

Notes to the consolidated financial statements

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31 Contingent liabilities

A number of subsidiary companies and Northern Foods plc are guarantors in respect of the Senior loan notes 2012–2017, whereby they absolutely and unconditionally guarantee the principal and interest on the Senior loan notes 2012–2017. Additionally, the same subsidiary companies are cross guarantors in respect of the five year syndicated Revolving credit facility 2010.

A subsidiary undertaking is party to a letter of credit issued by Barclays Bank plc for £nil (2007/08: £4.5m) secured against the assets of the subsidiary undertaking.

Northern Foods plc is the guarantor in respect of the obligations of several subsidiary undertakings with Allied Irish Bank. As at 28 March 2009 Northern Foods plc guaranteed £0.7m (2007/08: £nil).

32 Operating lease commitments

The Group recognised the following lease payments under operating leases as an expense in the year:

	2009 £m	2008 £m
Plant and machinery	2.2	2.7
Land and buildings	0.8	2.2
	3.0	4.9

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases fall due as follows:

	2009 £m	2008 £m
Within one year	4.2	4.8
In the second to fifth years inclusive	12.0	9.4
After five years	3.2	10.5
	19.4	24.7

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The Group also leases plant and machinery and vehicles under non-cancellable operating lease agreements.

33 Finance leases

The Group's finance lease obligations are shown below:

	2009 £m	2008 £m
Within one year	0.2	0.2
In the second to fifth years inclusive	0.3	0.6
	0.5	0.8

The fair value of the Group's finance lease obligations approximates to their carrying value.

34 Equity settled share based payments

Equity settled share option plan

The Group has applied the requirements of IFRS 2 'Share-based payments'. In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested at 1 January 2005.

The Group operates long term incentive schemes for executive directors and senior management within the Group in addition to issuing an HM Revenue & Customs Savings-related share option scheme for all employees. Options are granted with a fixed exercise price. Options lapse when an employee leaves the Group subject to certain 'good leaver' provisions.

The fair value per option granted and the assumptions used in the calculations are as follows:

Executive share options	Grant of share options	Grant of share options	Grant of share options	Grant of share options
Date of grant	19 Dec 2003	17 Dec 2004	14 Dec 2005	4 July 2006
Number of instruments granted	3,375,195	2,313,123	2,059,231	4,218,455
Exercise price (pence)	137.0	169.7	153.3	79.7
Share price at date of grant (pence)	135.0	166.5	153.5	84.0
Contractual life (years)	10	10	10	10
Performance conditions	Note A	Note B	Note B	Note B
Settlement	Equity	Equity	Equity	Equity
Expected volatility	37%	33%	30%	30%
Expected option life at grant date (years)	5	5	5	5
Risk free interest rate	4.78%	4.44%	4.30%	4.70%
Expected dividend (dividend yield)	6.79%	5.25%	6.00%	5.40%
Fair value per granted instrument determined at the grant date (pence)	27.5	36.0	26.4	15.3
Valuation model	Black-Scholes	Black-Scholes	Black-Scholes	Black-Scholes

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34 Equity settled share based payments continued

Other arrangements	Long term incentive plan	Long term incentive plan	Share bonus plan	Share bonus plan	Deferred share bonus plan
Date of grant	12 Dec 2005	4 July 2006	4 July 2006	13 June 2007	13 July 2006
Number of instruments granted	474,442	1,013,523	408,809	357,028	4,928,287
Exercise price (pence)	nil	nil	nil	nil	nil
Share price at date of grant (pence)	153.7	84.0	84.0	123.5	81.8
Contractual life (years)	5	5	3	3	3
Performance conditions	Note C	Note C	Note D	Note D	Note E
Settlement	Equity	Equity	Equity	Equity	Equity
Expected volatility	30.0%	30.0%	30.0%	25.0%	30.0%
Expected life at grant date (years)	3	3	3	3	3
Risk free interest rate	4.30%	4.70%	4.70%	5.77%	4.70%
Expected dividend (dividend yield)	6.00%	5.40%	5.40%	4.78%	5.40%
Fair value per granted instrument determined at the grant date (pence)	128.1	61.1	61.0	88.9	40.9
Valuation model	Black-Scholes	Black-Scholes	Black-Scholes	Black-Scholes	Black-Scholes

