Til Erhvervsstyrelsen
Nærværende årsrapport for Arla Foods amba, CVR nr. 25 31 37 63 og koncernårsrapport for Arla-koncernen er behandlet og godkendt på selskabets ordinære repræsentantskabsmøde

Den 6-3-2018

Dirigent

CONSOLIDATED ANNUAL REPORT

2017
Driving innovation in dairy


SKYR
Kids
Kids
SKYR
ORGANIC
KEFIR
eko
SKYR
SKYR
yoggi
ORGANIC

As people all over the world are focusing on obtaining the most out of life, a healthy lifestyle is becoming the new normal. How we fuel ourselves and our families starts by what we find in our fridge.

At Arla, we create innovative products that delight consumers and help them live a balanced and healthier life. We push the boundaries of science and technology to build a bright future for dairy, and natural food for everyone.

Project management: Corporate external reporting, Arla. Copy, design and production: We Love People. Translation: TextMinded. Photos: Jens Bangsbo, Hans-Henrik Hoeg and Arla. The annual report is published in English, Danish, Swedish, German and French. Only the original English text is legally binding. The translation has been prepared for practical purposes.

Financial statements of the parent company

Under section 149 of the Danish Financial Statements Act, these consolidated financial statements represent an extract of Arla's complete annual report. In order to make this report more manageable and user-friendly, we publish Group consolidated financial statements without the financial statements of the parent company, Arla Foods amba. The annual report of the parent company is an integrated part of the full annual report and available on www.arlafoods.com. Profit sharing and supplementary payment from the parent company are set out in the equity section of the consolidated financial statements. The full annual report contains the statement from the Board of Directors and the Executive Board as well as the independent auditor's report.

Content

2017 Performance at a glance

All targets are based on full-year results.

- Target fully achieved
- Achievement on major components
- Target not achieved

* International share is based on retail and foodservice revenue, excluding revenue from third party manufacturing, Arla Foods Ingredients and Trading activities.

** Based on profit allocated to owners of Arla Foods amba.

Revenue

10.3

BILLION EUR

2017	10.3
2016	9.6
2015	10.3

● Target 2017 EUR 10 - 10.5 billion

Profit share**

2.8%

OF REVENUE

2017	2.8%
2016	3.6%
2015	2.8%

● Target 2017 2.8 - 3.2 %

Strategic branded volume driven revenue growth

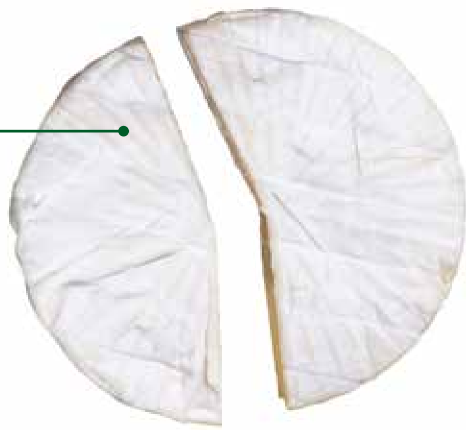
3.0%

2015 2016 2017

● Target 2017 1 - 3%

Brand share

44.6%



2017	44.6%
2016	44.5%
2015	42.1%

● Target 2020 >45%

International share*

20.2%

2017	20,2%
2016	19,7%
2015	18,1%

● Target 2020 >20%

Conversion cost

103.9

2017	103.9
2016	99.2
2015	98

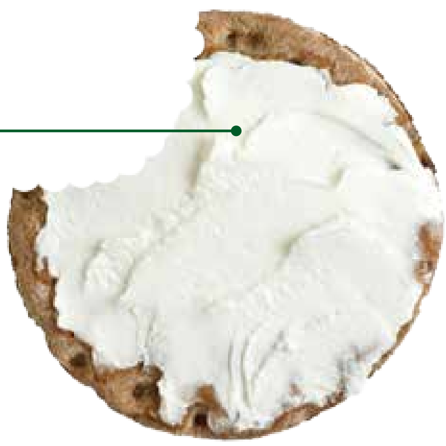
● Target 2017 <100

Leverage

2.6

2017	2.6
2016	2.4
2015	3.3

● Target 2017 2.8 - 3.4



A significant year on a positive journey

2017 was a good year for both Arla dairy farmers and dairy products, supported by a much-needed recovery in the milk price after the tough times farmers experienced last year. Our business remains focused on adding value to our products and responding to changing market dynamics.

Milk prices improved throughout 2017 and Arla succeeded in closing the year with the highest milk price in three years. Fat prices outperformed protein for the first time, with butter prices rising far beyond expectations, highlighting a significant change in market demands. Although butter prices declined modestly at the end of the year, they remain at a historically high level. Milk volumes were virtually unchanged for the year, with lower levels in the first half offset by increases in the second half as farmer owners responded to the recovering milk price.

Declining prices on the world market have begun as we enter 2018, meaning that Arla will need to continue its efforts to value-up products in order to secure highest possible returns to farmer owners through the milk price. Nevertheless, even if price declines persist in the months to come, we continue to expect reasonable price levels.

Operating in a consumer-driven market

It is crucial for us to understand that we operate in an extremely consumer-driven market, where demands on transparency are high and there is a growing interest from both consumers and customers in the origin of dairy products. They seek answers regarding how we treat our cows, what we feed them and how we operate our farms in relation to environmental issues.

In this market, being a farmer-owned cooperative is an immense strength, but only if we succeed in keeping a firm connection between consumers, customers, farmer owners and our cooperative.

