cost, but we are also maintaining the high quality that our sites are known for.”

Profit and loss accounts

for the year ended 31 March 2018

	2018	2017
	Group	Group
	£'000	£'000
Turnover - continuing operations	252,715	206,468
Less: share of joint ventures' turnover	(4,561)	(3,878)
Total turnover	248,154	202,590
Cost of sales	(233,848)	(181,437)
Gross profit	14,306	21,153
Administrative expenses		
- <i>Recurring</i>	(7,679)	(9,426)
- <i>Exceptional items</i>	(1,496)	(2,309)
	(9,175)	(11,735)
Operating profit		
- <i>Continuing operations</i>	5,131	9,418
Share of operating profit/(loss) in joint ventures		
- <i>Continuing operations</i>	377	470
Profit before interest	5,508	9,888
Finance income	20	21
Finance costs	(2,097)	(3,439)
Profit/(loss) on ordinary activities before taxation	3,431	6,470
Tax on profit/(loss) on ordinary activities	(275)	(425)
Profit/(loss) for the financial year	3,156	6,045

Balance sheets

as at 31 March 2018

	2018	2017
	Group	Group
	£'000	£'000
Fixed Assets		
Property, plant and equipment	31,202	32,717
Investments in joint ventures	931	554
Total fixed assets	32,133	33,271
Current assets		
Stocks	50,672	43,462
Trade and other debtors	30,243	27,940
Cash and cash equivalents	396	4,607
	81,311	76,009
Trade and other payables amounts falling due within one year	(32,488)	(32,086)
Net current assets	48,823	43,923
Total assets less current liabilities	80,956	77,194
Trade and other creditors amounts falling due after more than one year	(43,743)	(41,599)
Total net assets employed excluding pension liability	37,213	35,595
Pension liability	(9,777)	(13,554)
Net assets	27,436	22,041
Capital and reserves		
Share capital	75,508	73,886
Profit and loss reserve	(48,072)	(51,845)
Total capital and reserves	27,436	22,041

Statements of cash flows for the year ended 31 March 2018

	2018	2017
	Group	Group
	£'000	£'000
Net cash from operating activities	(5,029)	(2,494)
Taxation paid	-	-
Net cash (used in) / generated from operating activities	(5,029)	(2,494)
Cash flow from investing activities		
Finance income	20	21
Purchase of property, plant and equipment	(3,179)	(3,772)
Proceeds from sale of investment	-	242
Proceeds from sale of property, plant and equipment	250	202
Movement in loans with joint ventures	686	-
Net cash used in investing activities	(2,223)	(3,307)
Cash from financing activities		
Finance costs	(1,171)	(2,588)
Net proceeds from members	2,138	2,899
Draw down / (repayment) of loans	2,074	9,747
(Decrease) / increase in debt facilities	-	-
Net cash generated from financing activities	3,041	10,058
Net (decrease) / increase in cash and cash equivalents	(4,211)	4,257
Cash and cash equivalents at the beginning of the year	4,607	350
Cash and cash equivalents at the end of the year	396	4,607



“We have put our farmer members back at the heart of our business, through improved focus on member engagement and communication.”

The Board

as at 31 March 2018



Clive Sharpe
Chairman

Clive became chairman in February 2016. He stood down on 31 July 2018, to be replaced by Chris Thomas. Clive has had a food manufacturing career spanning 37 years, he is former chairman of Quorn Foods and Burtons Biscuits and former CEO of WT Foods, Golden Wonder and Homepride Foods.



Shelagh Hancock
Chief Executive

Shelagh joined First Milk as chief executive in April 2017. She has over 25 years' experience in the food and agricultural supply sectors. She held a number of senior executive positions including managing director at Medina Dairy and milk business unit director at farmer-owned co-operative Milk Link.



Brian Mackie
Non-Executive Director

Brian has held a range of international chief financial officer roles in a number of large businesses; Starbev/Molson Coors Europe, Maxxium Worldwide and Cott Corporation. He has also had international responsibility for IT, Legal, Human Resources, and Commercial Operations during his career.



Carl Ravenhall
Non-Executive Director

Carl was latterly managing director of Muller Wiseman Dairies.

Prior to that in a dairy career that spans more than 25 years, he held a number of senior executive roles including managing director of Milk Link's cheese business, and MD of Adams Foods.



Jim Baird
Farmer Director

Jim farms in Lanarkshire as part of a family partnership. He has undertaken a Nuffield scholarship, visiting countries including USA, China, Australia and New Zealand to research the key attributes of enterprising rural businesses. Jim also sits on the Scottish Advisory Board of the NFU Mutual.



Robert Craig
Farmer Director

Robert is a partner in two dairy farms. He is past county chairman of Cumbria NFU and a Nuffield scholar. In 2012, he became chairman of Penrith & the Border Conservative Association and in 2013 he jointly won the Farmers Weekly Dairy Farmer of The Year Award. Robert is also a trustee of RABDF.



Greg Jardine
Chief Financial Officer

Greg joined First Milk in 2010 and held several senior management and executive roles in finance and commercial before being appointed as Chief Financial Officer and joining the Board in September 2017. Greg has 13 years' dairy experience, having previously worked for Lactalis McLelland as Industrial Finance Director.

Member Council

as at 31 March 2018



Séan Rickard
Independent Chairman



Di Clements
Council Member



Mike Smith
Council Member



Scott Calderwood
Council Member



Christine Kelsall
Council Member



Willie Campbell
Council Member



Willie Purdie
Council Member



David Walker
Council Member

Role of the Member Council

The roles of the Council include:

- Holding the Board to account on behalf of the Members
- Approving the annual budget, business plan and company strategy
- In consultation with the Board, recommending candidates for the role of the chair and vice chair for election by Members at AGM
- In consultation with the Board, approving the nomination process for Independent Non-Executive Directors and Farmer Non-executive Directors
- Provide a communication channel between Members and the business.
- Setting the remuneration of the Non-Executive Directors



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