Other arrangements	Matching share award	Performance share plan	Performance share plan	Deferred share bonus plan
Date of grant	4 June 2007	29 Aug 2007	5 Dec 2007	26 Sept 2007
Number of instruments granted	1,040,460	2,441,010	3,350,000	194,586
Exercise price (pence)	nil	nil	nil	nil
Share price at date of grant (pence)	129.7	98.8	87.0	101.7
Contractual life (years)	3 and 4	3	3	2
Performance conditions	Note G	Note F	Note F	Note E
Settlement	Equity	Equity	Equity	Equity
Expected volatility	25.2%	27.2%	30.9%	30.0%
Expected life at grant date (years)	3 and 4	3	3	2
Risk free interest rate	5.77%	5.26%	4.41%	5.11%
Expected dividend (dividend yield)	0	0	0	0
Fair value per granted instrument determined at the grant date (pence)	89.14	58.90	49.17	101.70
Valuation model	Monte Carlo	Monte Carlo	Monte Carlo	Black-Scholes

Other arrangements	Save as you earn	Save as you earn	Performance share plan	Performance share plan
Date of grant	20 Dec 2007	20 Dec 2007	4 July 2008	9 Dec 2008
Number of instruments granted	4,607,258	5,390,539	4,238,949	310,625
Exercise price (pence)	76.0	76.0	nil	nil
Share price at date of grant (pence)	90.0	90.0	57.0	55.8
Contractual life (years)	3.5	5.5	3	3
Performance conditions	Note H	Note H	Note I	Note I
Settlement	Equity	Equity	Equity	Equity
Expected volatility	27.5%	27.4%	32.6%	40.5%
Expected life at grant date (years)	3.25	5.25	3	3
Risk free interest rate	4.45%	4.56%	4.97%	2.26%
Expected dividend (dividend yield)	4.78%	4.78%	0	0
Fair value per granted instrument determined at the grant date (pence)	20.11	21.53	3764	3747
Valuation model	Monte Carlo	Monte Carlo	Monte Carlo	Monte Carlo

Expected volatility was determined by calculating the historical volatility of the Group's share price over a period commensurate with the expected term of the relevant award. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