The value of our high standards

This is the reason why Arlagården® Plus was launched in 2017 as an essential tool in securing our continued growth. This quality assurance programme delivers data that enables us to provide fact-based insights about the high standards on our farms. We closed the first round of data collection in December 2017, and the participation from our farmer owners in all owner countries was promising. 75 per cent of all farmer owners delivering milk in November and December 2017 participated in the programme, thereby qualifying to receive an additional 1 EUR-cent/kg of milk. This is a result to be proud of as it demonstrates that our farmer owners understand the signs from the market and meet demands from customers and consumers. Our expectations are high for 2018, where Arlagården® Plus will continue and grow into being an important instrument in securing Arla's position as a unique and industry-leading cooperative, adding even more value to our brands and products.

Evolving our cooperative

Throughout 2017, we have seen our owner strategy evolve. The Board of Representatives adopted a new governance structure, an eligibility and election procedure and an annual meeting cycle. The first elections in our new governance structure were also conducted. Two Area Forum rounds, consisting of all elected representatives in each area, increased cross-border interaction and were very positively received for all involved. In the coming year, our goal is extend this strategy even further, amending the Articles of Association and offering direct membership for all owners, respecting that as we strive for equality across borders, all should be working under the same Articles. Direct membership for all farmer owners will further strengthen our democracy as we step up our efforts to act as a truly global company. As part of this process, our elected farmer owners are taking on increasing responsibility and will continue to develop the relevant education programmes needed to further strengthen their roles going forward.

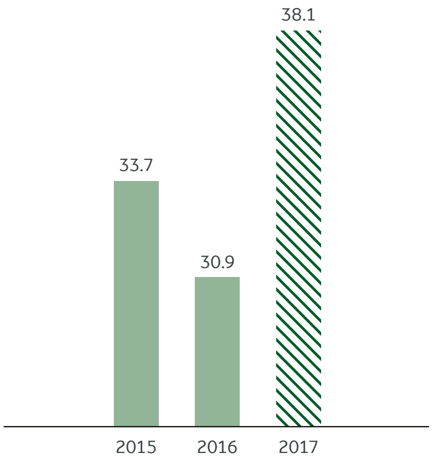
Embracing the future

Given the significant market volatility of recent years, it has become increasingly difficult to predict milk volume developments as well as how the market will evolve. We expect milk prices to decline during the first half of 2018. However, Arla is well equipped to react, in line with the Good Growth 2020 strategy. The market is changing and becoming ever more consumer-driven, and we must work continuously to ensure that our brands and products remain strong and competitive. We are doing it together, as farmer owners in cooperatives have done for centuries.

ÅKE HANTOFT
Chairman of the Board of Directors

Performance price
EUR-CENT/KG

38.1



ARLA'S MISSION

To secure the highest value for our farmers' milk while creating opportunities for their growth.

ARLA'S VISION

Creating the future of dairy to bring health and inspiration to the world, naturally.

Growing our brands to transform the business

In 2017, the shape of our business continued to improve as we grew our brands and delivered EUR 1 billion worth of sales price increases, an achievement that could not have been possible without focused effort and commitment across Arla. However, there remain challenges to overcome.

It was quite a turbulent year for the European dairy industry which started with a significant raw milk shortage, a reaction to the low market prices in 2016. With milk intake remaining at a low level, there was an unprecedented fat price rally in the second quarter, creating an extremely volatile market.

From an Arla perspective, 2017 showcased strong increases in market and farmer milk prices, although volatility continued across the dairy industry. For Arla, it was a year in which we focused on driving our long-term strategy, strong branded growth and a significant investment in innovation. From a business point of view, not all targets were met, especially due to the effects of Brexit on the milk price relative to competitors and increased production complexity to meet consumer demands for new and more differentiated dairy products. This approach, however, resonated with consumers who rewarded us with market share gains in nearly all our major brands and markets.

Strengthening our brands

An increased consumer demand for dairy products richer in fat drove fat prices to a historical high level in 2017. Combined with a growing demand for a diversified choice of dairy products, over the last year we saw a growing interest for organic and lactose-free dairy products, and those based on non-GMO feed. We held true to our heritage of producing natural products, and developed new innovations, encouraged by our strategy, Good Growth 2020. Thereby, we continue to send a clear signal to our consumers, customers, and business partners, that we are committed to creating the future of dairy by focusing our strong brands and having the confidence to innovate and adapt.

Innovation and bold moves

Another important milestone was the opening of our global Innovation Centre in Aarhus, Denmark, employing 150 experts from around the world. This is now the central hub for innovation in Arla and will be for many years to come. Not only developing new products, innovation is also about creating packaging and technologies to ease transport of fresh milk and dairy products across continents, and exploring new sales channels.

E-commerce is growing rapidly, and we increased our focus on this area in 2017 and will continue to do so in 2018 in close cooperation with some of the biggest players in the field.

Another crucial success factor is our Ingredients business, which showed significant top and bottom line growth in its specialty protein range.

We made some important milk moves for the future this year, expanding our world-leading position for high-margin mozzarella with our cooperations with DMK in Germany and Mengniu in China, who will deliver approximately 35,000 tonnes and 13,000 tonnes respectively starting in 2019. These bold moves pave the way for our future, ensuring important margin gains for farmer owner milk in the future.

Developments in our markets

Our International business continued to develop strongly in 2017, with impressive growth seen in Sub-Saharan Africa, China and South East Asia. Europe continued to deliver solid sales growth despite volume declines and adverse currency effects. Arla is in a strong position to create joint ventures and strategic partnerships all over the world, being a truly global company with operations in 38 countries. In 2017, a great example of this was in Nigeria, where product innovation, brand and retail knowledge, local consumer understanding and execution power resulted in a reach to ten thousands of shops. This represents a role model for partnerships in Arla.

Expectations for 2018

In 2018, we will continue to strengthen Arla's business even further in line with our strategy, Good Growth 2020, having identified eight essential business priorities on which we will focus in the coming year. One of these is to further strengthen our cornerstone Arla® brand. Another is to transform our business with a group-wide focus on value creation and efficiencies, through our new transformation programme, Calcium. Calcium will allow us to reinvest back into our business, creating a stronger company that is able to invest even more in growth.

