first milk

ANNUAL REPORT AND FINANCIAL STATEMENTS 2016

the farmers' business

FIRST MILK LIMITED
ANNUAL RESULTS
YEAR ENDED 31 MARCH 2016

Executive Summary

Headlines:

- Group turnover was £291.5m (2015: £442.2m)
- Operating profit (before exceptional items) was £6.0m (2015: £22.1m loss) - £28.1m improvement
- Net loss for the year was £5.1m (2015: loss £28.1m) - £23.0m improvement
- Net bank borrowings reduced to £32.1m (2015: £60.3m)
- Capital investment of £4.8m across all our sites in the year (2015: £5.4m)
- Total group capital and reserves increased to £17.4m (2015: £5.4m)

Chairman Clive Sharpe commented:

The financial performance of the business improved significantly in the year to 31 March 2016 reflecting the results of the turnaround plan executed by the new management team, and the focus on delivering operational efficiencies and quality improvements in the core business. Overall we returned a modest operating profit in the year, compared to a large loss in the previous year – a £28.1m improvement (before exceptional items).

Milk prices continued to decline throughout the course of the year as a result of continued growth in global supply not matched by growth in demand. The reduced value of milk and other dairy ingredients, accompanied by a significant reduction in the volumes of bought-in milk and the impact of divestment of loss-making businesses, led to a significant drop in group turnover in the year. The business is smaller, but is in much better shape than last year.

The turnaround plan executed by the new management team included the following:

- Restructuring and downsizing of central functions to reduce overhead costs
- Improving operational performance and product quality in the hard cheese business
- Divestment of the loss-making Glenfield soft cheese business
- Exit from the loss-making Westbury skimmed milk powder, butter and cream business
- Step changing the CNP sports nutrition business bringing it closer to break-even (subsequently divested after year-end)

The cost of implementing the turnaround plan resulted in exceptional items of £5.1m during the year.

Through the turnaround we have continued to invest in the capital assets of the business, including a major project to renew the cheese belts at the Lake District Creamery, costing over £3m, which was completed on time and on budget. This project will increase capacity and improve product quality at the site, the benefits of which will be seen in the new financial year.

We continued to develop the long term relationship with Ornua Foods (previously Adams Foods) and worked with them to ensure that our product specifications and recipes meet customer requirements. Through our enhanced collaboration we significantly reduced the impact of inconsistent quality and the volume of surplus cheese sold at a discount that had cost us dearly in the previous year.

A comprehensive review of corporate governance was undertaken following the publication of the Greenburn Report, which was commissioned in 2015 to review governance short-comings. The full implementation of the recommendations of the report has resulted in a smaller, more commercial Board structure, and the creation of an independently chaired Member Council.

Our pension liabilities reduced significantly, largely as a consequence of the decision by the trustees of the Milk Fund to change the indexation measure used from RPI to CPI. In total, our pension liabilities (net of deferred tax assets) reduced from £20.1m to £6.4m during the year.

Looking to the future:
As a consequence of being a more balanced business in terms of supply and demand subsequent to the year end we have modified our “A” and “B” pricing structures by reducing the proportion of “B” milk from 20% to 10% with effect from April 2016. We also reverted to the 0.5ppl capital contribution due from members as from August 2015, as promised.

Since the year end the capital structure of the group has been revised, with the creation of a new class of shares and the conversion of member loan accounts, B preference shares and debentures into the new C preference shares. This was completed in August 2016.

Looking to the future - continued:

Our bank facilities were successfully renewed on 24 December 2015 and extended to 1 February 2017, and now that the turnaround plan has been substantially delivered, we will shortly start discussions to extend them for a longer period. Throughout the difficulties of the last two years we are pleased to have maintained the support and confidence of our lenders, and are now in a position to discuss longer term, committed facilities.

Whilst the year to 31 March 2016 has been a difficult year for the dairy industry, First Milk's business is now on a firmer footing. Milk prices are finally starting to rise, and we have been pleased to deliver the first fruits of the turnaround plan in the form of higher, non-market driven, milk prices to members, with 2ppl business performance supplements paid as promised, and a substantial 7ppl increase in the "B" price from July/August 2016. The hard work done throughout the last year has started to show returns.

The board is pleased to announce that the improvement in financial performance has continued into the new financial year with operating profit on track to deliver to plan and in excess of the year to 31 March 2016. It is this with reducing debt and improving liquidity that has allowed the board to increase milk prices paid to members by two pence per litre above market related movements since 31st March 2016.

Annual Report

Year ended 31 March 2016

Contents **Page**

Officers and Professional Advisers

Directors
Clive Sharpe (chairman)
Nigel Evans (vice chairman)
Jim Baird
Carl Ravenhall
Mike Gallacher
Brian Mackie

Secretary
Angus Waugh

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PricewaterhouseCoopers LLP
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G2 7EQ

Strategic Report

The directors of First Milk Limited ("First Milk", the "Group" or the "Society") present their strategic report for the year ended 31 March 2016.

The Business and Principal Activities

First Milk Limited is a dairy farmers' co-operative registered under the Co-operative and Community Benefit Societies Act 2014 (number: IP29199R). The principal activities of the Group and Society are the marketing of milk on behalf of its members and the manufacture and sale of dairy and lifestyle nutritional products.

Results

The financial statements on pages 17 to 50 detail the trading results and financial position of the Group and Society, which includes The First Milk Cheese Company Limited, Scottish Milk Products Limited, Scottish Milk Dairies Limited and joint ventures: Westbury Dairies Limited, Fast Forward FFW Limited and First Milk Energy Limited.

Key Financial Performance Indicators

The table below provides key financial performance indicators ("KPIs") relating to the Group's performance during the year.

Financial KPI	**2016**	**2015**
Operating profit/loss before tax and exceptional items	Profit £6.0million	Loss £22.1 million
Net loss for the year	£5.1 million	£28.1 million
Total Capital and reserves	£17.4million	£5.4 million
Net bank debt	£32.1 million	£60.3 million

The Group's and Society's profit and loss accounts and balance sheets are shown on pages 18 and 19.

Prospects and Strategic Aspiration

The Group is focused on reshaping the business and building a sustainable milk price for its members.

The directors' plan to deliver this objective includes the following elements:

- Reshaping the cost base of the business
- Developing a profitable core cheese and liquid milk business
- Building an engaged, highly commercial culture and team
- Delivering operational excellence
- Achieving a step change in milk sourcing

Review of the Business – key events timeline

On 1 April 2015, Kate Allum resigned as a director of the Society.

On 3 June 2015, the Group reached agreement with its lenders to extend its bank facilities to February 2016.

On 15 June 2015, Brian Mackie was appointed as a non-executive director of the Society.

On 23 June 2015, Sir Jim Paice announced his resignation as chairman and a director of the Society and that he would step down when his replacement is appointed.

On 30 September 2015, Gerry Sweeney resigned as a director of the Society.

On 30 September 2015, Richard Davis resigned as a director of the Society.

On 1 October 2015, Brian Mackie was appointed as Chief Operating officer of the Society and became an executive director of the Society.

On 29 October 2015, Sir Jim Paice resigned as a director and as chairman of the Society and Carl Ravenhall was appointed as a non-executive director of the Society.

On 2 December 2015, the Group disposed of its soft cheese business based in Glenfield, Fife.

On 15 December 2015, members of the Society approved Rule changes that introduced a new governance structure for the Society.

On 24 December 2015, the Group reached agreement with its lenders to extend its bank facilities to February 2017.

Strategic Report (continued)

On 15 January 2016, the Society disposed of its shareholding in Westbury Dairies Limited.

On 31 January 2016, Willie Campbell, Robert Craig and Wendy Radley resigned as directors of the Society on implementation of the new governance structure.

On 1 February 2016, Clive Sharpe was appointed as a director and chairman of the Society.

On 17 March 2016, the board announced its intention to convert all member loan accounts, B preference shares and debentures held by members and former members of the Society to equity.

Post Balance Sheet Events

On 1 April 2016, the Area Representatives were replaced by the Member Council in implementation of the new governance structure.

On 24 June 2016, the United Kingdom voted to leave ("Brexit") the European Union ("EU"). The areas that could be impacted are foreign exchange rates, tariffs, imports and exports, agriculture subsidies and pensions. It is too early to assess the potential impact in these areas. It remains to be seen what agriculture policy an independent UK Government will follow and whether the recent reduction in interest rates will have a sustained impact on pension liabilities.

On 1 July 2016, members approved Rule changes that created a new class of shares, namely C Preference Shares.

On 3 August 2016, the board of directors converted all loan capital, B Preference Shares and debentures to C Preference Shares.

On 21 October 2016 the Group disposed of its CNP Professional lifestyle nutrition business, based in Hyde, near Manchester.

Principal Risks and Uncertainties

Loss of milk production volumes
The Board addresses the risk of losing milk volumes by paying its members the maximum milk price possible through a market related pricing structure which recognises that market returns and costs to supply in different market segments vary. As a result, the business aims to return prices to members that are in line with the actual returns received for their milk.

In addition, members' milk price is reviewed on a regular basis and the Board has a policy of keeping members appraised of factors influencing the amount paid. This is supported by a pro-active communications policy, through which members are kept up-to-date at meetings and through letters and regular email news briefings.

Competitive risk
The Society sells milk to processors, many of whom have the option of sourcing their raw milk requirement directly from individual farmers.

First Milk sells hard cheese and dairy ingredients into domestic and export markets. In doing so, it faces competition from other similar companies at home and abroad. It also manufactures milk derivatives and faces the risk of customers using alternative supplies or substituting milk derivatives with non-dairy alternatives in their own products.

First Milk addresses these risks by ensuring that sales staff are fully aware of relevant markets, including export markets, offering products at market competitive prices, providing excellent service levels and developing long-term strategic relationships with key customers.

Regulatory risk
The Group and Society is required to comply with various regulatory regimes in areas such as competition law, health & safety and environmental regulation. This is achieved through the adoption of appropriate policies and structures, risk assessments, monitoring and review of performance, recruitment and training of suitably qualified staff and support from external consultants, including legal advisers, where appropriate.

Input cost risk
First Milk is exposed to market price movements for commodities, including electricity, gas, plastics and cardboard. This risk is mitigated in relation to many input costs by maintaining awareness of markets and by forward buying where this is appropriate. In addition, the use of such commodities is kept to a minimum and reduced where possible. The business addresses the exposure to energy costs by buying energy in the wholesale market, with expert assistance from energy consultants.

Financial Risks
The Group and Society's activities expose it to a number of financial risks including price, credit, interest rate, liquidity and fraud risk. The use of financial derivatives is governed by the Group and the Society's risk management framework as approved by the Board of Directors. The Group and Society does not use derivative financial instruments for speculative purposes.

Price risk
The risk of the business receiving low prices compared to market levels is mitigated, where possible, by the use of up-to-date market intelligence.

Strategic Report (continued)

Credit risk
First Milk's principal financial assets are trade and other receivables, investments, bank balances and cash.

The Group and Society's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables. An allowance for impairment is made where there is an identified triggering event which, based on previous experience, is evidence of a reduction in the recoverability of the cash flows.

Credit risk attributable to trade receivables is mitigated through the use of credit insurance.

Interest rate risk
The Group and Society's activities expose it to the financial risks of changes in interest rates. The Group and Society has used interest rate swap contracts in the past, where appropriate, to hedge these exposures. Presently there are no such contracts in place.

Liquidity risk
In order to maintain liquidity to ensure that sufficient funds are available for ongoing operations and future developments, the Group and Society aims to use a mixture of long-term and short-term debt finance. Management monitors rolling forecasts of the Group's liquidity reserve and cash and cash equivalents on the basis of expected cash flows. Further information with regard to the management of current liquidity risk is contained in note 1 to the financial statements.

Fraud risk
First Milk recognises the risk of fraud, particularly in the current economic climate. This risk is mitigated through reviews of controls within systems, conducted, where appropriate, with the assistance of internal auditors, and by the adoption of an Anti-bribery and Corruption Policy.

Approved by the Directors
and signed by order of the Board

Angus Waugh

Angus Waugh
Secretary
26 October 2016

Directors' Report

The directors present their report and the audited financial statements of First Milk Limited for the year ended 31 March 2016.

Business Performance and Future Developments
The business performance and future developments of the Group are highlighted in the strategic report set out of page 2.

Employees
The recruitment, development, retention and maintenance of a highly skilled workforce is key to the future of the business. It is the policy of the Board of Directors to enlist the commitment of all employees in attaining the Group's and Society's objectives. Implementation of this policy is by encouraging employee involvement through effective communications, which includes an induction process for new employees, team briefings, newsletters, a company intranet and any other appropriate means of individual or collective consultation.

Disabled Employees
It is the Board of Directors' policy to ensure that continuous employment is offered to employees who become temporarily or permanently disabled where it is practicable to do so within the scope of the business activities of the Group and Society.

Political Donations
The policy of the Board of Directors is not to make donations of a political nature.

The Board of Directors
The directors who held office during the year to 31 March 2016 and up to the date of signing the financial statements were as follows:

Clive Sharpe	-	non-executive director and chairman (appointed 1 February 2016)
Sir Jim Paice	-	non-executive director and chairman (resigned 29 October 2016)
Kate Allum	-	executive director (resigned 1 April 2015)
Jim Baird	-	non-executive farmer director
Richard Davis	-	non-executive farmer director (resigned 30 September 2015)
Willie Campbell	-	non-executive farmer director (resigned 31 January 2016)
Wendy Radley	-	non-executive farmer director (resigned 31 January 2016)
Robert Craig	-	non-executive farmer director (appointed 29 October 2015 and resigned 31 January 2016)
Nigel Evans	-	non-executive farmer director and vice-chairman
Mike Gallacher	-	executive director
Brian Mackie	-	executive director (appointed 15 June 2015 initially as a non-executive director)
Carl Ravenhall	-	non-executive director (appointed 29 October 2015)
Gerard Sweeney	-	executive director (resigned 30 September 2015)

The non-executive farmer directors' capital account balance and interests in the preference shares of the Society at 31 March 2016 and 31 March 2015 were:

	31 March 2016		31 March 2015	
	Member Capital Account £	New Preference Shares £	Member Capital Account £	New Preference Shares £
Jim Baird	123,314	17,179	96,137	17,179
Nigel Evans	68,314	7,046	44,385	7,046

Each non-executive farmer director is also a member of First Milk Limited and as such holds one ordinary share.