34 Equity settled share based payments continued

Performance conditions – notes

- A Performance condition measured by reference to earnings per share. The target requires that the real growth in earnings per share over the three year performance period is greater than 3% per annum compound. The performance condition allowed for retesting after years four and five against the full period from the grant.
- B Performance condition measured by reference to earnings per share. The target requires that the real growth in earnings per share over the three year performance period is greater than 3% per annum compound. The performance condition does not allow for retesting.
- C The LTIP has two performance conditions:
- TSR: The total number of shares that will vest will be up to 50% dependent on how the TSR in relation to an ordinary share of Northern Foods over the relevant performance period compares with TSR in relation to the ordinary shares of the companies in the comparator group in the same period. Where the TSR of Northern Foods over the performance period places it between the median and the upper quartile the number of shares will be calculated on a straight line basis with 20% of the shares being received when Northern Foods is placed above median, and 50% being received where Northern Foods is placed in the upper quartile. Where Northern Foods growth in TSR places it below median, no shares will vest in relation to this element of the award.
- Return on invested capital (ROIC): 50% of the total award vests on achievement of a minimum growth in ROIC over the performance period. Growth in ROIC over the period has to be 100 or more basis points. The number of shares that each participant receives is calculated on a straight line basis with 7.5% of the shares being received if Northern Foods achieves growth of 100 basis points and maximum of 50% being received if the Company achieves growth of 200 basis points.
- D Under the Share bonus plan, 80% of annual bonus opportunity is linked to specific financial targets, including targets for profit from operations and profit before tax, both measured before restructuring items. The other 20% is directly related to individual performance against personal performance contracts set at the start of the financial year, which contain six individual and business performance targets which are considered appropriately stretching.
- E The Deferred share bonus plan (DSBP) was introduced in June 2006 so as to incentivise and retain the key talent necessary to drive the specific performance improvements required. Performance was assessed against key milestones over the 12 month period to 31 March 2007. These four key milestones related to improving free cash flow and reducing net debt as at 1 April 2006 by £125m, reducing the run rate for central costs by £12m per annum compared to 2005/06 and the successful resolution of the pension deficit. This DSBP provided a smaller number of key senior executives with an award of shares with a value up to 100% of base salary, at the prevailing market price of 81.75 pence per share on 13 July 2006. These shares will be satisfied by the transfer of existing shares held in trust after the vesting date in July 2009.
- F The Performance share plan was introduced to incentivise the Group's senior executives. There are two performance conditions which will align the interests of senior executives with those of shareholders.
- TSR: The total number of shares that will vest will be up to 50% dependent on TSR growth over the performance period. TSR is required to grow by 30% from the effective base of £1.24 for 7.5% of the shares to vest up to a maximum of 50% being received if the TSR grows by 80% or more.
- ROIC: 50% of the total award vests on achievement of a minimum growth in ROIC over the performance period. The number of shares that each participant receives is calculated on a straight line basis with 7.5% of the shares being received if the Group achieves growth of 100 basis points and maximum of 50% being received if the Group achieves growth of 200 basis points or more.
- G The award of matching shares to S Barden was made as part of his recruitment as chief executive. The performance conditions attached to the matching share award are the same as those for the Performance share plan (see F) save that threshold vesting of the TSR element will not occur unless the Group achieves growth in TSR of 35% over the relevant period. Half the matching award will vest on the third anniversary of the grant with the other half vesting on the fourth anniversary of the grant to the extent that the performance conditions are met and providing he retains the purchased shares and remains employed by the Group.
- H The Group introduced a HM Revenue & Customs approved savings-related share option plan for all employees. There are no performance conditions attached to these options.
- I This relates to the second year of awards under the Performance share plan. The two performance conditions which will align the interests of senior executives with those of shareholders are:
- TSR: The total number of shares that will vest will be up to 50% dependent on TSR growth over the performance period. TSR is required to grow by 30% from the effective base of £0.659 for 7.5% of the shares to vest up to a maximum of 50% being received if the TSR grows by 80% or more.
- ROIC: 50% of the total award vests on achievement of a minimum growth in ROIC over the performance period. The number of shares that each participant receives is calculated on a straight line basis with 7.5% of the shares being received if the Group achieves growth of 100 basis points and maximum of 50% being received if the Group achieves growth of 200 basis points or more.

For further information on share incentive schemes see the Remuneration report on pages 41 to 52.

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34 Equity settled share based payments continued

Details of movements in share options during the period are as follows:

	Options 2009 number	Weighted average exercise price 2009 £	Options 2008 number	Weighted average exercise price 2008 £
Outstanding at start of period	1,920,865	0.80	8,533,451	1.23
Forfeited during period	(517,762)	0.80	(5,410,637)	1.34
Expired during period	–	–	(1,201,949)	1.46
Outstanding at end of period	1,403,103	0.80	1,920,865	0.80
Exercisable at end of period	1,403,103	0.80	1,920,865	0.80

Forfeiture arises when the employee leaves within the vesting period. Expiration of shares occurs when the last date for exercise has passed and the option has not been exercised.

There were no share options exercised during the period (2007/08: nil). The options outstanding had a weighted average remaining contractual life of 7.27 years (2007/08: 8.27 years). The weighted average fair value of the share options outstanding is £0.15 (2007/08: £0.15) per share. The exercise price of options outstanding at the period end was £0.80 (2007/08: £0.80).

The Group recognised total expenses of £2.7m (2007/08: £1.1m) in the period relating to equity settled share based payment transactions.

35 Retirement benefit obligations

Defined benefit schemes

The Group operates a number of defined benefit schemes for qualifying employees, principally the Northern Foods Pension Scheme ('the Scheme') and Northern Foods Pension Builder ('Pension Builder') in the United Kingdom and the Green Isle Foods Group Retirement and Death Benefit Plan ('the Plan') in the Republic of Ireland. Under the Scheme, Pension Builder and the Plan, employees are entitled to retirement benefits based on pay and service. The Scheme, Pension Builder and the Plan are funded schemes whilst the Group's Post retirement medical benefit scheme is unfunded. The Scheme and the Plan are final salary schemes. The assets of the Scheme, Pension Builder and the Plan are held in trustee administered funds separate from the finances of the Group.

On 22 March 2005 the Company announced the closure of the Scheme to new entrants and withdrew its agreement to allow early retirement on an enhanced basis. Pension Builder was introduced on 1 May 2005 and is available to all UK based employees. Pension Builder is a defined benefit scheme based on the career average principle.