There is no doubt that we will meet an even more consumer-driven market, where inclusiveness with the whole value chain and holistic responsibility will be more important for us than ever. As a farmer-owned dairy company, we must meet these demands by being even more transparent and using the tools we have in our quality assurance programme, Arlagården®, to bring consumers and customers closer to Arla.

We have seen market milk prices begin to decline, but we are well-positioned to deliver in 2018. We intend to keep our strategic promise of brand growth, knowing that the forecast for 2018 is for another volatile year. We have come out of 2017 as a stronger company, and financially we have never had more room to operate and invest in the future.

PEDER TUBORGH
CEO

Highlights

By growing our brands, pursuing innovative ideas and making key investments for the future, Arla continued to improve the shape of our business in 2017. With commitment and inspiration, all segments of our business contributed new product launches and exciting initiatives as we continue to fulfil our Good Growth 2020 strategy.

Starbucks™ finishes the year on a high
Starbucks™ continued its double-digit growth streak, fuelled by a lot of activities in 2017. Finishing the year on a high note, distinctive Christmas packaging was released and consumers were invited to share a moment of connection over social media, reaching over 12 million people across five markets.

Cocio® bridging retail and digital
Cocio® delivered strong engagement with its young millennial consumers. A shopper campaign, Shake To Win, bridged retail with the digital space through a mobile campaign site and successful engagement via Facebook and YouTube. The campaign ran across several markets, including Norway, Greece, the Netherlands and Denmark.

Getting going in Ghana
Arla added another market to its Sub-Saharan Africa business region, by establishing a new sales and packaging facility in Ghana. The subsidiary began selling Arla® branded products in Ghana from September 2017 in response to a growing demand for nutritious dairy products.

Celebrating World Milk Day
World Milk Day successfully took place in 81 countries on 1st June 2017, initiated by the Food and Agriculture Organisation of the United Nations. Milk and all dairy products were celebrated by farmers, chefs, nutritionists, academics and others raising their glasses to the benefits of milk in their lives, starting at sunrise in New Zealand and ending with the sunset in Hawaii.

Arla® Organic Milk launches in MENA
Arla® Organic Milk hit the shelves of leading retailers across the United Arab Emirates as Arla's ambition to win as an innovative dairy brand in this region picked up pace. The launch presents a sizeable opportunity to share our organic products with consumers that seek a stronger availability, awareness, and affordability of more natural and organic products.

Grand opening of the Arla Innovation Centre
Arla's new state-of-the-art Innovation Centre officially opened in May 2017, and continues to play a pivotal role in the pursuit of our strategy by adding more value-added products to the market. Chefs, scientists, consumers and customers collaborate at the centre to redefine trends and technologies that shape worldwide dairy.

Proudly farmer-owned
Our farmer-owned campaign raises consumer awareness, differentiates us from competitors and instills higher consumer trust in our products. To date we have integrated the marque on 90 per cent of all Arla® branded packaging, displayed on more than 900 different products.

Creating our own Lurpak® Christmas tree
Key seasons are important times of the year for the Lurpak®. We increased our ambition on Ramadan and Easter and had a significant presence at Christmas this year, with a successful media campaign spanning across markets. We also created our own Lurpak® Christmas tree in the UK that we took to high footfall shopping locations and our retail partners.

12
MILLION EUR
Invested in an upgrade of AKAFA site.

Investing in high-quality child nutrition
Arla aims to be among the world's leading dairy companies within the high-growth child nutrition category, investing EUR 12 million in an upgrade of our AKAFA production site in Denmark, which is essential in a category where quality is the key differentiator.

Financial overview

Financial key figures (EURm)	2017	2016	2015	2014	2013
Performance price					
EUR-cent/kg owner milk	38.1	30.9	33.7	41.7	41.0
Income statement					
Revenue	10,338	9,567	10,262	10,614	9,870
EBITDA	738	839	754	681	737
EBIT	385	505	400	368	425
Net financials	-64	-107	-63	-30	-88
Profit for the year	299	356	295	320	300
Profit appropriation for the year					
Individual capital	38	30	31	39	43
Common capital	120	193	141	171	131
Supplementary payment	127	124	113	104	121
Balance sheet					
Total assets	6,422	6,382	6,736	6,613	6,187
Non-current assets	3,551	3,714	3,903	3,774	3,427
Current assets	2,871	2,668	2,833	2,839	2,760
Equity	2,369	2,192	2,148	1,874	1,708
Non-current liabilities	1,554	1,742	2,084	2,137	2,189
Current liabilities	2,499	2,448	2,504	2,602	2,290
Net interest-bearing debt including pension liabilities	1,913	2,017	2,497	2,547	2,394
Net working capital	970	831	999	928	906
Cash flows					
Cash flow from operating activities	386	806	669	511	342
Cash flow from investing activities	-286	-167	-402	-416	-470
Free cash flow	100	639	267	95	-128
Cash flow from financing activities	-155	-624	-274	-93	110
Investments in property, plant and equipment	-248	-263	-348	-429	-505
Purchase of enterprises	-7	-	-29	15	-
Financial ratios					
Profit share	2.8%	3.6%	2.8%	3.0%	3.0%
EBIT margin	3.7%	5.3%	3.9%	3.5%	4.3%
Leverage	2.6	2.4	3.3	3.7	3.2
Interest cover	12.9	13.3	13.2	8.2	11.1
Equity ratio	36%	34%	31%	28%	28%
Inflow of raw milk (mkg)					
Inflow from owners in Denmark	4,827	4,728	4,705	4,550	4,508
Inflow from owners in the UK	3,203	3,210	3,320	3,088	1,254
Inflow from owners in Sweden	1,855	1,909	1,995	2,035	2,016
Inflow from owners in Germany	1,759	1,758	1,741	1,526	1,332
Inflow from owners in Belgium	524	515	531	403	253
Inflow from owners in Luxembourg	151	144	130	119	111
Inflow from owners in the Netherlands	54	56	41	17	-
Inflow from others	1,564	1,554	1,729	1,832	3,202
Total inflow of raw milk	13,937	13,874	14,192	13,570	12,676
Number of owners					
Owners in Sweden	2,780	2,972	3,174	3,366	3,385
Owners in Denmark	2,675	2,877	3,027	3,144	3,168
Owners in Germany	2,327	2,461	2,636	2,769	2,500
Owners in the UK	2,395	2,485	2,654	2,854	2,815
Owners in Belgium	815	852	882	997	529
Owners in Luxembourg	215	218	221	228	232
Owners in the Netherlands	55	57	56	55	-
Total number of owners	11,262	11,922	12,650	13,413	12,629

Please refer to glossary on page 134.