Directors' Report (continued)

Post Balance Sheet Events

Events after 31st March 2016 are referred to in the key events timeline in the strategic report.

Going Concern

The consolidated financial statements have been prepared on a going concern basis.

Current Trading and Borrowings

Substantial losses were incurred in the year to 31 March 2015, but the trading results of the Group have significantly improved in the year to 31 March 2016. The Group's operating profit before exceptional items improved by £28.1million compared to the previous year, to a profit of £6.0million. The loss for the year after tax was £5.1million after net exceptional charges of £5.1 million, which included £7.1million exceptional cash costs off-set by £2.0 million non-cash net gains (see note 4). The Group's trading position before exceptional items was profitable and this trend has continued into the current year. The Group's net bank debt reduced significantly from £60.3million to £32.1million during the year, and has further reduced to £26.1million as at 30th September 2016.

Existing Funding

The business is financed through a combination of members' capital contributions and bank facilities. Members' capital contributions are collected through the retention of 0.5 pence per litre from each member's milk payment until they reach their capital target. On 1 January 2015 the members' capital target was increased to 7.0 pence per litre, based on an average annual volume over three years, an increase from 5.0 pence per litre. The monthly capital retention was increased from 0.5 pence per litre to 2.0 pence per litre between January and August 2015, but has reverted to 0.5 pence per litre since September 2015. In the financial year members' capital contributions totalled £10.2 million.

On 3 August 2016, the board exercised its power under the Rules to convert all loan capital accounts, B preference shares and debentures held by members and former members, totalling £63.5 million, into equity in the form of C Preference Shares. This conversion has improved the financial position of the Society in that it removes future repayments of capital to former members, and designates all member capital as permanent capital.

Following successful negotiations with our bank lenders the Group's borrowing facilities were further extended to 1 February 2017. These facilities are secured by fixed securities over certain Group assets, a floating charge over Scottish Milk Products Limited and a debenture over First Milk Limited and The First Milk Cheese Company Limited. There are no financial covenants applicable to the facilities which are repayable on demand. The maximum facility available to the Group is £70million, with the amount available at any time depending on the value of stock and debtors and is based on a percentage draw-down specified in the facility agreement. The amount available from the facility at 30 September 2016 was £33.8 million (31 March 2016: £38.7m). In addition to the facility there is a term loan based on fixed asset values which at 30 September 2016 was £522k (31 March 2016: £909k). The Board's forecasts show that there would be adequate headroom within this level of bank facilities over the next year, (assuming they are extended on current terms beyond February 2017), these forecasts include an intention to continue to implement above-market increases in milk prices paid to members, which is ultimately a discretionary choice. However these milk price increases have been implemented at a faster rate than the Board's original forecast, as a result of higher available liquidity headroom than originally forecast. Discussions are currently under way for the renewal of the bank facilities and the Directors believe that they will be successfully concluded by 1 February 2017.

Forecasts

The Board has undertaken a thorough review of the Group's forecasts and associated risks. These forecasts extend for a period beyond one year from the date of approval of these financial statements. The forecasts make key assumptions based on information available to the directors at the time of the approval of these financial statements that:

- the price paid for milk supplies and other costs will fluctuate with returns available to the business to ensure the projected profitability is achieved;
- there is no material diminution in the bank facilities available to the Group as a result of the market value of stock falling, given this is a factor in establishing the amount of the borrowing facilities available to the Group, or other adverse working capital movements;
- the lenders will not seek early repayment of the existing facility and will continue to make it available to the Group; and
- the existing bank facilities will be extended or renewed from February 2017 and similar and sufficient facilities will be available to the Group for at least one year from the date of the approval of these accounts; and
- key customer and supplier contracts continue as per their existing commercial arrangements over the contractually agreed periods.

The directors have based their conclusions regarding going concern upon these forecasts.

Directors' Report (continued)

Going Concern Continued.

Conclusion on Going Concern
At the date of these financial statements, the directors consider that, based upon the financial projections and the ability of the Society to maintain adequate banking facilities prior to the expiry of the current facility, the Group will have sufficient funding to continue as a going concern for at least the next twelve months although it is noted that the current funding is repayable on demand.

The directors have concluded that the dependency upon the continued support of its lenders from the date of these financial statements, the risk of not obtaining adequate debt facilities beyond February 2017 and the risk of not achieving the forecast performance, represent the existence of a material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. This may mean that the Group is unable to continue to realise its assets and discharge its liabilities in the normal course of business.

Nevertheless, after making enquiries and, in particular, considering the measures taken by the Group as set out above, the directors have a reasonable expectation that the Group will have adequate resources to continue in operational existence for the foreseeable future, and for this reason, they continue to adopt the going concern basis of accounting in preparing the annual financial statements. Accordingly, the directors consider it appropriate to prepare the financial statements on a going concern basis. The financial statements do not include the adjustments that would result if the Group was unable to continue as a going concern.

Disclosure of Information to Auditors
In the case of each of the persons who are directors of the Group and Society at the date when this report was approved:

- So far as each of the directors is aware, there is no relevant audit information of which the Group and Society's auditors are unaware; and
- Each of the directors has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the Group and Society's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Statement of Directors' Responsibilities
The directors are responsible for preparing the annual report and financial statements in accordance with applicable law and regulations.

The directors have chosen to prepare the financial statements for the Group and Society in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102).

Legislation requires the directors to prepare such financial statements for each financial year which give a true and fair view of the state of affairs of the Group and Society and of the surplus or deficit of the Group and Society for that year and comply with UK GAAP and the Co-operative and Community Benefit Societies Act 2014 and the Co-operative and Community Benefit Societies (Group Accounts) Regulations 1969. In preparing those financial statements the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed subject to any departures disclosed and explained in the financial statements; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to assume that the Group and Society will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Society and enable them to ensure that the financial statements comply with the Co-operative and Community Benefit Societies Act 2014 and the Co-operative and Community Benefit Societies (Group Accounts) Regulations 1969. They are also responsible for safeguarding the assets of the Group and Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that they have complied with these requirements and, having a reasonable expectation that the Group and Society have adequate resources to continue in operational existence for the foreseeable future, have adopted the going concern basis for preparing the financial statements.

Directors' Report (continued)

Independent Auditors

Following a tendering process carried out by the Audit, Finance and Risk Committee in 2016, the board have agreed to recommend to members that Deloitte LLP be appointed as external auditors with effect from the year to 31 March 2017 and a resolution that they be appointed will be proposed at the Annual General Meeting ("AGM").

By order of the Board

Angus Waugh
Secretary
26 October 2016

Corporate Governance Report

The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of First Milk.

The Board

The Board of Directors is committed to operating the business with integrity, high-ethical values and professionalism and aims to achieve high standards of corporate governance.

The Board of Directors of First Milk has adopted the Corporate Governance Code for Agricultural Co-operatives ("the Code") that has been prepared by the Scottish Agricultural Organisation Society "SAOS" and Co-operatives UK.

The Code sets out a number of high-level and supporting principles across a range of areas of governance covering the Board and its committees, member participation in governance, and the audit and Annual Report. The Code also sets out specific provisions against which a co-operative's own governance can be measured.

A copy of the Code can be found at http://www.soas.coop/member-services/

As a consequence, this Corporate Governance report focuses on those aspects that are covered by the Code and should be read in conjunction with the Audit, Finance and Risk Committee and Remuneration reports on pages 13 and 14.

The Greenburn Report

In 2015, the board of Directors commissioned a review of governance within First Milk. The review was carried out by Greenburn Associates and their report made a number of recommendations in areas covering:

- Strategic planning & Direction
- Financial Oversight
- Processes, practices and behaviours relative to good practice
- Leadership
- Culture

All the recommendations made in the Greenburn Report have either been implemented or their implementation is in progress.

Internal review of governance structure

Simultaneously with the Greenburn review, the Board of Directors conducted its own internal review of the governance structure of First Milk in consultation with the Area Representatives and the members of First Milk.

As this review and the consultations progressed, the board of directors formulated proposals for a new governance structure for First Milk that incorporated the Greenburn recommendations.

On 1 December 2015, members approved Rule changes that implemented these proposals and they have been implemented in stages through 2016.

This corporate governance report sets out the new governance structure for the Society.

Members

Members' powers include the power to:

- Ratify (or vote not to ratify) the appointment of directors at the Annual General Meeting;
- Remove a director at an Annual General meeting or a Special General Meeting (by a two-thirds majority);
- Bring any matter for a member decision at a Special General Meeting that has the support of one-tenth of the membership;
- Approve Rule changes that relate to key matters such as board or Council governance and changes to the member capital structure;
- In groups of 10 or more members, bring matters of interest to the Council (members may still raise matters relating to their own individual situations with the Society)
- Approve acquisitions and disposals in excess of £25m

Corporate Governance Report (continued)

The Council

The Council has a range of powers, including:

- Holding the board to account on behalf of members;
- Recommending candidates for the roles of board chair and vice-chair for election by members at the Annual General Meeting;
- Approving the Nomination process for non-executive directors;
- Removing directors from office;
- Approving non-executive directors' remuneration;
- Approving the annual budget and business plan for the Society;
- Approving acquisitions and disposals (in the case of transactions with a value in excess of £25m, prior to approval by members);
- Approving certain matters relating to member capital, such as the setting of capital targets;
- Approving certain Rule changes
- Making representations to the board with regard to matters concerning members.

The Council comprises seven members who were appointed following a selection process in which fifteen candidates were assessed against set criteria. The selection process included the involvement of an independent advisor. The Council members' appointments are subject to ratification at the 2016 Annual General Meeting. The board and Council will review the composition of the Council and the process of appointment of Council members before the end of 2016.

The Council is chaired by an independent chairman, Dr Sean Rickard, who does not have a vote.

The Council members are: Scott Calderwood, Willie Campbell, Di Clements, Robert Craig, Christine Kelsall, Willie Purdie and Mike Smith and the Council chair is Sean Rickard.

The Council meets formally on a quarterly basis when it receives a report from the board on performance of the business against strategic objectives and deals with other matters within its remit. The Council receives monthly information with regard to business performance. The board also consults the Council as appropriate on matters affecting members.

Board

The role of the board of First Milk Limited is to set strategy and ensure that the business is effectively and efficiently managed and controlled. In particular, the board is responsible for:

- Determining the strategy of the Society (subject to its approval by the Council);
- Making recommendations for strategic acquisitions and disposals (subject to approval by the Council and where appropriate, the members);
- Overseeing the business of the Society in accordance with the strategy;
- Motivating and retaining the executive management;
- Holding the executive management to account;
- Ensuring adequate succession planning
- Overseeing a risk and internal audit framework;
- Setting the milk price paid to members;
- Setting capital targets (subject to Council approval)
- Approving the business for the AGM;

In terms of the Rules, the board comprises seven members and is structured to bring a variety of skills and experience to the performance of its roles. It comprises:

- A chair and two other independent non-executive directors who bring experience from diverse backgrounds;
- Two farmer directors
- Two executive directors, currently the chief executive and the chief operating officer.

The two farmer directors were appointed following a selection process. As with the Council selection process noted above, candidates were assessed against set criteria and the selection process included the involvement of an independent advisor.

The board currently comprises six directors. This is due to Brian Mackie, having been appointed as a non-executive director in June 2015, moving to an executive role (as chief operating officer) in October 2015. It is envisaged that he will move back to a non-executive role in due course. The board decided not to appoint another non-executive director in the meantime.

As with the Council, all director appointments are subject to ratification by members at the 2016 AGM. In future years directors will retire by rotation each year and may be eligible for re-appointment.

Corporate Governance Report (continued)

Other directorships held by directors of First Milk are noted below:

Director	External Appointments
Clive Sharpe	Peters Foods Limited Peters Foods Holdings Limited Janan Meats Limited Sharpe Associates Limited TC3 Mobile Ltd
Nigel Evans	UK Weir Castle Ltd Cherry Orchard Homes Ltd Celtic Shire Property Ltd Aberavon Properties LLP Evanridge LLP Evanridge Properties LLP Evanridge Founder Partner LLP Evanridge Founder Shareholder LLP Evanridge Trustee LLP Sweden Evanridge Sweden AB Evanridge Sweden 3 AB
Jim Baird	Auchnotroch Wind Energy Limited
Mike Gallacher	Fast Forward FFW Limited*
Carl Ravenhall	CER Business Consultancy Limited
Brian Mackie	First Milk Energy Limited* The Scottish Milk Limited Retirement Benefits Plan* (trustee)
	*denotes office held as nominated First Milk director/trustee

The Board has eleven scheduled meetings each year, and meets at other times as required. At each meeting, it receives reports which enable it to review the Group's performance. In addition to financial, commercial and operational information and regular reports on safety, health and environment, the Board considers strategic matters and other issues that affect members' interests.