Northern Foods has reviewed the future cost of delivering benefits against a challenging background of social and economic changes in order to maintain competitiveness and long term success. This has resulted in approximately 300 of the senior management population moving from the Scheme and Pension Builder to a defined contribution scheme from 29 March 2009.

The most recent valuation of the Scheme for the purpose of the financial statements and the present value of defined benefit obligations was carried out at 28 March 2009 by an independent qualified actuary, PricewaterhouseCoopers LLP. The present value of the defined benefit obligation/asset, the related current service cost and past service cost was measured using the projected unit credit method. The principal assumptions used for the purpose of the actuarial valuation of the Scheme and Pension Builder are detailed below.

	Valuation date	
	2009	2008
Rate of increase in salaries	3.0%	3.9%
Rate of increase to pensions in payment	2.7%	3.1%
Rate of increase to deferred pensions	3.0%	3.4%
Discount rate	6.8%	6.4%
Inflation assumption	2.8%	3.4%

35 Retirement benefit obligations continued

Sensitivities

The mortality assumptions used are based on mortality experience of the Scheme and anticipated mortality experience. The assumptions are below the national average reflecting the socio-economic make up of the Scheme membership. For the valuation at 28 March 2009, the Company has adopted the medium cohort principle for the Scheme and Pension Builder (2007/08: medium cohort). If life expectancy is increased or decreased by one year, liabilities are estimated to increase or decrease by £15.0m respectively. The impact of a 0.1% increase or decrease in the discount rate would decrease or increase liabilities by £11.0m respectively. The impact of a 0.1% increase or decrease in the rate of increase to pensions would increase or decrease liabilities by £5.2m respectively. The impact of a 0.1% increase or decrease in the inflation assumption would increase or decrease liabilities by £1.5m respectively.

The life expectancy in years for a member aged 65 is as follows:

	Valuation date	
	2009	2008
Current pensioner – male	18.7	18.7
– female	21.0	21.0
Future pensioner – male	20.0	20.0
– female	22.2	22.2

Post retirement medical benefit scheme

Until 31 March 1999, the Group operated a post retirement medical benefit scheme. The method of accounting, assumptions and the frequency of valuations are similar to those used for defined benefit pension schemes detailed on page 94. The main actuarial assumptions are the underlying medical cost inflation of 4.8% per annum (2007/08: 5.4%) and the discount rate of 6.8% per annum (2007/08: 6.4%).

If the assumed rate of underlying medical cost inflation increased or decreased by 1.0% per annum then the valuation of the liabilities is estimated to increase or decrease by approximately £0.5m (2007/08: £0.4m) respectively.

Amounts recognised in the income statement in respect of the Group's defined benefit schemes and post employment medical benefit scheme are as follows:

	Defined benefit schemes		Post retirement medical benefit scheme		Total retirement benefit schemes	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Current service cost	6.2	9.7	–	–	6.2	9.7
Interest on obligation	45.0	42.3	0.3	0.2	45.3	42.5
Expected return on scheme assets	(53.8)	(58.2)	–	–	(53.8)	(58.2)
Curtailment gain	(1.2)	–	–	–	(1.2)	–
	(3.8)	(6.2)	0.3	0.2	(3.5)	(6.0)

The service cost for the period has been included within cost of sales £5.4m (2007/08: £8.4m), distribution costs £0.3m (2007/08: £0.5m) and administrative expenses £0.5m (2007/08: £0.8m). The interest on obligation and expected return on scheme assets is included within financing. Actuarial gains and losses have been reported in the Consolidated statement of recognised income and expense.

The curtailment gain of £1.2m consists of a £0.4m gain following the mothballing of the Fenland site, and a £0.8m gain on moving 300 members of the leadership population out of the defined benefit schemes to a defined contribution scheme effective 1 April 2009.