Essential business priorities for 2017

In 2017, our essential business priorities focused on delivering price increases and driving margin focus as our strategic focus shifted to driving bold brand growth to create the future of dairy and deliver the highest value to our farmer owners. As volatility persisted in the global dairy industry, we knew that there would be challenges to overcome, but a firm focus on our essential business priorities and Good Growth 2020 strategy were, and continue to be, central to our success.

Deliver price increases and drive margin focus

Our strategic focus to proactively manage prices in 2017 across all European and International markets and categories delivered over EUR 1 billion of sales price increases, and was driven by improved price management analytics and processes. Solid commercial and financial discipline enabled us to succeed, and thereby provide a competitive milk price to our farmer owners.

Make leadership matter in the milk, yogurt and powder category

Successful launches of specialty product ranges, such as Arla® Organic, Lactose-free, skyr, and Protein, in combination with strong branded growth led to advances in driving market leadership in our biggest product category MYPC. We also continued to improve our position with non-genetically modified feed across the European markets.

Drive bold brand growth and bold innovation

We maintained focus on growing our strategic brands Arla®, Lurpak®, Castello®, and Puck® to improve the profitability of our product mix, reflected in higher market shares. Brands accounted for 44.6 per cent of sales in 2017, close to our 2020 goal of a brand share greater than 45 per cent. Our new state of the art Innovation Centre will boost the innovation pipeline to support further branded growth.

Partner for growth with leading customers

In 2017, we made significant progress on our ambition to strengthen the customer centricity of our business and win with leading customers. This required special attention to growth and profitability, joint category development, and delivery service, amongst others. In 2017, we successfully launched a new organisation within Foodservice in Europe.

Control costs, drive operational efficiencies and release cash

Financial leverage outperformed our long-term target range of 2.8 to 3.4 at 2.6 in 2017, illustrating our strong financial position. An increasing mix complexity of our branded portfolio impacted conversion cost in supply chain. Higher price levels challenged our working capital on inventory and receivables, countered by improvements on overdue collection. Marketing spend efficiency increased materially.

Build leading market positions in International

Our International commercial segment achieved significant growth, fueled by numerous new product launches. Across the Middle East and North Africa, Sub-Saharan Africa, the Americas, China and South-East Asia, and other markets including Russia, this was driven by strengthened relevance with consumers, increased market investments, as well as local partnerships.

Strengthen the important German market position

In the challenging German market where margins are pressured, our increased focus on brands and innovation was crucial to improve quality and profitability of our business, and strategic choices towards a new value-focused direction were made. Our commercial bets in Germany focused on managing prices, strengthening our branded positions as well as improving our operational basics.

Accelerating the value journey in Arla Foods Ingredients

Our Ingredients business continued to deliver growth in 2017 with its high-value added products. New investments and strong research and development efforts paved the way to transform the business with a focus on higher-value specialties. Collaboration with partners continued to be a priority to increase the supply of raw materials, supporting our growth ambitions.

Target fully achieved
Achievement on major components
Target not achieved

OUR STRATEGY

As the world's largest producer of organic dairy products, we constantly develop and produce new, high quality organic products.

Arla Baby&Me® Organic is our 100% organic product line for little ones. This product range is designed to give babies a great, organic start to life.

Towards Good Growth 2020

Good Growth is a name with a dual purpose. It identifies both our corporate identity and the strategy that will help us create the future of dairy towards 2020. We want to develop Arla's role as a global food company that adds value to people's lives through natural nutrition and responsible operations. The Good Growth 2020 strategy is our foundation to do so, proactively acting to changing supply and demand for milk, competition, the occurrence of new demographic realities and fast developing consumer trends. By excelling in eight categories, focusing on six regions and winning as one Arla, we strive to achieve global growth and create value for our farmer owners towards 2020.

Our strategy
With the Good Growth 2020 strategy, Arla has a fantastic foundation in place to fulfil people's needs and our dairy products play an important role in doing so. We have matched or own strengths in the dairy categories to the consumer demands we see globally, identifying growth opportunities on a global and regional scale in eight categories. Determining the regions in which Arla has the greatest potential to grow a long-term profitable business for our farmer owners has focused us geographically as we strengthen our global category and brand building, our innovation across borders and our commercial excellence.

Our vision

Create the future of dairy to bring health and inspiration to the world, naturally.

Our identity

Good Growth

Good Growth describes who we are and how we are creating the future of dairy. It is what we stand for as a company, defined and shaped by our actions. It guides how we develop our cooperative, products, markets and ways of working.

Responsible Growth
Growing by ensuring safety, taking responsibility for our impact on society and the environment, and having a long-term perspective in everything we do.

Cooperative Growth
Growing by being farmer-owned and cooperating with all our stakeholders for mutual benefit.

Healthy Growth
Growing by promoting dairy nutrition and helping people live healthier lives.

Natural Growth
Growing by making natural products of the highest quality.

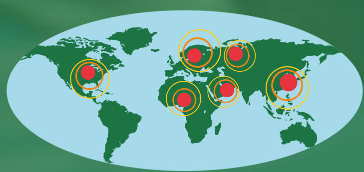
Our mission

To secure the highest value for our farmers' milk while creating opportunities for their growth.