The board and committee meetings held in the year to 31 March 2016 and director attendance at each meeting was as follows:

	2015									2016		
	22/4	**15/5**	**15/6**	**2/7**	**29/7**	**24/8**	**24/9**	**28/10**	**2/12**	**27/1**	**24/2**	**30/3**
Clive Sharpe	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	yes	yes	yes
Sir Jim Paice	yes	yes	yes	yes	yes	yes	yes	yes	n/a	n/a	n/a	n/a
Nigel Evans	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
Jim Baird	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
Willie Campbell	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	n/a	n/a
Robert Craig	n/a	n/a	n/a	n/a	n/a	n/a	n/a	yes	yes	yes	n/a	n/a
Richard Davis	yes	yes	yes	yes	yes	yes	yes	yes	n/a	n/a	n/a	n/a
Wendy Radley	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	n/a	n/a
Carl Ravenhall	n/a	n/a	n/a	n/a	n/a	n/a	n/a	yes	yes	yes	yes	yes
Gerard Sweeney	yes	yes	no	yes	yes	yes	no	n/a	n/a	n/a	n/a	n/a
Mike Gallacher	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	no
Brian Mackie	n/a	n/a	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes

AUDIT, FINANCE AND RISK COMMITTEE

	2015			2016
	29/7	**24/8**	**28/10**	**24/2**
Brian Mackie (1)	yes	yes	n/a	n/a
Nigel Evans	yes	yes	yes	yes
Jim Baird	yes	yes	yes	yes
Carl Ravenhall	n/a	n/a	yes	yes

(1) Ceased to be a member of the committee on appointment to an executive role

Corporate Governance Report (continued)

NOMINATION AND REMUNERATION COMMITTEE

	2015		2016	
	24/8	**2/10**	**24/2**	**30/3**
Nigel Evans	yes	yes	yes	yes
Sir Jim Paice	yes	yes	n/a	n/a
Brian Mackie (1)	yes	yes	n/a	n/a
Carl Ravenhall	n/a	n/a	yes	yes
Clive Sharpe	n/a	n/a	yes	no

(1) Ceased to be a member of the committee on appointment to an executive role

The implementation of strategy and day-to-day operational matters are delegated to First Milk's Leadership Team, which operates under terms of reference set by the Board. However the matters for which the board is responsible, as noted above, are reserved to the board. The Leadership Team is led by Mike Gallacher (chief executive), who reports to the Board on its activities, and also consists of Brian Mackie (chief operating officer), Owen Shearer (finance director), Kenny Bain (group operations director), Paul Flanagan (membership and external relations director), Greg Jardine (commercial director), Maureen Ross (HR and corporate services director), and Angus Waugh (secretary).

In order to be able to devote sufficient time to strategic issues, the Board delegates certain tasks to its standing committees, which operate under set terms of reference. Each committee comprises non-executive directors only.

First Milk's board committee structure comprises the following committees:

Audit, Finance and Risk Committee
The Audit, Finance and Risk Committee is chaired by Jim Baird on an interim basis and also comprises Nigel Evans and Carl Ravenhall. Jim Baird has chaired the committee since September 2015 following Brian Mackie's move to an executive role.

The committee's roles include overseeing the annual external audit, the annual internal audit plan, reviewing the effectiveness of internal controls and risk management and monitoring First Milk's budget process, ongoing forecasts of financial performance and capital requirements. A report on the activities of the Audit, Finance and Risk Committee can be found on page 12.

Nomination and Remuneration Committee
The Nomination and Remuneration Committee is chaired by Carl Ravenhall and also comprises Clive Sharpe and Nigel Evans.

Its roles include identifying and nominating, for Board approval, candidates for Board vacancies, considering succession planning and the structure, size and composition of the Board and approving remuneration policies for the First Milk Group and specific remuneration packages for senior executives.

In the year to 31 March 2016, the Committee (with different composition through the year) led the process for appointing new non-executive directors and the chairman. The committee used professional search agencies to assist with these appointments as appropriate after considering the requirements of the role in question and the knowledge, skills and experience required of the persons to be appointed. Under the new governance structure, the Council will, in consultation with the board, approve the nomination process for non-executive directors and will recommend candidates for the roles of chair and vice-chair of the board for election by members at the Annual General Meeting.

A Remuneration report can be found on page 14.

Sustainability Committee
The Sustainability committee's role is to review First Milk's compliance with legal requirements on health & safety, environment and employment matters and to review and approve First Milk's Health and Safety strategy.

Board and Council Training and Evaluation
First Milk's Rules provide that the board and the chair of Council must ensure that a formal and rigorous evaluation of the board and Council's performance takes place annually. This evaluation must include a review of working practices, information flows, the interaction between the Council and the board and must make recommendations for developmental requirements that arise from the evaluation.

Individual performance and development reviews for the chairman and other directors took place in August and it is intended that the annual evaluation of the board's and Council's performance will take place towards the end of the first year of operation of the new governance structure.

Newly appointed directors and Council members go through a comprehensive induction process. The Board also receives periodic training as a group on areas such as health & safety and directors' general legal duties.

Corporate Governance Report (continued)

First Milk's compliance with the Corporate Governance Code for Agricultural Co-operatives

The code operates on a "comply or explain" basis, meaning that its provisions are not binding but that an organisation that has adopted the Code should provide an explanation if it does not comply with a particular provision of the Code.

The board of First Milk monitors it compliance with the Code and is compliant with all its provisions under exception of the following:

Code Provision 60 recommends that in order to safeguard the democratic status of the board, a co-operative should ensure that external (non-member) directors and management directors should not exceed 49% of the board.
Under new the governance structure approved by members on 1 December 2015, external members comprise two of the seven board positions (although at present one of the non-executive director positions is not filled, as noted above). However First Milk's democratic status is safeguarded by the member Council having substantial powers as noted above.

Code Provision 65 states that the board should appoint, from its own number, a chair and at least one vice chair.
Under the new governance structure, candidates for the roles of chair and vice chair are recommended by the Council for election by members at the Annual General Meeting.

Code provision 78 states that the secretary's main reporting line should be to the board.
First Milk's Secretary reports to both the board and the chief executive due to his additional roles of general counsel, administration of member capital and provision of secretariat support to the Leadership Team.

For and on behalf of the Board

Angus Waugh
Secretary
26 October 2016

Audit, Finance and Risk Committee Report

The Board has overall responsibility for internal controls, including the scope of both external and internal audits, the management of risk and financial matters. It delegates these tasks to the Audit, Finance and Risk Committee under agreed terms of reference.

External Audit

The Audit, Finance and Risk Committee meets with the external audit firm at least twice in the course of the year, first to review the scope of the external audit plan and then to receive and discuss the audit report and financial statements. The Committee also makes recommendations on the appointment of the external auditors, the fees payable for work carried out by the audit firm and reports to the Board in respect of non-audit services carried out by the auditors. In considering all of the above, the Committee has due regard to the cost effectiveness, independence and objectivity of the audit function.

PricewaterhouseCoopers LLP was re-appointed by members as First Milk's external auditors at the Annual General Meeting in October 2015. Their report on the financial statements can be found on pages 14 and 15.

The Committee undertook a tendering process for the internal audit in 2016 and on its advice, the board agreed to recommend to members that Deloitte LLP be appointed as First Milk's external auditors with effect from the year to 31 March 2017. The Committee would like to express its thanks to PricewaterhouseCoopers LLP, who have served as auditor since 2007.

Risk and controls

The Audit, Finance and Risk Committee monitors internal control procedures and reviews their effectiveness on an on-going basis. There are inherent limitations in any system of internal control, which can provide only reasonable, and not absolute, assurance with respect to the preparation of financial information and the safeguarding of assets.

The key features of the internal control system that operated throughout the year covered by the financial statements are:

- A control environment based on a clearly defined organisational structure;
- The identification and evaluation of business risk, control actions and monitoring activities to manage risk and establish priorities for the allocation of resources;
- The operation of control procedures covering financial transactions, verification and reconciliation procedures, commitment and authorisation limits, asset recording and protection; and
- A monitoring process particularly through the operating plan, forecast review and trading reporting processes, which highlights the key business performance indicators, risks and significant variances from expectations.

The Audit, Finance and Risk Committee and the Board review the key risk areas and relevant controls to ensure that, as far as possible, controls are being operated in line with the established procedures. Risks are monitored through the maintenance and review of a risk register that identifies the key risks faced by the business and actions to control and reduce these risks. On an on-going basis, steps are taken to deal with areas of improvement which come to the attention of management and the Board.

The internal auditors, KPMG LLP, review specific areas of the business as agreed in consultation with management and the Audit, Finance and Risk Committee. Reviews of key risk areas and relevant controls across the Group are carried out and reported to the Committee together with any recommendations for improvements.

Budget process, forecasts, financial performance and capital requirements

Under Terms of Reference approved by the Board, the Audit, Finance and Risk Committee also reviews and monitors First Milk's budget process, on-going forecasts of financial performance, capital requirements and pension matters. Although the Board retains primary responsibility for these matters, the committee is able to give detailed consideration to such matters and report to the Board on key issues.

For and on behalf of the Audit, Finance and Risk Committee

Jim Baird
Chairman of the Audit, Finance and Risk Committee
26 October 2016

Remuneration Report

The Board has overall responsibility, subject to Council approval, for both executive and non-executive directors' remuneration within First Milk Limited and has delegated its duties relating to their remuneration to the Nomination and Remuneration Committee under agreed terms of reference. The Nomination and Remuneration Committee sets the remuneration of Council members.

Executive Remuneration

The following principles are applied to executive remuneration within First Milk:

- Total remuneration for all executives should be sufficiently market competitive in total annual cash terms to attract and retain the calibre of executive required, bearing in mind that this must also reflect the nature and purpose of First Milk Limited as a member owned co-operative;
- The overall remuneration policy is to operate a clear, consistent and easy to communicate remuneration structure based around competitive salaries and a bonus scheme that rewards excellent corporate and individual performance. In particular the bonus scheme must take account of the absence of any share option scheme. The bonus scheme must also align the interests of employees with that of members of First Milk. This is achieved by basing a significant proportion of the rewards potentially payable under the scheme on improvements in First Milk's milk price relative to the published milk prices of other milk buyers.

These principles apply to executives across the Group.

Details of the remuneration of the Chief Executive and Group Finance Director/Chief Operating Officer in the years to 31 March 2016 and 31 March 2015 can be found in note 6 to the financial statements.

All employees of the Group are given the opportunity to participate in a defined contribution pension scheme. First Milk Limited participates in the Scottish Milk Limited Retirement Benefits Plan and the Milk Pension Fund, both of which are defined benefit schemes and closed to future accrual.

Non-executive Remuneration

The Nomination and Remuneration Committee regularly reviews the fees of non-executive directors to ensure that the level of fees paid is appropriate for the duties, responsibilities and time commitment of directors. These reviews also ensure that non-executive directors' fees are not out of step with fees paid in comparable businesses.

Currently the annual fees paid to the non-executive chairman and other non-executive directors of First Milk are £90,000 and £35,000, respectively.

The vice-chairman, who is also a farmer director, receives a total annual fee of £60,000, comprising the fee paid to other non-executive directors and a further £25,000 to reflect the additional time commitment required.

In the year to 31 March 2016, Carl Ravenhall carried out work in addition to his director's duties and £36,000 was paid to him for consultancy services in addition to his remuneration as a director.

No changes to the fees currently paid to the chairman, the vice-chairman, the other non-executive directors and council members are proposed at present. However the level of these fees will be kept under review and appropriate benchmarking of fees will be undertaken.

For and on behalf of the
Nomination and Remuneration Committee

Carl Ravenhall
Chairman of the Nomination and Remuneration Committee
26 October 2016

Independent Auditor's Report to the Members of First Milk Limited

Report on the Financial Statements

Our opinion

In our opinion, First Milk Limited's Group financial statements and Society financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and of the Society's affairs as at 31 March 2016 and of the Group's loss, the Society's profit and the Group's and the Society's cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Co-operative and Community Benefit Societies Act 2014.

Emphasis of matter – Going Concern

In forming our opinion on the Group's and the Society's financial statements, which is not modified, we have considered the adequacy of the disclosures made in note 1 to the financial statements concerning the Group's and the Society's ability to continue as a going concern. The Group incurred a loss of £5.1 million during the year ended 31 March 2016. Additionally, the Group's and the Society's bank facilities are repayable on demand and currently expire on 1 February 2017. As set out in the directors' report and note 1 to the financial statements, the ability of the Group and the Society to realise their assets and discharge their liabilities in the normal course of business is dependent upon the adequacy of the bank facilities and the continued support of their lenders, achievement of forecast financial performance and securing financing for the period beyond the expiry of the current facility. These conditions, along with the other matters explained in note 1 to the financial statements, indicate the existence of a material uncertainty which may cast significant doubt about the Group's and the Society's ability to continue as a going concern. The Group's and the Society's financial statements do not include the adjustments that would result if the Group and the Society were unable to continue as a going concern.

What we have audited

The financial statements, included within the Annual Report, comprise:

- the Group and the Society balance sheets as at 31 March 2016;
- the Group and the Society profit and loss accounts for the year then ended;
- the Group and the Society statements of cash flows for the year then ended;
- the Group and the Society statements of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation is United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice), and applicable law.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example, in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Other matters on which we are required to report by exception

Adequacy of accounting records, system of internal control and information and explanations received

Under the Co-operative and Community Benefit Societies Act 2014 we are required to report to you if, in our opinion:

- a satisfactory system of control over transactions has not been maintained; or
- we have not received all the information and explanations we require for our audit; or
- proper accounting records have not been kept by the Society; or
- the Society's financial statements are not in agreement with the accounting records.

We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of the Directors' Responsibilities set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the members of First Milk Limited as a body in accordance with Section 87 (2) of the Co-operative and Community Benefit Societies Act 2014 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Independent Auditor's Report to the Members of First Milk Limited (continued)

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and the Society's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Mark Hoskyns-Abrahall (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Glasgow
26 October 2016

(a) The maintenance and integrity of the First Milk Limited website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the annual accounts since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of annual accounts may differ from legislation in other jurisdictions.