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35 Retirement benefit obligations continued

The amounts recognised in the Consolidated balance sheet in respect of the Group's defined benefit schemes and post retirement medical benefit scheme are as follows:

	Defined benefit schemes		Post retirement medical benefit scheme		Total retirement benefit schemes	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Present value of obligations	(705.1)	(718.2)	(3.6)	(4.4)	(708.7)	(722.6)
Fair value of scheme assets	637.2	784.2	–	–	637.2	784.2
	(67.9)	66.0	(3.6)	(4.4)	(71.5)	61.6

The following table shows the split of the Group's defined benefit schemes and post retirement medical benefit scheme between retirement benefit assets and retirement benefit obligations:

	Defined benefit schemes		Post retirement medical benefit scheme		Total retirement benefit schemes	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Retirement benefit assets	–	71.5	–	–	–	71.5
Retirement benefit obligations	(67.9)	(5.5)	(3.6)	(4.4)	(71.5)	(9.9)
	(67.9)	66.0	(3.6)	(4.4)	(71.5)	61.6

The table above does not include the related deferred tax assets and liabilities.

Movements in the present value of obligations are as follows:

	Defined benefit schemes		Post retirement medical benefit scheme		Total retirement benefit schemes	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
At start of period	718.2	805.4	4.4	4.7	722.6	810.1
Current service cost	6.2	9.7	–	–	6.2	9.7
Interest on obligation	45.0	42.3	0.3	0.2	45.3	42.5
Actuarial gains	(36.1)	(109.2)	(0.8)	(0.3)	(36.9)	(109.5)
Curtailment gain	(1.2)	–	–	–	(1.2)	–
Contributions from scheme members	4.8	5.1	–	–	4.8	5.1
Benefits paid	(34.9)	(37.5)	(0.3)	(0.2)	(35.2)	(37.7)
Exchange differences	3.1	2.4	–	–	3.1	2.4
At end of period	705.1	718.2	3.6	4.4	708.7	722.6

Movements in the fair value of scheme assets are as follows:

	Defined benefit schemes	
	2009 £m	2008 £m
At start of period	784.2	801.5
Expected return on scheme assets	53.8	58.2
Actuarial losses	(180.0)	(74.2)
Contributions from sponsoring companies	7.1	29.5
Contributions from scheme members	4.8	5.1
Benefits paid	(34.9)	(37.5)
Exchange differences	2.2	1.6
At end of period	637.2	784.2

35 Retirement benefit obligations continued

The fair value of scheme assets at the balance sheet date and the expected rate of return are analysed as follows:

	2009 £m	2008 £m	2009 %	2008 %
Defined benefit schemes				
Equity	338.9	498.0	8.1	7.9
Bonds	284.5	284.0	6.8	6.4
Other	13.8	2.2	0.5	5.3
	637.2	784.2		

The expected return on individual classes of pension scheme assets are determined by reference to external indices and after taking advice from external advisers. The overall expected rate of return is the weighted average of the returns above, allowing for anticipated balances held in each asset class according to the Scheme's investment strategy. The actual return on scheme assets was a loss of £126.2m (2007/08: £16.0m).

Work has continued to reduce future funding volatility of the Scheme as the revised investment strategy, agreed in 2008/09 is implemented. Paragraph 106 of IAS 19 requires the expected return on plan assets to be based on market expectations of returns over the entire life of the related obligation and as such the revised expected returns have been reflected. The weighted average expected return of the revised investment strategy is 7.1% and this will be used to calculate the expected return on assets for 2009/10.

The history of experience adjustments is as follows:

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Defined benefit schemes					
Present value of obligations	(705.1)	(718.2)	(805.4)	(813.0)	(729.3)
Fair value of scheme assets	637.2	784.2	801.5	727.8	562.9
Deficit in the scheme	(67.9)	66.0	(3.9)	(85.2)	(166.4)
Experience adjustments on scheme obligations:					
Amount loss/(gain)	56.0	–	–	30.2	(0.7)
Percentage of scheme obligations	7.9%	–	–	3.7%	0.1%
Experience adjustments on scheme assets:					
Amount (loss)/gain	(180.0)	(74.2)	(15.5)	99.6	14.2
Percentage of scheme obligations	25.5%	9.5%	1.9%	13.7%	2.5%

The cumulative effect of the experience adjustments on scheme liabilities as included in the Consolidated statement of recognised income and expense is a loss of £26.5m (2007/08: gain of £29.5m).

The cumulative effect of the experience adjustments on scheme assets as included in the Consolidated statement of recognised income and expense is a loss of £170.2m (2007/08: gain of £9.8m).

The Group expects to make contributions of approximately £5m to its defined benefit schemes in 2009/10.