Excel in eight categories

The global dairy industry is developing at high speed and is characterised by a constant evolution of consumer habits and preferences. Analysing consumer needs and trends and matching these to our own strengths, we identified eight product categories that are the core focus for our efforts to shape the dairy market. By offering innovative products with natural ingredients, great taste and good nutrition, we are making it easier for consumers to live healthy lives. Our key categories are milk and powder; milk-based beverages; spreadable cheese; yogurt; butter and spreads; specialty cheeses; mozzarella and ingredients.

Focus on six regions



The six regions represent the markets in which we believe Arla has the biggest potential to grow a long-term profitable business. Arla has a strong position in Northern Europe as the preferred dairy company for consumers, and in Middle East and North Africa where our brands are among the strongest in the food industry. Arla is continually expanding market positions in growth markets such as China, South East Asia and Sub-Saharan Africa, whilst further engaging in opportunities in the US and Nigeria. The six regions are Europe, Middle East and North Africa, Sub-Saharan Africa, China and South East Asia, USA, and Russia.

Win as ONE Arla

Arla has grown significantly in Europe with mergers and acquisitions in Central Europe, the UK and Sweden. The past few years have been spent aligning the different companies into ONE, thereby harvesting the synergies that the mergers created. With Good Growth 2020, we will take this unity to the next level. Arla's ambition is that all our 18,973 employees work from ONE strong common platform. We want to create ONE global Arla where we actively use each other's different competencies and, in so doing, contribute to our success.

Trends in the world around us

Arla is an international business. Key market dynamics impact the global dairy market as we move towards 2020. Analysing these is critical to our success. Shifting economic power, rapidly developing technology, population growth, environmental shifts and changing values are all drivers for an exponentially changing world. Megatrends shape the world around us, presenting both new opportunities and challenges. We have identified the trends most influential to Arla.

2

Authenticity

Authenticity is a standout consumer value declared by everyone from changemakers and celebrities to supermarkets and chefs. In a world where millions share their lives on social media, there is a consumer eagerness to be 'real' and authentically different. Consumers are making more considered purchasing decisions, buying from 'responsible' brands that sell quality products with real value, and following alternative eating trends like flexitarian, vegan and vegetarian. With excellent products and strong brands, a business can be close to consumers as a key differentiator. Arla is in a unique position in this sense, being the largest organic dairy producer in the world and a leading producer of lactose-free alternative dairy products. These characteristics, along with being a farmer-owned cooperative, make our brands and products authentic.

Organic and lactose-free dairy alternatives

1

Healthy living

Whilst being healthy is not a new trend, aspirations for healthy living are more comprehensive today, including aspects of health, wellness and conscious living. This development has led to the creation of new dairy products as well as dairy-free alternatives. Consumers are increasingly looking for transparency in products and packaging. Rapidly changing macro trends lead to diverse consumer requirements for products, formats and packaging. Retailers increasingly seek differentiation and focus on non-genetically modified feed and animal welfare product claims, continually pushing for ways to differentiate milk in order to gain customer loyalty. Our product portfolio caters to a broad range of health needs and we continuously innovate to meet consumers' demands and to aid a balanced lifestyle.

Innovative dairy products to aid a balanced lifestyle

3

Simplicity

Almost 70 per cent of people are looking for ways to simplify their lives, according to Euromonitor's Global Consumer Trends Survey. As technology is becoming so engrained in all aspects of life, consumers have a growing desire for simplicity, an antidote to consumerism, endless choice and constantly updated products and services. Freedom to choose, to see, to listen, to do and to say is crucial for today's consumer. The trend for increased simplicity also applies to food products. As consumers look for items with limited or no artificial ingredients, Arla's product benefits, a clean label and short ingredient lists, meet consumer demands of today. Compelling attributes of Arla products are no synthetic hormones and no preservatives features - natural products from cow to consumer.

Natural products from cow to consumer

4

Connected consumers

Consumers are becoming increasingly connected. Connected consumers use smartphones, computers, tablets and other devices to connect to the internet, in order to experience and interact with digital content. These digital connections disrupt and challenge the traditional structures of shopping, entertainment and socialising, amongst others, and underpin shifts in how consumers live, work and consume. The experience is becoming almost more important than the product itself. While connectivity first spread through developed markets, the growth of affordable mobile technology has enabled consumers in the developing world to come online. This is underpinning generational shifts in how they live, work, shop and play. Digitalisation is essential in all industries but also in creating the future of dairy.

Connecting with farmers and consumers via virtual reality

Market presence in developing markets

5

Shifting market frontiers

As some areas of the globe become over-populated or otherwise reach their maximum potential, others gain prominence for their unexploited potential. By 2030, emerging and developing countries will account for almost half of global GDP and 86 per cent of the population. Rising business investment, increasing disposable incomes, better infrastructure and growing access to internet have contributed to exponential growth in areas of the world such as China, Nigeria, Ghana and Bangladesh. To ensure future growth, businesses need to adapt to changing demographic, economic and technological developments bringing new markets from frontier into the spotlight. Understanding and reacting to these critical shifts is a global differentiator. Arla's European origin has an international appeal and our International business segment is continuing to delivering solid double digit growth rates.

The trends on this and the previous page were identified by Euromonitor International, 2017.

Responding to change

In December 2015, Arla presented a new five-year strategy, Good Growth 2020. Two years into the strategic period, we are tracking well against our initial ambitions for growth with key brands, markets and customers. However, we also believe that our strategy must constantly evolve to incorporate changing market conditions, consumer trends and base assumptions. It is our job to analyse, understand and respond to these trends and their potential impact on our strategy and financial results. Here we highlight the major trends and changed assumptions over the last two years and our corresponding responses to maximise our strategy.