Profit and Loss Accounts for the year ended 31 March 2016

	Note	2016 Group £'000	2016 Society £'000	2015 Group £'000	2015 Society £'000
Turnover - continuing operations	2	294,232	228,847	460,087	384,565
Less: share of joint ventures' turnover		(2,781)	-	(17,895)	-
Total turnover		291,451	228,847	442,192	384,565
Cost of sales	3	(274,669)	(211,258)	(454,016)	(378,880)
Gross profit/(loss)		16,782	17,589	(11,824)	5,685
Administrative expenses					
- Recurring	4	(10,748)	(5,865)	(10,255)	(12,154)
- Exceptional items		(5,104)	(2,387)	(1,371)	(45,785)
		(15,852)	(8,252)	(11,626)	(57,939)
Operating profit/(loss)					
- Continuing operations	5	930	9,337	(23,450)	(52,254)
Share of operating (loss)/profit in joint ventures					
- Continuing operations		(501)	-	634	-
- Discontinued operations		150	150	-	-
Profit/(loss) before interest		579	9,487	(22,816)	(52,254)
Finance income	8	26	24	526	873
Finance costs	9	(4,044)	(1,953)	(3,252)	(810)
(Loss)/profit on ordinary activities before taxation		(3,439)	7,558	(25,542)	(52,191)
Tax on (loss)/profit on ordinary activities	10	(1,687)	(1,687)	(2,552)	(1,157)
(Loss)/profit for the financial year		(5,126)	5,871	(28,094)	(53,348)

Statements of other comprehensive income for the year ended 31 March 2016

	Note	2016 Group £'000	2016 Society £'000	2015 Group £'000	2015 Society £'000
(Loss)/profit for the financial year:					
Group/Society		(4,775)	5,721	(28,728)	(53,348)
Associates and joint ventures		(351)	150	634	-
		(5,126)	5,871	(28,094)	(53,348)
Other comprehensive income:					
Actuarial gain/(loss) relating to the pension schemes	24	8,933	8,933	(10,391)	(10,391)
UK deferred tax attributable to actuarial gain/(loss)		(1,943)	(1,943)	2,078	2,078
Other comprehensive income/(expense) for the year net of tax		6,990	6,990	(8,313)	(8,313)
Total comprehensive income/(expense) for the year		1,864	12,861	(36,407)	(61,661)

Balance Sheets as at 31 March 2016

	Note	2016			2015		
			Group £'000	Society £'000		Group £'000	Society £'000
Fixed Assets							
Intangible fixed assets	11		-	-		2,573	-
Property, plant and equipment	12		33,078	398		33,855	966
Investments in subsidiary undertakings	13		-	34,523		-	34,523
Investments in joint ventures:	13		-	826		-	1,282
Share of gross assets		2,064			7,978		
Share of gross liabilities		(1,981)	83	-	(5,851)	2,127	-
Total fixed assets			33,161	35,747		38,555	36,771
Current assets							
Inventories	14		37,296	95		58,693	370
Trade and other receivables	15		28,447	39,487		48,901	46,167
Cash and cash equivalents			350	111		390	-
			66,093	39,693		107,984	46,537
Trade and other payables amounts falling due within one year	16		(70,325)	(33,204)		(113,135)	(47,496)
Net current (liabilties)/assets			(4,232)	6,489		(5,151)	(959)
Total assets less current liabilities			28,929	42,236		33,404	35,812
Trade and other payables amounts falling due after more than one year	17		(2,928)	(2,174)		(2,811)	(2,155)
Provisions for liabilities and charges	20		(833)	(833)		(22)	(22)
Total net assets employed excluding pension liability			25,168	39,229		30,571	33,635
Pension liability	24		(7,802)	(7,802)		(25,170)	(25,170)
Net assets			17,366	31,427		5,401	8,465
Capital and reserves							
Share capital	22		8,616	8,616		8,656	8,656
Profit and loss reserve			(52,555)	(38,494)		(54,419)	(51,355)
Revaluation reserve			-	-		52	52
Members' funds			(43,939)	(29,878)		(45,711)	(42,647)
Loan Capital	22		61,305	61,305		51,112	51,112
Total capital and reserves			17,366	31,427		5,401	8,465

The financial statements on pages 18 to 51 were approved by the Board of Directors on 26 October 2016 and signed on its behalf by:

Clive Sharpe – Chairman

Brian Mackie – Director

Group Statement of Change in Equity for the Year Ended 31 March 2016

	Note	Share Capital £'000	Income & Expenditure £'000	Revaluation Reserve £'000	Loan Capital £'000	Total £'000
Balance as at 1 April 2014		8,656	(16,676)	52	43,955	35,987
Loss for the financial year		-	(28,094)	-	-	(28,094)
Other comprehensive income for the year:						
Actuarial loss relating to the pension schemes	24	-	(10,391)	-	-	(10,391)
UK deferred tax attributable to the actuarial loss		-	2,078	-	-	2,078
Total comprehensive expense for the year		-	(36,407)	-	-	(36,407)
Return on loan capital		-	(1,336)	-	-	(1,336)
Repayments during year		-	-	-	(2,806)	(2,806)
Transfer of 'B' preference shares to debentures		-	-	-	(34)	(34)
(members contributions)		-	-	-	9,997	9,997
Total transactions with owners recognised in capital		-	(1,336)	-	7,157	5,821
Balance as at 31 March 2015		8,656	(54,419)	52	51,112	5,401
Loss for the financial year		-	(5,126)	-	-	(5,126)
Other comprehensive income for the year:						
Actuarial gain relating to the pension schemes		-	8,933	-	-	8,933
UK deferred tax attributable to actuarial gain		-	(1,943)	-	-	(1,943)
Release of revaluation reserve		-	-	(52)	-	(52)
Shares cancelled		(40)	-	-	-	(40)
Total comprehensive income for the year		(40)	1,864	(52)	-	1,772
Transfer of 'B' preference shares to debentures		-	-	-	(20)	(20)
Increase in year (member contributions)		-	-	-	10,213	10,213
Total transactions with owners' recognised directly in capital		-	-	-	10,193	10,193
Balance as at 31 March 2016		**8,616**	**(52,555)**	**-**	**61,305**	**17,366**

Society Statement of Changes in Equity for the Year Ended 31 March 2016

	Note	Share Capital £'000	Income & Expenditure £'000	Revaluation Reserve £'000	Loan Capital £'000	Total capital and reserves £'000
Balance as at 1 April 2014		8,656	11,642	52	43,955	64,305
Loss for the financial year		-	(53,348)	-	-	(53,348)
Other comprehensive income for the year:						
Actuarial loss relating to the pension schemes	24	-	(10,391)	-	-	(10,391)
UK deferred tax attributable to the actuarial loss		-	2,078	-	-	2,078
Total comprehensive expense for the year		-	(61,661)	-	-	(61,661)
Return on loan capital		-	(1,336)	-	-	(1,336)
Repayments during year		-	-	-	(2,806)	(2,806)
Transfer of 'B' preference shares to debentures		-	-	-	(34)	(34)
Increase in year (member contributions)		-	-	-	9,997	9,997
Total transactions with owners recognised in capital		-	(1,336)	-	7,157	5,821
Balance as at 31 March 2015		8,656	(51,355)	52	51,112	8,465
Profit for the financial year		-	5,871	-	-	5,871
Other comprehensive income for the year						
Actuarial gain relating to the pension schemes	24	-	8,933	-	-	8,933
UK deferred tax attributable to actuarial gain		-	(1,943)	-	-	(1,943)
Release of revaluation reserve		-	-	(52)	-	(52)
Shares cancelled		(40)	-	-	-	(40)
Total comprehensive income for the year		(40)	12,861	(52)	-	12,769
Transfer of 'B' preference shares to debentures		-	-	-	(20)	(20)
Increase in year (member contributions)		-	-	-	10,213	10,213
Total transactions with owners' recognised directly in capital		-	-	-	10,193	10,193
Balance as at 31 March 2016		**8,616**	**(38,494)**	**0**	**61,305**	**31,427**

Statements of Cash Flows for the Year Ended 31 March 2016

	Note	2016 Group £'000	2016 Society £'000	2015 Group £'000	2015 Society £'000
Net cash from operating activities	23	24,104	(6,098)	(391)	(170)
Taxation paid		-	-	-	-
Net cash generated from/(used in) operating activities		24,104	(6,098)	(391)	(170)
Cash flow from investing activities					
Finance income		26	24	26	373
Purchase of property, plant and equipment		(4,827)	(23)	(5,364)	(335)
Movement in investment in joint ventures		1,693	606		
Proceeds from sale of property, plant and equipment		1,357	295	1,485	-
Sale of intangible assets		-	-	2,000	-
Net cash generated from / (used in) investing activities		(1,751)	902	(1,853)	38
Cash from financing activities					
Finance costs		(2,737)	(646)	(2,969)	(810)
Return of members' capital		-	-	(443)	(443)
Net proceeds from members		10,101	10,101	7,191	7,191
Repayment of loans		(28,316)	(2,707)	(2,713)	(6,998)
Movement in loans with joint ventures		982	982	820	820
Pension contributions		(2,442)	(2,442)	-	-
Increase in debt facilities		19	19	34	34
Net cash generated (used in) / from financing activities		(22,393)	5,307	1,920	(206)
Net (decrease) / increase in cash and cash equivalents		(40)	111	(324)	(338)
Cash and cash equivalents at the beginning of the year		390	-	714	338
Cash and cash equivalants at the end of the year		350	111	390	-
Cash and cash equivalents consists of:					
Cash		350	111	390	-
Short term deposits		-	-	-	-
Cash and cash equivalents		350	111	390	-

1. Accounting Policies

General Information

First Milk Limited is a dairy farmers' co-operative registered under the Co-operative and Community Benefit Societies Act 2014 and is incorporated in Scotland. The registered office is Cirrus House, Glasgow Airport Business Park, Marchburn Drive, Paisley, PA3 2SJ.

The principal activities of the Group and Society are the marketing of milk on behalf of its members and the manufacture and sale of dairy and lifestyle nutritional products.

Statement of compliance

The Group and individual financial statements of First Milk Limited have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, ''The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland'' (''FRS 102'') and in accordance with the Co-operative and Community Benefit Societies Act 2014 and the Co-operative and Community Benefit Societies (Group Accounts) Regulations 1969.

Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated and separate financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

These consolidated and parent company financial statements have been prepared, on the going concern basis, under the historical cost convention, modified to include the revaluation of certain fixed assets, and in accordance with applicable United Kingdom Accounting Standards. The financial statements have been prepared in accordance with the Co-operative and Community Benefit Societies Act 2014 and the Co-operative and Community Benefit Societies (Group Accounts) Regulations 1969. This is the first year in which the financial statements have been prepared under FRS 102. The date of transition to FRS 102 was 1 April 2014. Details of the transition to FRS 102 are disclosed in Note 27.

The preparation of financial statements in conformity with FRS 102 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Society's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in 'Critical accounting judgements and key source of estimation uncertainty' section of this note.

Going Concern

The consolidated financial statements have been prepared on a going concern basis.

Current Trading and Borrowings

Substantial losses were incurred in the year to 31 March 2015, but the trading results of the Group have significantly improved in the year to 31 March 2016. The Group's operating profit before exceptional items improved by £28.1million compared to the previous year, to a profit of £6.0million. The loss for the year after tax was £5.1million after net exceptional charges of £5.1 million, which included £7.1million exceptional cash costs off-set by £2.0 million non-cash net gains (see note 4). The Group's trading position before exceptional items was profitable and this trend has continued into the current year. The Group's net bank debt reduced significantly from £60.3million to £32.1million during the year, and has further reduced to £26.1million as at 30th September 2016.

Existing Funding

The business is financed through a combination of members' capital contributions and bank facilities. Members' capital contributions are collected through the retention of 0.5 pence per litre from each member's milk payment until they reach their capital target. On 1 January 2015 the members' capital target was increased to 7.0 pence per litre, based on an average annual volume over three years, an increase from 5.0 pence per litre. The monthly capital retention was increased from 0.5 pence per litre to 2.0 pence per litre between January and August 2015, but has reverted to 0.5 pence per litre since September 2015. In the financial year members' capital contributions totalled £10.2 million.

On 3 August 2016, the board exercised its power under the Rules to convert all loan capital accounts, B preference shares and debentures held by members and former members, totalling £63.5 million, into equity in the form of C Preference Shares. This conversion has improved the financial position of the Society in that it removes future repayments of capital to former members, and designates all member capital as permanent capital.

Following successful negotiations with our bank lenders the Group's borrowing facilities were further extended to 1 February 2017. These facilities are secured by fixed securities over certain Group assets, a floating charge over Scottish Milk Products Limited and a debenture over First Milk Limited and The First Milk Cheese Company Limited. There are no financial covenants applicable to the facilities which are repayable on demand. The maximum facility available to the Group is £70million, with the amount available at any time depending on the value of stock and debtors and is based on a percentage draw-down specified in the facility agreement. The amount available from the facility at 30 September 2016 was £33.8 million (31 March 2016: £38.7m). In addition to the facility there is a term loan based on fixed asset values which at 30 September 2016 was £522k (31 March 2016: £909k). The Board's forecasts show that there would be adequate headroom within this level of bank facilities over the next year, (assuming they are extended on current terms beyond February 2017), these forecasts include an intention to continue to implement above-market increases in milk prices paid to members, which is ultimately a discretionary choice. However these milk price increases have been implemented at a faster rate than the Board's original forecast, as a result of higher available liquidity headroom than originally forecast. Discussions are currently under way for the renewal of the bank facilities and the Directors believe that they will be successfully concluded by 1 February 2017.

Accounting Policies (continued)

Going Concern (continued)

Forecasts

The Board has undertaken a thorough review of the Group's forecasts and associated risks. These forecasts extend for a period beyond one year from the date of approval of these financial statements. The forecasts make key assumptions based on information available to the directors at the time of the approval of these financial statements that:

- the price paid for milk supplies and other costs will fluctuate with returns available to the business to ensure the projected profitability is achieved;
- there is no material diminution in the bank facilities available to the Group as a result of the market value of stock falling, given this is a factor in establishing the amount of the borrowing facilities available to the Group, or other adverse working capital movements;
- the lenders will not seek early repayment of the existing facility and will continue to make it available to the Group; and
- the existing bank facilities will be extended or renewed from February 2017 and similar and sufficient facilities will be available to the Group for at least one year from the date of the approval of these accounts; and
- key customer and supplier contracts continue as per their existing commercial arrangements over the contractually agreed periods.

The directors have based their conclusions regarding going concern upon these forecasts.

Conclusion on Going Concern

At the date of these financial statements, the directors consider that, based upon the financial projections and the ability of the Society to maintain adequate banking facilities prior to the expiry of the current facility, the Group will have sufficient funding to continue as a going concern for at least the next twelve months although it is noted that the current funding is repayable on demand.

The directors have concluded that the dependency upon the continued support of its lenders from the date of these financial statements, the risk of not obtaining adequate debt facilities beyond February 2017 and the risk of not achieving the forecast performance, represent the existence of a material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. This may mean that the Group is unable to continue to realise its assets and discharge its liabilities in the normal course of business.

Nevertheless, after making enquiries and, in particular, considering the measures taken by the Group as set out above, the directors have a reasonable expectation that the Group will have adequate resources to continue in operational existence for the foreseeable future, and for this reason, they continue to adopt the going concern basis of accounting in preparing the annual financial statements. Accordingly, the directors consider it appropriate to prepare the financial statements on a going concern basis. The financial statements do not include the adjustments that would result if the Group was unable to continue as a going concern.

Exemptions for qualifying entities under FRS 102

FRS 102 allows a qualifying entity certain disclosure exemptions, if certain conditions, have been complied with, including notification of and no objection to, the use of exemptions by the Society's shareholders. A qualifying entity is defined as a member of a Group that prepares publicly available financial statements, which give a true and fair view, in which that member is consolidated. First Milk Limited can take exemptions in its standalone financial statements.

As a qualifying entity, the Society has taken advantage of the following exemptions:

i) from the requirement to present certain financial instrument disclosures, as required by sections 11 and 12 of FRS 102; and
ii) from the requirement to present a reconciliation of the number of shares outstanding at the beginning and end of the period as required by paragraph 4.12(a)(iv) of FRS 102.

Accounting Policies (continued)

Basis of Consolidation

The Group financial statements incorporate the financial statements of First Milk Limited and its subsidiary undertakings made up to 31 March 2016.

A subsidiary is an entity controlled by the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Where the Group owns less than 50% of the voting powers of an entity but controls the entity by virtue of an agreement with other investors which give it control of the financial and operating policies of the entity it accounts for that entity as a subsidiary.

Where a subsidiary has different accounting policies to the Group, adjustments are made to those subsidiary financial statements to apply the Group's accounting policies when preparing the consolidated financial statements.

A jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venture has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the ventures establishes joint control over the economic activity of the entity.

In the consolidated financial statements, shares in joint ventures are accounted for using the equity method. The consolidated income statement includes the Group's share of the pre-tax profits or losses and attributable taxation of the joint venture based on the latest available financial statements for these undertakings.

The Group's share of the net assets of these undertakings is shown in the consolidated balance sheet. The Group's share of joint venture revenue is included in total revenue in the income statement.

Any subsidiary undertakings sold or acquired during the year are included up to, or from, the dates of change of control.

Where control of a subsidiary is lost, the gain or loss is recognised in the consolidated income statement. The cumulative amounts of any exchange differences on translation, recognised in equity, are not included in the gain or loss on disposal and are transferred to Income and expenditure reserve. The gain or loss also includes amounts included in other comprehensive income that are required to be reclassified to profit or loss but excludes those amounts that are not required to be reclassified.

All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

Foreign currency

i) Functional and presentation currency

The Group financial statements are presented in pounds sterling and rounded to thousands.

The Society's functional and presentation currency is the pound sterling (£).

ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the spot exchange rates at the dates of the transactions.

At each period end foreign currency monetary items are translated using the closing rate. Non-monetary items measured at historical cost are translated using the exchange rate at the date of the transaction and non-monetary items measured at fair value are measured using the exchange rate when fair value was determined.

Foreign exchange gains and losses resulting from the settlement of transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the income statement within 'finance (expense)/ income'. All other foreign exchange gains and losses are presented in the income statement within 'Other operating (losses)/gains'.

Accounting Policies (continued)

Revenue recognition

Group and Society

Revenue, which is stated net of value added tax, represents amounts invoiced to third parties for goods or services supplied during the year, and is recognised on the sale of milk and other ingredients products at the point of collection and on dispatch of cheese. Revenue and operating surplus relate to the continuing operations of the Group and are all attributable to the principal business activity, being the marketing, manufacture and sale of milk, cheese and other dairy and lifestyle nutritional products.

Society

The revenue and operating surplus relate to continuing operations within the UK. For the Society, these include intra group transactions which are eliminated on consolidation in the Group figures.

Exceptional items

The Group classifies certainl non-recurring charges or credits that have a significant impact on the Group's financial results as 'exceptional items'. These are disclosed separately to provide further understanding of the financial performance of the Group.

Employee benefits

The Group provides a range of benefits to employees, including annual bonus arrangements, paid holiday arrangements and defined benefit and defined contribution pension plans.

i) Short term benefits

Short term benefits, including holiday pay and other similar non-monetary benefits, are recognised as an expense in the period in which the service is received.

ii) Defined contribution pension plans

The Group operates a defined contribution plan for its employees. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. Once the contributions have been paid the Group has no further payment obligations. The contributions are recognised as an expense when they are due. Amounts not paid are shown in accruals in the balance sheet. The assets of the plan are held separately from the Group in independently administered funds.

iii) Defined benefit pension plans

The Group operates two defined benefit plans for certain employees. A defined benefit plan defines the pension benefit that the employee will receive on retirement, usually dependent upon several factors including age, length of service and remuneration. A defined benefit plan is a pension plan that is not a defined contribution plan. Both plans are now closed to new members.

The liability recognised in the balance sheet in respect of each defined benefit plan is the present value of the defined benefit obligation at the end of the reporting date less the fair value of the plan assets at the reporting date.

The defined benefit obligation is calculated using the projected unit credit method. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The present value is determined by discounting the estimated future payments using market yields on high quality corporate bonds that are denominated in sterling and that have terms approximating the estimated period of the future payments ('discount rate').

The fair value of plan assets is measured in accordance with the FRS 102 fair value hierarchy and in accordance with the Society's policy for similarly held assets. This includes the use of appropriate valuation techniques.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income. These amounts together with the return on plan assets, less amounts included in net interest, are disclosed as 'Remeasurement of net defined benefit liability'.

The cost of the defined benefit plan, recognised in profit or loss as employee costs, except where included in the cost of an asset, comprises:

(a) the increase in pension benefit liability arising from employee service during the period; and

(b) the cost of plan introductions, benefit changes, curtailments and settlements.

The net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of plan assets. This cost is recognised in profit or loss as 'Finance expense'.

Accounting Policies (continued)

Taxation

Taxation expense for the period comprises current and deferred tax recognised in the reporting period. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case tax is also recognised in other comprehensive income or directly in equity respectively.

Current or deferred taxation assets and liabilities are not discounted.

i) Current tax

Current tax is the amount of income tax payable in respect of the taxable profit for the year or prior years. Tax is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the period end.

ii) Deferred tax

Deferred tax arises from timing differences that are differences between taxable profits and total comprehensive income as stated in the financial statements. These timing differences arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in financial statements.

Deferred tax is recognised on all timing differences at the reporting date except for certain exceptions. Unrelieved tax losses and other deferred tax assets are only recognised when it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

Deferred tax is measured using tax rates and laws that have been enacted or substantively enacted by the period end and that are expected to apply to the reversal of the timing difference.

Business combinations and goodwill

Business combinations are accounted for by applying the purchase method.

The cost of a business combination is the fair value of the consideration given, liabilities incurred or assumed and of equity instruments issued plus the costs directly attributable to the business combination. Where control is achieved in stages the cost is the consideration at the date of each transaction.

On acquisition of a business, fair values are attributed to the identifiable assets, liabilities and contingent liabilities unless the fair value cannot be measured reliably, in which case the value is incorporated in goodwill. Where the fair value of contingent liabilities cannot be reliably measured they are disclosed on the same basis as other contingent liabilities.

Goodwill recognised represents the excess of the fair value and directly attributable costs of the purchase consideration over the fair values to the Group's interest in the identifiable net assets, liabilities and contingent liabilities acquired.

On acquisition, goodwill is allocated to cash-generating units ('CGU's') that are expected to benefit from the combination.

Goodwill is amortised over its expected useful life. Where the Group is unable to make a reliable estimate of useful life, goodwill is amortised over a period not exceeding 5 years. Goodwill is assessed for impairment when there are indicators of impairment and any impairment is charged to the income statement. Reversals of impairment are recognised when the reasons for the impairment no longer apply.

The Group and the Society have taken transition exemption under paragraph 35.10(a) relating to business combinations that were effected before the transition date (1 April 2014) and have elected not to apply Section 19 Business Combinations and Goodwill to business combinations that were effected before its FRS 102 transition date.

Property, plant and equipment

All property, plant and equipment are stated at historical cost less accumulated depreciation and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance expenditures are charged to the income statement during the financial year in which they are incurred.

Depreciation is calculated to write off the cost or valuation of property, plant and equipment by equal annual instalments over their estimated useful lives.

The useful lives assumed for buildings vary between 20 and 50 years and for plant, equipment and vehicles between 4 and 15 years. Land is not depreciated.

Tangible assets are derecognised on disposal or when no future economic benefits are expected. On disposal, the difference between the net disposal proceeds and the carrying amount is recognised in profit or loss and included in 'Other operating (losses)/gains'.

Accounting Policies (continued)

Leases

At inception the Group assesses agreements that transfer the right to use assets. The assessment considers whether the arrangement is, or contains, a lease based on the substance of the arrangement.

i) Operating leased assets

Leases that do not transfer all the risk and rewards of ownership are classified as operating leases. Payments under operating leases are charged to the income statement on a straight line basis over the period of the lease.

ii) Lease incentives

Incentives received to enter into an operating lease are credited to the income statement, to reduce the lease expense, on a straight-line basis over the period of the lease.

Impairment of non-financial assets

At each balance sheet date non-financial assets not carried at fair value are assessed to determine whether there is an indication that the asset (or asset's cash generating unit) may be impaired. If there is such an indication the recoverable amount of the asset (or asset's cash generating unit) is compared to the carrying amount of the asset (or asset's cash generating unit).

The recoverable amount of the asset (or asset's cash generating unit) is the higher of the fair value less costs to sell and value in use. Value in use is defined as the present value of the future cash flows before interest and tax obtainable as a result of the asset's (or asset's cash generating unit) continued use. These cash flows are discounted using a pre-tax discount rate that represents the current market risk-free rate and the risks inherent in the asset.

If the recoverable amount of the asset (or asset's cash generating unit) is estimated to be lower than the carrying amount, the carrying amount is reduced to its recoverable amount. An impairment loss is recognised in the income statement, unless the asset has been revalued when the amount is recognised in other comprehensive income to the extent of any previously recognised revaluation. Thereafter any excess is recognised in profit or loss.

If an impairment loss is subsequently reversed, the carrying amount of the asset (or asset's cash generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the revised carrying amount does not exceed the carrying amount that would have been determined (net of depreciation or amortisation) had no impairment loss been recognised in prior periods. A reversal of an impairment loss is recognised in the income statement.

Goodwill is allocated on acquisition to the cash generating unit expected to benefit from the synergies of the combination. Goodwill is included in the carrying value of cash generating units for impairment testing.

Investments - Society

i) Investment in subsidiary company

Investment in a subsidiary company is held at cost less accumulated impairment losses.

ii) Investment in joint venture entities

Investment in joint venture entity is held at cost less accumulated impairment losses.

At each reporting date investments are assessed to determine whether there is an indication that the asset may be impaired. If there is such an indication the recoverable amount of the investments is compared to the carrying amount of the asset.

If the recoverable amount of the investments is estimated to be lower than the carrying amount, the carrying amount is reduced to its recoverable amount. An impairment loss is recognised in the income statement immediately.

The Society have taken advantage of the exemptions under paragraph 35.10(f) of FRS 102 in respect of investment in subsidiaries and jointly controlled entities on the date of transition to FRS 102 (1 April 2014) and continues to measure investment at their existing cost.

Government Grants

Government grants relating to property, plant and equipment are treated as deferred income and released to the profit and loss account over the expected useful lives of the assets concerned. Other grants are credited to the profit and loss account as the related expenditure is incurred.

Accounting Policies (continued)

Inventories
Inventories of milk are valued at the lower of cost and estimated selling price less costs to sell. Cost is the prevailing monthly payment for milk purchased. Inventories of cheese and other inventories are valued at the lower of cost and estimated selling price less cost to sell. Where applicable, cost includes direct costs, direct labour and an attributable proportion of manufacturing overheads based on normal levels of activity. Provision is made for obsolete, slow moving or defective items where appropriate.

Cost is determined on the basis of standard cost, adjusted for production and price variances.

At the end of each reporting period inventories are assessed for impairment. If an item of inventory is impaired, the identified inventory is reduced to its selling price less costs to complete and sell and an impairment charge is recognised in the income statement. Where a reversal of the impairment is required the impairment charge is reversed, up to the original impairment loss, and is recognised as a credit in the income statement.

Cash and cash equivalents
Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts, when applicable, are shown within borrowings in current liabilities.

Provisions
A provision is recognised when the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation; and the amount of the obligation can be estimated reliably. If the effect is material, expected future cash flows are discounted using a pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations might be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as a finance cost.

Financial Instruments
The Group has chosen to adopt sections 11 and 12 of FRS 102 in respect of financial instruments.

i) Financial assets

Basic financial assets, including trade and other receivables and cash and bank balances, are initially recognised at transaction price unless the arrangement constitutes a financing transaction, where the transaction is measured at the present value of the future receipts discounted at a market rate of interest.

Such assets are subsequently carried at amortised cost using the effective interest method where applicable.

At the end of each reporting period financial assets measured at amortised cost are assessed for objective evidence of impairment. If an asset is impaired the impairment loss is the difference between the carrying amount and the present value of the estimated cash flows discounted at the asset's original effective interest rate. The impairment loss is recognised in the profit or loss.

If there is decrease in the impairment loss arising from an event occurring after the impairment was recognised the impairment is reversed. The reversal is such that the current carrying amount does not exceed what the carrying amount would have been had the impairment not previously been recognised. The impairment reversal is recognised in profit or loss.

Financial assets are derecognised when (i) the contractual rights to the cash flows from the asset expire or are settled, or (ii) substantially all the risks and rewards of the ownership of the asset are transferred to another party or (iii) despite having retained some significant risks and rewards of ownership, control of the asset has been transferred to another party who has the practical ability to unilaterally sell the asset to an unrelated third party without imposing additional restrictions.