	Consumers	Customers
Change	Consumers are becoming more and more conscious and selective of what they consume, which has led to, amongst others, a very strong drive for a healthy lifestyle and buzz around naturalness of products. Growing urbanisation is driving a liking for on-the-go food consumption. These developments have accelerated versus our original evaluation, and we acknowledge that flexitarian consumption with less meat and more lifestyle protein alternatives, and the demand for more milk types in the EU has grown faster than we expected.	Digitalisation of the industry is progressing at an even faster than anticipated pace and on multiple levels with, for example, digital platforms and digital marketplaces. In China, our e-commerce sales grew by 11.5 per cent in 2017. Other customer developments are continuing as expected in 2017 and beyond, for example the ongoing private label pressure in the EU. It is important to adapt, together with our customers, to the growing developments in order to stay relevant to the consumers.
Our Response	For Arla, naturalness is at the core of our identity and heritage. We continuously innovate to fulfill consumers' demands and to aid a balanced lifestyle. In response to changing consumer demands, we have expanded our product portfolio to cater to a broad range of health needs and consumption preferences, from high-protein to low sugar and on-the-go. Arla is also the largest organic dairy producer in the world and a leading producer of lactose-free alternative dairy products. We are also a farmer owned cooperative and uphold high animal welfare standards. These niche traits contribute to our products' and brands' unique characteristics and give consumers the possibility of purchasing products to either meet their dietary preferences, contribute to animal welfare or support a community of farmers.	Digitalisation is essential to creating the future of dairy. Arla sells through e-commerce channels in many countries, introduced the concept of virtual reality farming on social media and engaged in an array of digital marketing initiatives, for example, live streaming how everyday people experience our products, as well as virtual reality cheese tastings. We drive the dairy category together with our customers through joint category development to ensure growth in value above volume. Our largest focus is on our brands-brand growth is key for stronger profitability and to drive less volatile earnings. At the same time, our aim is to optimise our private label positions and to be a strategic own-label partner to our customers and forge long-lasting relationships.

"We believe that the best strategies are those that are dynamic and adaptable to change. At Arla, we continuously evaluate developments and trends as they unfold in order to ensure that we are directed by the best strategy for our business."

Peder Tuborgh, CEO

Owners

The dairy industry is global, but the supply and demand for milk are increasingly geographically detached. Since the abolition of the EU quota system in 2015, farmers are able to produce unlimited quantities of milk for the first time ever, which led to an underlying assumption of increased production in the EU. As a result, we expect approximately 1.5 billion kg more milk in Arla by 2020, however, this is approximately 1 billion kg less than originally anticipated.

Ensuring that we create the most value possible for the existing milk pool is critical. In order to do so, we continue to channel our milk through the means and to the markets where the highest value can be added. The premium of the branded business is generating higher margins than other alternatives. Prices remain volatile across the dairy industry, which emphasises the need to continually improve the underlying business composition. In the long run, the branded business will win over the commodity market through stability and prices. Our branded business has grown dramatically in recent years and now represents approximately 44.6 per cent of total revenue.

Emerging macro

Emerging markets other than the EU and US continue to drive firm growth and generate approximately 95 per cent of dairy growth. Meanwhile, the economic outlook in the Middle East and North Africa was affected by oil price declines. Whilst this development was considered when setting our strategy, the impact in the region has been more severe than originally anticipated. Other macro developments such as the embargo in Russia which is still present, are in line with original expectations.

With a wide presence in emerging markets, International continues to drive solid double digit growth rates in 2017 and exhibits a positive growth outlook for the foreseeable future. The Middle East is a special focus area for us, being our biggest strategic growth market outside Europe and the aim is for Arla's business in the region to double by 2020. We recently launched organic milk here under the Arla® brand, a first for consumers in this region. To sustain double-digit International growth and balance risks, we continue to broaden our distribution networks and strengthen our production footprint. To respond to the embargo in Russia for example, we managed to set up local production and limited imports of speciality cheese.

EU macro

The majority of our revenue is generated in Europe which makes it a very important market to us. We continue to expect a stable development in this region, however, Brexit is a destabilising factor in the EU and the severity of it remains unknown. That said, as negotiations progress and we fully take charge of the opportunity to ensure our views are heard at the highest level in the UK, the great unknown of Brexit becomes less destabilising.

As a company, we are in favour of the free movement of goods and people. We want the final trade deal between the UK and EU to be free from tariff and non-tariff barriers in milk and dairy. As the negotiations progress, we continue to deliver strong, evidence-based arguments to politicians and policy makers hand in hand with our farmer owners and peers in the dairy industry. We are also collaborating with partners in the dairy industry and the wider food and farming community to build support for our position across Europe. For Arla, this is a mission to work to protect the competitiveness of the UK dairy industry within the wider EU, as well as the global dairy market. Refer to page 50 for more on Brexit.

Essential business priorities for 2018

To achieve our long-term strategy, we need a short-term action plan. The essential business priorities are an enabler for our strategy, Good Growth 2020, as they consist of critical areas that we should prioritise in the short-term on our journey to success. In order to continuously deliver strong results for our owners, the Executive Management Team determines our Essentials each year, subject to approval by the Board of Directors. The Essentials are a set of clear and aligned business priorities, aiming to support the growth agenda and direction for the business set out in our strategy.

Improve gross margins

Create the future of dairy with more innovation

Take efficiencies to a new level

Drive strategic brand growth

Drive growth in high-profit areas

Win with customers

Transform Germany and the UK in light of new realities

Arla Foods Ingredients next

As volatility in the underlying commodity market continues, we will maintain a strategic focus on proactive price management. Managing a continually diversifying milk pool, we aim to implement gross margin-enhancing initiatives to optimise the balance between complexity and customer requirements, short-term price volatility, and long-term market positions. With commercial and financial discipline, we are confident that we can ensure a competitive milk price for our farmer owners.