Accounting Policies (continued)

Financial Instruments (continued)

ii) Financial Liabilities

Basic financial liabilities, including trade and other payables and loans from fellow Group companies are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the debt instrument is measured at the present value of the future receipts discounted at a market rate of interest.

Debt instruments are subsequently carried at amortised cost, using the effective interest rate method.

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognised initially at transaction price and subsequently measured at amortised cost using the effective interest method.

Derivatives, including interest rate swaps and forward foreign exchange contracts, are not basic financial instruments.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Changes in the fair value of derivatives are recognised in profit or loss in finance costs or income as appropriate.

The Group does not currently apply hedge accounting for interest rate and foreign exchange derivatives.

Financial liabilities are derecognised when the liability is extinguished, that is when the contractual obligation is discharged, cancelled or expires.

iii) Offsetting

Financial assets and liabilities are offset and the net amount presented in the financial statements when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Critical accounting judgements and key source of estimation uncertainty

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the application of the accounting policies and the reported amounts of assets and liabilities, revenue and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are explained below.

i) Useful economic lives of property, plant and equipment

The annual depreciation charge for property, plant and equipment is sensitive to changes in the estimated useful economic lives and residual values of the assets. The useful economic lives and residual values are re-assessed annually. They are amended when necessary to reflect current estimates, based on technological advancement, future investments, economic utilisation and the physical condition of the assets. See note 12 for the carrying amount of the property, plant and equipment and accounting policy above for the useful economic lives for each class of assets.

ii) Inventory provisioning

The Group manufactures and sells dairy and lifestyle nutritional products and is subject to changing consumer demands. As a result it is necessary to consider the recoverability of the cost of inventory and the associated provisioning required. When calculating the inventory provision, management considers the nature and condition of the inventory, as well as applying assumptions around anticipated saleability of finished goods and future usage of raw materials. See note 14 for the net carrying amount of the inventory and associated provision.

iii) Impairment of trade and other receivables

The Group makes an estimate of the recoverable value of trade and other trade receivables. When assessing impairment of trade and other trade receivables, management considers factors including the current credit rating of the trade receivables, the ageing profile of trade receivables and historical experience. See note 15 for the net carrying amount of the trade and other receivables and associated impairment provision.

iv) Defined benefit pension scheme

The Society has an obligation to pay pension benefits to certain employees. The cost of these benefits and the present value of the obligation depend on a number of factors, including; life expectancy, salary increases, asset valuations and the discount rate on corporate bonds. Management estimates these factors in determining the net pension obligation in the balance sheet. The assumptions reflect historical experience and current trends. See note 20 for the disclosures relating to the defined benefit pension scheme.

2. Turnover

Group
Turnover, which is stated net of value added tax, represents amounts invoiced to third parties for goods or services supplied during the year, and is recognised on the sale of milk and other ingredients products at the point of collection and on dispatch of cheese. Turnover and operating surplus relate to the continuing operations of the Group and are all attributable to the principal business activity, being the marketing, manufacture and sale of milk, cheese and other dairy and lifestyle nutritional products.

The majority of turnover is to the UK with £41.2m (2015: £41.1m) being to Continental Europe. There were no sales to the rest of the world (2015: £213,000).

Society
The turnover and operating surplus relate to continuing operations within the UK and include intra group transactions which are eliminated on consolidation in the Group figures.

3. Cost of Sales

Cost of sales primarily includes payments made to members for milk supplied each month. These payments are made up of payments for compositional quality and hygienic quality adjustments and reflect deductions for milk collection charges. Cost of sales also includes the costs of ex-farm milk collection, distribution to customers and testing the milk for compositional and hygienic quality as well as costs of production of cheese and other dairy and lifestyle nutritional products.

Costs previously included in administration expenses in the 2015 financial statements, have been re-classed as cost of sales in order to more accurately reflect site manufacturing costs of production and ensure consistency across the group, as shown below:

Group	2015 £'000
Cost of sales	
As previously reported	446,170
Re-classification of administration expenses	7,846
As reported in these financial statements	454,016
Administration expenses - recurring	
As previously reported	17,494
Re-classification as cost of sales	(7,846)
Adjustment for fair value of derivatives upon transition to FRS102 (see note 27)	607
As reported in these financial statements	10,255

4. Exceptional items

The non-recurring items in the Group profit and loss account for 2016 of £5.104m comprise, professional fees of £1.553m , goodwill impairment of £1.669m relating to the CNP business, impairment of a loan to First Milk Energy Limited of £707k, redundancy costs of £666k, asset impairment and contractual termination costs of £8.071m in relation to the divestments of the soft cheese business and the Westbury joint venture, other sundry credits of £262k and a credit of £7.300m resulting from a change of the indexation basis of benefits in the Milk Fund pension scheme (note there is an offsetting deferred tax charge of £1.460m in relation to this, included in the tax charge in the profit and loss account).

The non-recurring items in the Group profit and loss account for 2015 of £1.371m comprise professional fees of £2.082m, goodwill impairment of £1.200m relating to the CNP business, impairment of a loan to First Milk Energy Limited of £598k, redundancy costs of £391k, and a credit of £2.900m (net of fees) relating to the sale of our UK customer base for hard cheese to Ornua Foods UK Limited.

4. Exceptional items - continued

The non-recurring items in the society Profit and Loss account for 2016 of £2.387m comprise professional fees £1.533m, impairment of a loan to First Milk Energy Limited of £707k, redundancy costs of £451k, asset impairment and contractual termination costs of £6.817m in relation to the divestments of the Westbury joint venture, other sundry costs of £179k and a credit of £7.300m resulting from a change of the indexation basis of benefits in the Milk Fund pension scheme (note there is an offsetting deferred tax charge of £1.460m in relation to this, included in the tax charge in the profit and loss account).

The non-recurring items in the society Profit and Loss account for 2015 of £45.785m comprise a provision for a £37.000m balance owed by a subsidiary undertaking reflective of the accumulated trading losses in that subsidiary, the write off of investments in subsidiary undertakings totalling £5.889m, professional fees of £2.082m associated with the work undertaken to review the financial position and prospects of the business and to secure appropriate funding, a write off of a loan with First Milk Energy Limited of £598k and restructuring and redundancy charges of £216k.

5. Operating profit /(loss)

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
Operating (deficit)/surplus is stated after charging/(crediting):				
Depreciation and impairment of property, plant and machinery	4,269	295	3,653	442
Goodwill amortisation	904	-	892	-
Impairment of goodwill	1,669	-	1,200	-
Write down of investment in subsidiary undertakings	-	-	-	5,889
Write down of balance due from First Milk Cheese Co. Limited	-	-	-	37,000
Write down of loan to First Milk Energy Limited	707	707	598	598
Asset impairment and contractual termination costs in relation to the divestment of the soft cheese business and Westbury joint venture	8,071	6,817	-	-
Pension fund change in indexation basis of benefits	(7,300)	(7,300)	-	-
Operating lease rentals	382	203	374	222
Auditors' remuneration:				
Audit Services:				
-audit of society and group financial statements	65	65	65	65
-audit of subsidiary companies	72	-	75	-
Non-Audit services:				
-tax services	42	42	33	33
-services relating to corporate finance transactions	1,190	1,190	773	773
-pension advisory services	20	20	-	-
Government grants released	(246)	-	(206)	-
(Gain)/loss on disposal of fixed assets	(22)	1	83	-

6. Directors' Remuneration

The executive directors are all employed by the Society and their remuneration, excluding pension contributions, was as follows:

	Salary £	Benefits in kind £	Bonuses £	2016 Total £	2015 Total £
Mike Gallacher	250,000	13,619	275,000	538,619	3,985
Brian Mackie (from 1 October 2015)	87,500	5,300	7,292	100,092	-
Gerard Sweeney (to 30 September 2015)	219,706	6,847	-	226,553	217,735
Kate Allum (to 31 March 2015)	-	-	-	-	331,738
	557,206	25,766	282,292	865,264	553,458

6. Directors' Remuneration - continued

The remuneration received by the non-executive and farmer elected and selected directors, who were all employed by the Society, was as follows:

	2016 £	2015 £
Sir Jim Paice (to 31 October 2015)	52,500	90,000
Clive Sharpe (from 1 February 2016)	15,000	-
Nigel Evans	60,000	60,000
Richard Davies (to 30 September 2015)	17,500	35,000
James Baird	35,000	35,000
Willie Campbell (to 31 January 2016)	29,167	35,000
Wendy Radley (to 31 January 2016)	29,167	35,000
Brian Mackie (from 15 June to 30 September 2015)	11,818	-
Carl Ravenhall (from 29 October 2015)	14,849	-
Robert Craig (from 29 October 2015 to 31 January 2016)	9,015	-
Bob Stott (to 31 December 2014)	-	26,250
	274,016	316,250

In the year to 31 March 2016 Carl Ravenhall carried out additional work in addition to his director's duties, and £36,000 was paid to him for consultancy services, in addition to his remuneration as a director disclosed in the table above.

The aggregate emoluments paid to directors in the year to 31st March 2016 were £1,139k (2015 £870k). No directors (2015: none) accrued benefits during the year under defined benefit pension schemes. Post employment benefits are accruing to one director (2015: three) under defined contribution pension schemes.

Key management includes the executive directors and members of the leadership team. The compensation paid or payable to key management for employee services is shown below:

	2016 £'000	2015 £'000
Leadership Team (excluding executive directors listed above)	851	526

7. Employee Information

Staff costs and the average monthly number of persons (including executive directors) employed by the Group and Society during the year was:

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
Staff costs				
Wages and salaries	12,136	3,928	14,536	3,963
Social security costs	1,215	454	1,438	497
Other pension costs	768	319	871	330
	14,119	4,701	16,845	4,790
Employee numbers	Number	Number	Number	Number
Selling and distribution	22	22	18	4
Administration	83	52	133	81
Production	261	-	279	-
	366	74	430	85

8. Finance income

	2016 Group £'000	2016 Society £'000	2015 Group £'000	2015 Society £'000
Interest on short-term deposits with banks	2	-	1	1
Interest from Joint Venture	24	24	25	25
Interest from subsidiary undertakings	-	-	-	347
Pension scheme finance income (note 24)	-	-	500	500
Total finance income on financial assets not measured at fair value through the profit and loss account	26	24	526	873
Gain on derivative financial instruments	168	168	-	-
Total finance income	194	192	526	873

9. Finance costs

	2016 Group £'000	2016 Society £'000	2015 Group £'000	2015 Society £'000
Bank loans, overdrafts and revolving credit facilities	2,737	646	2,946	787
Preference shares	-	-	5	5
Pension scheme finance cost (note 24)	1,307	1,307	283	-
Other	-	-	18	18
Total finance cost on financial liabilities not measured at fair value through the profit and loss account	4,044	1,953	3,252	810
Losses on derivative financial instruments	-	-	607	344
Total finance costs	4,044	1,953	3,859	1,154

10. Tax on (loss)/profit on ordinary activities

	2016 Group £'000	2016 Society £'000	2015 Group £'000	2015 Society £'000
Current tax				
Adjustments in respect of prior periods	-	-	-	-
Deferred tax				
Origination and reversal of temporary differences	1,687	1,687	3,214	1,283
Adjustments in respect of previous years	-	-	(521)	(77)
Effects of change in tax rates	-	-	(141)	(49)
Total deferred tax	1,687	1,687	2,552	1,157
Total tax per income statement	1,687	1,687	2,552	1,157

10. Tax on (loss)/profit on ordinary activities (continued)

Tax expense/(income) included in other comprehensive income:

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
Deferred tax current year charge/(credit)	1,943	1,943	(2,078)	(2,078)

The standard rate of tax for the year, based on the UK standard rate of corporation tax, is 20% (2015: 21%). The actual tax charge for the current and the previous year differs from the standard rate for the reasons set out in the following reconciliation:

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
(Deficit)/surplus on ordinary activities before tax	(3,193)	7,558	(25,542)	(52,191)
Tax credit/(charge) on loss on ordinary activities at standard rate of 20% (2015: 21%)	(639)	1,512	(5,364)	(10,960)
Expenses not deductible for tax purposes	1,696	548	932	8,512
Income not taxable	(59)	-	(507)	424
Deferred tax not provided	688	(373)	8,153	3,308
Adjustment in respect of prior years	-	-	(521)	(77)
Tax rate changes	-	-	(141)	(49)
Total tax charge	1,687	1,687	2,552	1,157

The UK corporation tax rate fell from 21% to 20%, effective from 1 April 2015.

In addition to this change in rate, further changes to the UK corporation tax system were announced in the July 2015 UK Budget statement. The main rate of corporation tax is to be reduced from 20% to 19% from 1 April 2017, and to 18% from 1 April 2020.

A further reduction of 1% in UK corporation tax rate effective from 1 April 2020 was announced in the March 2016 budget. This will reduce the main rate of corporation tax, previously announced from 18%, to 17%. The reduction to 17% was not enacted until after the year end, the rate used in these financial statements is therefore 18%.

11. Intangible Fixed Assets - Group

	2016 £'000	2015 £'000
Goodwill		
Cost/Valuation		
At 1 April 2015/2016	10,637	10,437
Additions	-	200
At 31 March 2016/2016	10,637	10,637
Accumulated amortisation and impairment		
At 1 April 2015/2016	8,064	5,972
Amortised in year	904	892
Impairment	1,669	1,200
At 31 March 2016/2015	10,637	8,064
Net book value		
At 31 March 2016/2015	-	2,573
At 31 March 2015/2016	2,573	4,465

The impairment charge in the year, of £1,669,000, reduces the value of goodwill to £NIL because the directors believe that the expected future cashflows from the acquired assets no longer support a value above the value of the tangible assets.

12. Property, plant and equipment - Group

	Freehold land and buildings £'000	Plant, equipment and vehicles owned £'000	leased £'000	Total £'000
Cost/Valuation				
At 1 April 2015	13,018	63,983	1,195	78,196
Additions	694	4,133	-	4,827
Disposals	(5,055)	(10,667)	(15)	(15,737)
At 31 March 2016	8,657	57,449	1,180	67,286
Accumulated depreciation				
At 1 April 2015	6,281	36,865	1,195	44,341
Charge for the year	666	3,603	-	4,269
Disposals	(3,776)	(10,611)	(15)	(14,402)
At 31 March 2016	3,171	29,857	1,180	34,208
Net book value				
At 31 March 2016	5,486	27,592	-	33,078
At 31 March 2015	6,737	27,118	-	33,855

There are no outstanding liabilities in respect of leased assets.

12. Property, plant and equipment – Society

	Freehold land and buildings	Plant, equipment and vehicles	Total
	£'000	£'000	£'000
Cost/Valuation			
At 1 April 2015	1,700	5,836	7,536
Additions		23	23
Disposals	(1,700)	(4,756)	(6,456)
At 31 March 2016	-	1,103	1,103
Accumulated depreciation			
At 1 April 2015	1,419	5,151	6,570
Charge for the year	2	293	295
Disposals	(1,421)	(4,739)	(6,160)
At 31 March 2016	-	705	705
Net book value			
At 31 March 2016	-	398	398
At 31 March 2015	281	685	966

Property, plant and vehicles amounting to £32.8m (2015: £33.5m) are pledged as security for bank borrowings.

Land and buildings of the Group and Society were valued on an open market basis at 31 October 1994. The Group has elected to adopt the transitional rules of FRS 102 for its revalued assets and consequently these valuations have not been updated. The land and buildings of the Society were disposed of in the year and consequently the historical cost net book value at 31 March 2016 was as follows:

	2016		2015	
	Group	Society	Group	Society
	£'000	£'000	£'000	£'000
Freehold land and buildings	7,093	-	7,588	495

13. Investments

Society	Shares in subsidiary undertakings	Investment in Joint Ventures	Total
	£'000	£'000	£'000
Cost			
At 1 April 2015	49,037	3,150	52,187
Additions	-	-	-
Disposals	-	(730)	(730)
At 31 March 2016	49,037	2,420	51,457
Provisions			
At 1 April 2015	14,514	1,868	16,382
Impairment	-	-	-
Disposals	-	(274)	(274)
At 31 March 2016	14,514	1,594	16,108
Net book value			
At 31 March 2016	34,523	826	35,349
At 31 March 2015	34,523	1,282	35,805

Details of the principal subsidiary undertakings in the Group at 31 March 2016 are as follows:

	Nature of business	Proportion of ordinary shares held
Scottish Milk Products Limited	Manufacture and sale of cheese	100%
Scottish Milk Dairies Limited	Non-trading	100%
The First Milk Cheese Company Limited	Manufacture and sale of cheese and other dairy and lifestyle nutritional products	100%
CNP Professional Limited (divested after year end - note 28)	Non-trading	100%
Kingdom Cheese Company Ltd	Dormant	100%
Kingdom Dairy Company Ltd	Dormant	100%
KCSUBCO 1 Limited	Dormant	100%

Details of the joint ventures in the Group at 31 March 2016 are as follows:

	Nature of business	Proportion of ordinary shares held
Fast Forward FFW Limited	Sale of whey products	49%
First Milk Energy Limited	Renewables	50%

All subsidiary undertakings and joint ventures are incorporated in the UK. The directors consider the value of investments to be supported by their underlying assets. A 59.3% investment in the Westbury Dairies Limited joint venture, held at 31st March 2015, was disposed of in the year.

14. Inventories

	2016 Group £'000	2016 Society £'000	2015 Group £'000	2015 Society £'000
Raw materials and consumables	3,460	-	4,360	-
Finished goods and goods for resale	33,836	95	54,333	370
	37,296	95	58,693	370

Inventory is valued on the basis of standard cost, adjusted for price and production cost variances.

The amount of inventory recognised as an expense during the year was £264m (2015: £419m) for the Group and £212m (2015: £379m) for the Society.

15. Trade and other receivables

	2016 Group £'000	2016 Society £'000	2015 Group £'000	2015 Society £'000
Due within one year:				
Trade receivables	23,534	7,566	34,357	10,316
Amounts owed by subsidiary undertakings	-	28,089	-	24,721
Amounts owed by joint ventures	1,226	1,226	2,208	2,208
Other recievables	974	763	3,432	3,185
Value added tax	427	-	1,159	485
Prepayments and accrued income	882	439	2,711	218
Deferred tax	1,404	1,404	5,034	5,034
	28,447	39,487	48,901	46,167

The directors consider that the carrying amount of trade and other receivables approximates to their fair value.

16. Trade and other payables: Amounts Falling Due Within One Year

	2016 Group £'000	2016 Society £'000	2015 Group £'000	2015 Society £'000
Bank loans and overdrafts (note 18)	32,413	5,297	60,729	8,004
Trade payables: amounts due to members	18,630	18,630	25,684	25,684
Trade payables: other	6,379	3,291	11,709	6,349
Amounts owed to subsidiary undertakings	-	346	-	101
Other taxes and social security	336	163	658	203
Other payables	210	45	200	200
Value added tax	-	113	-	-
Provisions	1,834	1,834	-	-
Accruals and deferred income	10,523	3,485	14,155	6,955
	70,325	33,204	113,135	47,496

Trade payables: amounts due to members represents purchases of milk at the prevailing monthly price, which are payable according to standard terms of trade (refer to note 3 for basis of payments). The directors consider that the carrying amount of trade payables approximates to their fair value. There are no fixed repayment dates for amounts owed to subsidiary undertakings or joint ventures.

17. Trade and other payables: Amounts Falling Due After More Than One Year

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
Debentures	2,174	2,174	2,155	2,155
Deferred income	754	-	656	-
	2,928	2,174	2,811	2,155

On ceasing to be a member of First Milk Limited, the "B" preference shares held by a member at that time are converted into debentures on the basis of £1 debenture for each £1 of "B" preference shares held (note 22). On 3rd August 2016 the debentures were converted to C Preference shares (see note 22).

18. Bank Borrowings

Bank loans and facilities are repayable as follows:

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
Within one year	32,747	5,631	60,943	8,004
Unamortised issue costs	(334)	(334)	(214)	-
	32,413	5,297	60,729	8,004

Group bank borrowings at 31 March 2016 of £32.7m (2015: £60.9m) are secured by fixed securities over certain Group assets, a floating charge over Scottish Milk Products Limited and a debenture over First Milk Limited and First Milk Cheese Company Limited. These facilities are not subject to any financial covenants and are payable on demand.

19. Financial instruments

The Group has the following financial instruments:

	Note	2016 Group £'000	2015 Group £'000
Financial assets at fair value through profit or loss			
Derivative financial instruments	15	168	-
Financial assets that are debt instruments measured at amortised cost			
Trade receivables	15	23,534	34,357
Amounts owed by joint ventures	15	1,226	2,208
Other receivables	15	806	3,432
		25,566	39,997
Financial liabilities measured at fair value through profit or loss			
Derivative financial instruments	16	-	607
Financial liabilities measured at amortised cost			
Bank loans and overdrafts	16, 18	32,413	60,729
Trade payables: amounts due to members	16	18,630	25,684
Trade payables: other	16	6,379	11,102
Other trade payables	16	210	200
Accruals	16	10,523	14,155
		93,721	111,870

Derivative financial instruments – Forward contracts

The Group enters into forward foreign currency contracts to mitigate the exchange rate risk for certain foreign currency receivables. At 31 March 2016, the outstanding contracts all mature within 7 months (2015: 7 months) of the year end. The Group is committed to sell €3.5m and receive a fixed sterling amount (2015: €7.4m and US$ 0.7m).

The forward currency contracts are measured at fair value, which is determined using valuation techniques that utilise observable inputs. The key inputs used in valuing the derivatives are the forward exchange rates for GBP:USD and GBP:EUR. The fair value of the forward-foreign currency contracts is £168k benefit (2015: £514k loss) for the Group and £168k benefit (2015: £251k loss) for the Society.

Derivative financial instruments – Interest rate swaps

The Society entered into an interest rate swap to receive interest at LIBOR and pay interest at a fixed 2.5%. The swap was based on a principal amount of £35m and matured in 2015. The instrument was used to hedge the Group's exposure to interest rate movements on the Senior loan facility. The fair value of the interest rate swap is £nil (2015: £92,962 loss).

20. Provisions for Liabilities and Charges

Deferred tax asset

The movement on the deferred tax asset account for both the Group and the Society is shown below. The asset is presented within debtors (note 15).

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
Opening balance	(5,034)	(5,034)	(5,431)	(3,592)
Profit and loss account charge (note 10)	1,687	1,687	2,552	1,157
Deferred tax charge in OCI for the period	1,943	1,943	(2,078)	(2,078)
Adjustment in respect of prior years	-	-	(77)	(521)
Closing balance (note 15)	(1,404)	(1,404)	(5,034)	(5,034)

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
Deferred tax (assets) recognised				
Recoverable after 12 months	(1,404)	(1,404)	(5,034)	(5,034)
Deferred tax (assets) not recognised at the closing rate of 18%				
Fixed assets	(1,129)	(340)	343	(235)
Timing differences - trading	(1,085)	(651)	(2,932)	(119)
Losses	(8,316)	(2,199)	(9,859)	(3,521)
	(10,530)	(3,190)	(12,449)	(3,875)

Except in relation to pensions (balances shown as recoverable after 12 months above) no deferred tax balances have been recognised due to the uncertainty of the timing of the recoverability of these amounts.

Other provisions

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
Environmental provision	-	-	22	22
Onerous contract provision	833	833	-	-
	833	833	22	22

The onerous contract provision relates to obligations in respect of businesses divested during the year.

21. Financial Commitments

The Group and Society had the following future minimum lease payments under non-cancellable operating leases for each of the following periods:

	2016		2015	
	Group £'000	Society £'000	Group £'000	Society £'000
Commitments under non-cancellable operating leases not provided in the financial statements:				
within one year	46	-	214	125
within two to five years	1,321	857	91	29
later than five years	-	-	-	-
	1,367	857	305	154

22. Share and Loan Capital

Share capital (Group and Society)	Ordinary shares of £5 each		Ordinary shares of £10 each		New Preference Shares of £1 each		Total
	No.	£'000	No.	£'000	No.	£'000	£'000
Called up, allotted and fully paid							
At 1 April 2015	3,200	16	3,000	30	8,610,000	8,610	8,656
Share cancellations	(2,800)	(14)	(2,400)	(24)	(2,000)	(2)	(40)
At 31 March 2016	400	2	600	6	8,608,000	8,608	8,616

Loan Capital (Group and Society)	'B' Preference £'000	Member Capital Accounts £'000	Total £'000
At 1 April 2015	168	50,944	51,112
Transfer of 'B' preference shares to debentures	(20)	-	(20)
Increase in year	-	10,213	10,213
At 31 March 2016	148	61,157	61,305

First Milk Limited is a Society established under the Co-operative and Community Benefit Societies Act 2014. It is governed by its rules that require all members, on joining, to purchase a £10 ordinary share. Each member shall be bound but only entitled to hold one ordinary share. The £5 Ordinary shares and £10 Ordinary shares rank pari passu. When a member leaves, their ordinary share is cancelled. The 'adjustment to member's capital' disclosed in the table above refers to those shares cancellations.

'B' Preference Shares may only be held by members of the Society and attract interest at 2% above base rate. The 'B' Preference Shares of shareholders who cease to be members of First Milk Limited are exchanged for debentures on the basis of £1 debenture for each £1 preference share. The debentures attract interest at base rate and are repayable on 1 April 2020.

'B' Preference Shares carry no voting rights other than certain class consents.

On 1 April 2013, New Preference Shares were issued to each member in proportion to capital invested in the business. The Board has discretion as to whether a return is paid on New Preference Shares.

Members and former members have certain rights to trade capital. In particular, former members are entitled to sell their New Preference Shares for a period of three years at which point, if not sold, they are cancelled.

22. Share and Loan Capital - continued

On 3rd August 2016, the 'B' Preference Shares and Member Capital Accounts were converted into 'C' preference shares.

Under First Milk's rules, when a member retires from milk production, to the extent it has not been sold, capital can either be:

- transferred to a permitted successor; or
- repaid in 5 annual instalments from the date of cessation of membership as follows: 10% on the first anniversary, 20% on the second and third anniversary and 25% on the fourth and fifth anniversary.

If a member resigns from First Milk to supply another milk buyer, their Member Capital Account balance is repaid five years after cessation of membership.

The rules also give the Board the power to alter or extend the terms for repayment of capital. In March 2015, the Board decided to delay all capital repayments (including all instalments of capital repayments) by one year and to then split each capital repayment so that it is paid out over three years.

The Board has discretion as to the interest that is paid to members and former members on their Member Capital Account balances.

The Member Capital Account ranks behind all other creditors, including preference shareholders, on any winding up of the Society.

Following the conversion of the Member Capital Accounts into 'C' Preference Shares on 3rd August 2016, the above repayment obligations no longer apply.

23. Reconciliation of Operating (Deficit)/Surplus to Operating Cash Flows

	2016		2015	
	Group	Society	Group	Society
	£'000	£'000	£'000	£'000
Operating profit/(loss)	930	9,337	(23,450)	(53,514)
Depreciation and impairment charges	4,269	295	3,653	6,331
Amortisation of goodwill	904	-	2,092	-
Goodwill impairment	1,669	-	-	-
(Loss)/gain on sale of property, plant and equipment	(22)	1	83	-
Post employment benefits (see note 4)	(7,300)	(7,300)	-	-
Increase in provisions falling due more than one year	811	811	-	-
Decrease in inventories	21,397	275	16,458	171
Decrease in receivables	15,842	2,068	28,143	63,145
Decrease in payables	(14,396)	(11,585)	(27,370)	(16,303)
Net cash inflow/(outflow) from operating activities	24,104	(6,098)	(391)	(170)

24. Pension Schemes

First Milk Limited operates the Scottish Milk Limited Retirement Benefits Plan ("the Scottish Plan"), and also participates in The Milk Pension Fund ("the Milk Fund"), an industry scheme in which all participating employers report only their share of assets, liabilities and obligations while legally holding joint and several liability for the scheme as a whole. Both schemes are closed to accrual of benefits.