Innovation is a core lever to realise our vision to create the future of dairy, and we will take the next steps towards this by further enhancing our pipeline. Our focus is on the Arla® brand as we cater to the growing demand for lifestyle dairy products, including Arla® Lactofree and Organic. We will empower innovative digital solutions as we expand our presence across digital platforms, and plan to combine our social responsibility, brand and corporate communication programmes to enhance our identity.

Continually realising efficiencies in our business allows us to reinvest significantly into areas that fuel growth, which is what our holistic transformation programme, Calcium, will help us achieve. Calcium will cover activities throughout Arla, from further improving marketing efficiency to supply chain productivity initiatives, and will be a key driver in increasing our performance price. Our ambition is to achieve a bottom line impact of EUR 30 million in 2018.

In 2018, we will continue to develop and sharpen the profile of our strategic brands Arla®, Castello®, Lurpak® and Puck®, specifically, by introducing new sub-brands to our broad product portfolio. We believe that continuing to invest in our brands to increase the share of branded sales will ensure our future growth and profitability. We plan to invest in areas where we see the most growth potential, supported by exciting new marketing initiatives as we secure the identity of our global brands.

In 2018, we will strategically focus on delivering branded growth in high-profit market segments, such as Bangladesh, Nigeria, China, the US and MENA. We will continue to strengthen our partnerships, for example with Starbucks™, and continue to focus innovation on these key markets to ensure future growth. As the European food services market continues to grow, we aim to further develop this line of business in key markets.

Maintaining and building on our strong customer partnerships is at the core of Arla, and in 2018 we plan to continue to do so by driving category growth through our strategic brands, as well as through own-label innovation. Customer service is also a top priority for 2018, as we aim to improve and build long-term customer relationships. Another important and rapidly growing focus area is e-commerce, where we aim to closely cooperate with some of the biggest players.

The UK is an important market for us and as Brexit negotiations progress, we will continue to make our position clear and ensure that we can serve our great customer and consumer base in the UK post Brexit. Germany continues to be a challenging market, but we are committed to transforming the German business. Within supply chain, we will focus on continued development of our production footprint. An increased focus on brands and innovation will be crucial to improve product mix and profitability.

For Arla Foods Ingredients, we will focus on the continued transformation of existing products to higher-value specialties through new investments and focused research and development efforts. As the demand for our specialised ingredients keeps accelerating, we will strive to grow our raw material pool to secure more whey, enabling us to serve our global customer base. We will also strengthen our customer focus and sales capabilities as the business continues to grow in 2018.

OUR BRANDS AND COMMERCIAL SEGMENTS

We strive to redesign the future with renewable packaging. By removing a material layer of our Arla® organic milk carton in Sweden, the carton's climate impact has been reduced by 24 per cent.

Arla's overall ambition is to reduce the climate impact of packaging by 25 per cent by 2020, compared to 2005. We are already a good way along this journey, with new innovations like these paving the way for further climate footprint reductions.

The journey of our Arla® brand

The Arla® brand is our most widespread global brand with over 50 sub-brands in its broad portfolio. Arla® branded products are sold in more than 80 countries, including Northern Europe, China and more recently the US and the Middle East - it ranks as the fastest growing FMCG brand in many countries. The identity of the Arla® brand is very close to our heritage, staying true to our core values of healthy, natural, responsible and being farmer-owned. We bring these values and the goodness of dairy through our products to consumers across the globe.

In 2017, we identified an opportunity to sharpen and shift the Arla® brand, driven by a clear position of what our trusted brand represents, namely a close connection to our Scandinavian heritage and dairy filled with natural goodness. We will continue the journey in 2018 with more consumer facing activities and communication, building a stronger, trusted and loved brand. To enable this journey, we will move focus from many small local products to creating the future of dairy with big innovative global concepts that can travel to more markets and consumers.

The Arla® brand showed strong growth due to increased investment in innovative product ranges, such as Arla® Lactofree, skyr and other natural and high-protein products, as well as infant nutritional formula such as Arla Baby & Me®. The Arla® brand delivered a strategic volume driven revenue growth of 3.4 per cent and revenue for the brand grew by 10.1 per cent to EUR 3,026 million compared to last year, through stronger activation and roll-out of new product developments. The brand also won 21 awards in 2017 and the celebrated prize for being on the list of 'Brands Top-100 Fastest Growing brands in retail' in the Netherlands, achievements we are proud of.

In 2017, we focused particularly on growing the Arla® brand position among consumers. Through winning awards from large retailers globally this year for our Arla® products, we are gaining the acknowledgement from retailers in general which is integral for our continued success.

They say he starts his day with Arla® skyr, 2017

Staying strong with Arla® Protein
Supporting consumers to live an active and healthy lifestyle, in 2017, Arla® Protein extended its range through new package innovation with its on-the-go protein pouch, launched in Finland and the UK. Arla® Protein is now available in 14 markets worldwide and continues to deliver strong growth.

Bringing health and naturalness through good food habits

We believe that creating good food habits can make a positive impact on our lives. The choices we make when purchasing and preparing our meals have an effect on ourselves and the world around us. With the Arla® brand, we want to make eating well, simple and joyful for everyone. Our raw material milk is the best foundation on our journey, being both nutritious and natural.

We continue to stay true to our natural principles and in 2017, we strengthened our health focus with the use of the Arla® brand nutrition criteria, ensuring that all Arla branded products carrying a health claim always deliver on dairy goodness, such as calcium and protein. This builds a trusted and strong position in the long-run.
In addition, we joined the the EU Pledge initiative on responsible food marketing to children in 2017. Together with 21 other major international food brand owners, Arla is committed to responsible marketing to children across Europe.