In the event of participating employers ceasing to participate in the Milk Fund, the assets and liabilities previously associated with this employer are allocated to the remaining employer members.

Both are defined benefit pension schemes funded by sponsoring employers and (up to the date of closure to future accrual) by contributions from employees.

The Scottish Plan is structured such that the Society and other participating Group companies cannot separately identify its share of the underlying assets and liabilities of the scheme. As a consequence the deficit of this scheme was previously only reflected in the Group financial statements. Under FRS102 rules there is a requirement to estimate the share of the deficit for each participating employer, and since the majority of the liabilities of this scheme relate to First Milk Limited, the decision has been made to allocate 100% of the deficit to the Society. The impact is reflected in the FRS 102 transition note (note 27).

The Group also operates a defined contribution scheme, a Stakeholder Group Pension Plan with Standard Life.

The contributions to the defined contribution scheme charged to the profit and loss account in the year ended 31st March 2016 were £1.318m (2015 £1.348m)

The figures below for the defined benefits schemes have been based on the most recent actuarial valuations at 31 March 2012, updated to the current year-end by qualified independent actuaries. The major assumptions used for the actuarial valuation were:

Assumptions at 31 March	Scottish Plan % pa		Milk Fund % pa	
	2016	2015	2016	2015
Discount rate	3.5	3.2	3.4	3.2
Rate of increase in pensions in payment	2.3	2.3	1.7 to 1.9	1.8 to 3.0
Rate of increase in pensions in deferment	1.9	2.0	1.9	1.9 to 3.0
Inflation assumption (RPI)	2.9	3.0	3.0	3.0
Inflation assumption (CPI)	1.9	2.0	1.9	1.9
Mortality				
Longevity at age 65 for current pensioners				
Men	23	22	23	23
Women	25	24	25	26
Longevity at age 65 for future pensioners				
Men	24	24	25	25
Women	27	26	27	28

24. Pension Schemes (continued)

The fair value of assets in the schemes and the present value of liabilities in the schemes at each balance sheet date were:

Asset	Scottish Plan £'000		Milk Fund £'000	
	2016	2015	2016	2015
Equities, diversified growth and hedge funds	2,011	16,499	20,900	26,500
Gilts/LDI funds	40,771	16,370	3,400	4,300
Bonds	-	10,107	10,600	13,300
Property	-	-	6,700	6,900
Cash	354	216	200	1,500

	Scottish Plan £'000		Milk Fund £'000	
	2016	2015	2016	2015
Total market value of assets	43,136	43,192	41,800	52,500
Present value of scheme liabilities	(50,438)	(54,062)	(42,300)	(66,800)
Deficit in the scheme	(7,302)	(10,870)	(500)	(14,300)
Related deferred tax asset	1,314	2,174	90	2,860
Net pension liability	(5,988)	(8,696)	(410)	(11,440)

Liabilities	Scottish Plan £'000		Milk Fund £'000	
	2016	2015	2016	2015
Opening	(54,062)	(44,899)	(66,800)	(58,100)
Past service cost	-	-	7,300	-
Interest cost	(1,690)	(1,932)	(2,100)	(2,500)
Benefits paid	2,506	1,996	2,400	2,400
Settlements	-	-	300	300
Actuarial gains / (losses)	2,808	(9,227)	16,600	(8,900)
Closing	(50,438)	(54,062)	(42,300)	(66,800)

24. Pension Schemes (continued)

Assets	Scottish Plan £'000		Milk Fund £'000	
	2016	2015	2016	2015
Opening	43,192	36,860	52,500	48,800
Expected return on scheme assets	883	1,649	1,500	2,900
Actuarial gains/(losses)	125	5,136	(10,600)	2,600
Benefits paid	(2,506)	(1,996)	(2,400)	(2,400)
Settlements		-	(200)	(200)
Employer contributions	1,442	1,543	1,000	800
Closing	43,136	43,192	41,800	52,500

Cumulative actuarial gains and losses recognised in the statements of other comprehensive income (“SOCI”) are:

	2016		2015		2014	
	Scottish Plan £'000	Milk Fund £'000	Scottish Plan £'000	Milk Fund £'000	Scottish Plan £'000	Milk Fund £'000
Opening cumulative SOCI:	(13,457)	(17,900)	(9,456)	(11,600)	(7,535)	(9,100)
Actuarial (losses)/gains	2,933	6,000	(4,091)	(6,300)	(1,921)	(2,500)
Closing cumulative SOCI	(10,524)	(11,900)	(13,547)	(17,900)	(9,456)	(11,600)

24. Pension Schemes (continued)

Analysis of movement in the scheme deficit during the year:	2016 Scottish Plan £'000	2016 Milk Fund £'000	2015 Scottish Plan £'000	2015 Milk Fund £'000
Past service cost	-	7,300	-	-
Total included within operating surplus	-	7,300	-	-
Contributions	1,442	1,000	1,543	800
Amounts included as other finance income:				
Expected return on pension scheme assets	883	1,500	1,649	2,900
Interest cost on pension scheme liabilities	(1,690)	(2,100)	(1,932)	(2,500)
Gains on curtailments and settlements		100	-	100
Net finance (cost)/income	(807)	(500)	(283)	500
Analysis of the actuarial gains and losses in the statement of comprehensive income:				
Actual return less expected return on pension scheme assets				
Amount	125	(10,600)	5,136	2,600
Percentage of scheme assets	0%	-25%	12%	5%
Experience gains and losses arising on the scheme liabilities				
Amount	-	-	-	800
Percentage of present value of scheme liabilities	0%	0%	0%	1%
Changes in financial assumptions underlying the scheme liabilities				
Amount	2,808	16,600	(9,227)	(9,700)
Percentage of present value of scheme liabilities	6%	(39%)	(17%)	(15%)
Total actuarial gains and (losses) recognised in the statement of comprehensive income	2,933	6,000	(4,091)	(6,300)
Deficit at 1 April	(10,870)	(14,300)	(8,039)	(9,300)
Movement in year:				
Pension expense			-	-
Employer contributions	1,442	1,000	1,543	800
Net finance cost	(807)	(500)	(283)	500
Past service cost	-	7,300	-	-
Actuarial gain/(loss)	2,933	6,000	(4,091)	(6,300)
Deficit at 31 March	(7,302)	(500)	(10,870)	(14,300)

At 31 March 2016 First Milk's share of the total assets and liabilities in the Milk Pension Fund were approximately 10.5%, a reduction from the 13% share as at 31 March 2015, the result of an exercise conducted by the Trustee to more accurately allocate the "Orphan" assets and liabilities. Included in the 10.5% recognised at 31 March 2016 is a proportion of the 'Orphan' assets and liabilities, which relate to former employers who no longer participate in the fund. 'Orphan liabilities' refers to the expected future cost of providing the promised benefits to these orphan members. 'Orphan assets' refers to the proportion of the fund's total assets that the Trustees have notionally allocated to the orphan group of the fund for the purpose of setting contribution rates. The reduction in First Milk's share of these orphan liabilities is the main reason for the movement in experience losses on assets and gains on liabilities during the year. Additionally the Trustee of the Milk Pension Fund took the decision to amend the index used for the indexation of future benefits from RPI to CPI. This resulted in a £7.3 million exceptional credit in the profit and loss account during the year.

25. Related Party Transactions

During the year, the directors supplied raw milk from their farms to the Group and the Society at normal commercial rates totalling £1,293,068 (2015: £1,714,930). The outstanding balance owing to the directors at 31 March 2016 was £90,732 (2015: £100,474).

On 15 January 2016 First Milk Limited disposed of its shareholding in Westbury Dairies Limited ("Westbury"), a joint venture between First Milk Limited, Arla Foods Limited and Milk Link Limited. The Group processed milk with Westbury and up to the date of disposal the cost charged to the Group for processing this milk was £2.1m (year 2015: £8.1m). The outstanding balance owed to Westbury by the Group at the year-end was £218,833 (2015: £775,404). The Group sold lactose to Westbury and up to the date of disposal the value of these sales was £1.1m (year 2015: £1.8m). The outstanding trading balance owed by Westbury at the year-end was £253,920 (2015: £290,219). The outstanding loan balance owed to the Group by Westbury at the year-end was £Nil (2015: £274,260).

During the year, the Group supplied Fast Forward FFW Limited ("FFW"), a joint venture between First Milk Limited and Fonterra (Europe) Coöperatie U.A, with liquid whey amounting to £3.8m (2015: £3.7m) and invoiced FFW for manufacturing costs totalling £3.8m (2015: £4.0m). The outstanding trading balance owed by FFW at 31 March 2016 amounted to £796,000 (2015: £767,000). The outstanding loan balance owed to the Group by FFW at 31 March 2016 was £1,226m (2015: £1,226m).

At 31 March 2016, the outstanding trading balance owed by First Milk Energy Limited ("FME"), a joint venture between First Milk Limited and Green Engineering (Scotland) Limited, was £Nil (2015: £1,000). The outstanding loan balance owed to the Group by FME at 31 March 2016 was £Nil (2015: £500,000).

During the year the Group made payments to its two related pension funds of £2.4m (2015: £2.3m). For a break down, of these amounts, between the pension funds see note 24.

Amounts due to members at 31 March 2016 and 31 March 2015 for the purchase of milk are disclosed in note 16.

26. Capital and Other Financial Commitments

	2016 Group £'000	2015 Group £'000
Contracts placed for future capital expenditure not provided in the financial statements	1,800	1,400

27. Transition to FRS 102

This is the first year that the Group and the Society have presented results under FRS 102. The last financial statements under previous UK GAAP were for the year ended 31 March 2015. The date of transition to FRS 102 was 1 April 2014. Set out below are the changes in accounting policies which reconcile loss for the financial year ended 31 March 2015 and the total equity as at 1 April 2014 and 31 March 2015 between UK GAAP as previously reported and that reported in these financial statements under FRS 102.

Transition exemptions

The Group and Society have taken the following transition exemptions in preparing its first financial statements under FRS 102.

i) The Group and the Society have taken advantage of the exemptions under paragraph 35.10(f) of FRS 102 in respect of investment in subsidiaries and jointly controlled entities in its separate financial statements on the date of transition to FRS 102 (1 April 2014) and continues to measure investments at their existing cost value; and

ii) The Group and the Society have taken transition exemption under paragraph 35.10(a) relating to business combinations that were effected before the transition date (1 April 2014) and have elected not to apply Section 19 Business Combinations and Goodwill to business combinations that were effected before its FRS 102 transition date.

27. Transition to FRS 102 - continued

Reconciliations

In accordance with the requirements of FRS 102 a reconciliation of the prior year deficit and opening balances is provided as below:

	Note	2015 Group £'000	2015 Society £'000
Reconciliation of loss for the year			
Loss for the year as previously reported under UK GAAP		(27,487)	(54,012)
Recognition of derivative financial instruments	1	(607)	(344)
Recognition of Scottish Pension Plan Liability	2	-	1,008
Deficit for the year as reported under FRS 102		(28,094)	(53,348)

	Note	2015 Group £'000	2015 Society £'000
Reconciliation of other comprehensive expense for the year			
Other comprehensive income for year as previously reported under UK GAAP		(8,313)	(5,040)
Adjustment on transition	1	-	-
Recognition of Scottish Pension Plan Liability	2	-	(3,273)
Other comprehensive income for the year as reported under FRS 102		(8,313)	(8,313)

		Group £'000		Society £'000	
Reconciliation of capital and reserves	Note	1 April 2014	31 March 2015	1 April 2014	31 March 2015
Total capital and reserves as previously reported under UK GAAP		35,987	6,008	70,736	17,505
Recognition of derivative financial instruments	1	-	(607)	-	(344)
Inclusion of share of pension scheme liabilties				(6,431)	(8,696)
Total capital and reserves as reported under FRS 102		35,987	5,401	64,305	8,465

27. Transition to FRS 102 (continued)

Notes to reconciliations

1. Derivative financial instruments

FRS 102 requires derivative financial instruments to be recognised at fair value. Previously under UK GAAP the Group and Society did not recognise these instruments in the financial statements.

Accordingly due to the transition, the Group has recognised a liability of £514k in respect of forward foreign exchange contracts plus a liability of £93k in respect of interest rate swaps, with the equivalent increase in other administrative expenses for the year ended 31 March 2015.

The Society has recognised a liability of £251k in respect of forward foreign exchange contracts plus a liability of £93k in respect of interest rates swaps, with the equivalent increase in other administrative expenses for the year ended 31 March 2015.

There is no tax impact of this adjustment since the Group does not recognise tax gains / losses on short term timing differences.

Other adjustments arising on transition to FRS 102

In addition to the transition adjustments identified above which affect the reported loss for the financial year, the following adjustments have arisen which have had no effect on net assets or the profit and loss account but which have affected the presentation of these items in the financial statements.

2. Scottish Pension Liability

FRS 102 requires at least one entity to recognise a defined benefit scheme. Therefore the Society as the entity which is legally responsible for the cost has recognised the pension liability of the Scottish Plan. Previously this was accounted for on a group basis only.

Statement of cash flows

The Group and the Society's statement of cash flows reflects the presentation requirements of FRS 102, which are different to that prepared under FRS 1. In addition the statement of cash flows reconciles to cash and cash equivalents whereas under previous UK GAAP the statement of cash flows reconciled to cash. Cash and cash equivalents are defined in FRS 102 as 'cash on hand and demand deposits and short term highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value' whereas cash is defined in FRS 1 as 'cash in hand and deposits repayable on demand with any qualifying institution, less overdrafts from any qualifying institution repayable on demand'. The FRS 1 definition is more restrictive.

28. Post balance sheet events

On 3 August 2016, the board of directors converted all loan capital, B Preference Shares and debentures to C Preference Shares.

On 21 October 2016 the Group disposed of its CNP Professional lifestyle nutrition business, based in Hyde, near Manchester.