Building on our farmer-owned platform

We are trustworthy because we are farmer-owned and we will continue to build on this platform. It gives us the right to speak about healthy and natural food, sustainability and good food habits. It is clearly understood by consumers 'that when you grow it, you know it', making it trustworthy for Arla as a farmer-owned brand to have a voice when it comes to origin, naturalness and sustainability. This goes hand in hand with increased responsibility and commitment linking to the importance of our quality assurance programme, Arlagården®.

Our farmer owners play an important role in spreading the fact that we are farmer-owned and what this entails. For Open Farm Days, Organic Days and school visits, farmers in Denmark, Sweden, Germany and the UK invite the public to explore farm life. In 2017, we had a total of over 463,000 visitors in these core markets and educated as many as 33,000 Danish and 24,000 Swedish school children at our farms this year. Our farmer owners also welcomed hundreds of Arla employees to their farms, sharing their passion and knowledge for them to utilise and commercialise in their everyday work.

Focusing on growth areas as we continue our journey

Driven by our resharpened position of the Arla® brand, we will continue our journey in 2018. We identified a number of focus areas that have shown successful growth. We will be targeting our brand to these growth areas, such as Arla® Lactofree and Organic, for consumers seeking a more diverse choice of lifestyle dairy products, and fill-and-fuel for those that seek a balanced diet whilst consuming on-the-go.

Arla® skyr excels in Germany
With revenue growth of more than 94 per cent compared to last year, Arla® skyr is the success story in the German brand business. Arla® skyr will continue to make an important contribution in achieving Good Growth towards 2020.

Arla

Revenue
3,026
MILLION EUR

Revenue development
10.1%

Strategic branded volume driven revenue growth
3.4%
2016: 4.5%

Good food deserves Lurpak®

Lurpak® has long been a symbol of Denmark's dairy heritage, since 1901. Last year, Lurpak® celebrated its 115th birthday, and the high-quality standards of our butter still remain and are the foundation for the brand. Our brand mission is to make good food central to the lives of people by being the champion of good food. Lurpak® is sold in more than 75 countries, from Denmark to the UK and beyond, boasting a global fan base that spans the world.

Reaching consumers with digital

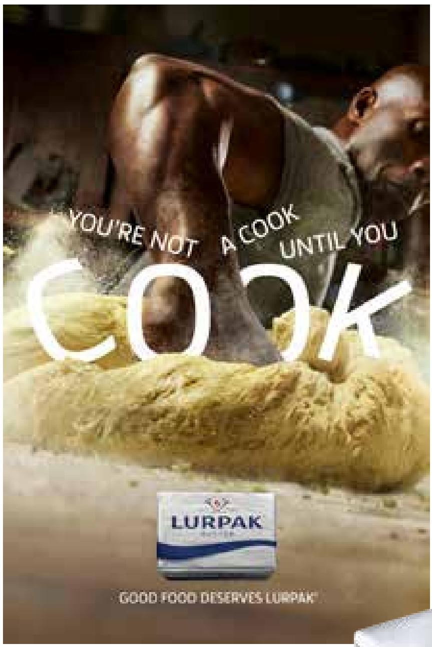
Everything Lurpak® says and does is designed to emotionally engage the public with the full wonder of good food. Be that its creation, enjoyment or discovery. 2017 was the year of step change for digital engagement of our Lurpak® brand. With increased media investment into prioritised channels, data-led targeting and high-quality content, the brand over-delivered compared to our 2020 engagement target, engaging 42 million consumers worldwide. Digital will continue to be a priority channel for Lurpak® going forward, as media landscapes change and we have the opportunity to reach more consumers in new ways.

Exciting initiatives in 2017

In 2017, we continued to roll out our global 'Game on Cooks' campaign into new markets such as Greece, Australia and Sweden to create a truly global campaign. Communicating the naturalness of our products was also a success this year, with a solid increase in the naturalness perception of our brand with a strong digital, shopper and public relations activation plan in key markets.

Impact of rising fat prices

Market fat prices were at a historical high in 2017, being valued more than protein for the first time ever. The increase in the market price eventually translated into increases in sales prices across all core markets for high-fat dairy products such as butter. This development challenged the strategic branded revenue growth for the Lurpak® brand, which was -2.7 per cent for 2017, most notable for Arla in the UK and Denmark.



LURPAK

Revenue

528

MILLION EUR

Revenue development

8.3%

Strategic branded volume driven revenue growth

-2.7%

2016: 7.7%

Indulgent sensations with Castello®

Castello® is a heritage and tradition of creative cheese making since 1893. Innovative new cheeses, dozens of varieties and intriguing flavours, all that tell their own unique story. Castello® cheeses are developed with a real understanding of how we perceive flavour as well as taste, so you can experience something special with every bite. Our speciality cheeses are sold all around the world under the Castello® brand.

Our latest campaign "Sensations by Castello®"

Castello® cheeses each bring to the consumer a unique and indulgent sensation. Be it the intensity of Castello® yellow cheese, the creaminess of the whites or the sharpness of the blues, each cheese delivers an everyday indulgent sensation. Castello® cheeses are developed with a real understanding of how we perceive flavour as well as taste, so our consumers can experience something special with every bite. We believe that eating should not be a one-dimensional experience, so we use our experience and creativity to create cheeses to surprise your senses with every bite.

Castello® achieving growth

The Castello® brand achieved a solid strategic branded growth of 2.7 per cent in 2017. The brand showed especially strong growth in Australia and Greece.

Revenue
181
MILLION EUR

Revenue development
3.1%

Strategic branded volume driven revenue growth
2.7%
2016: 3.0%

Celebrating the everyday chef with Puck®

Puck® is MENA's leading brand and is reaping the benefits of its transformation, a journey that started two and a half years ago. A new brand positioning based on strong consumer insights, upgraded packaging graphics for the entire portfolio and a fresh new look and feel across all communication platforms are just some of the things that Puck® underwent. Its trusted and natural product range includes mozzarella, labneh, and several cream cheeses.

Continuing Puck's® growth streak

The Puck® brand achieved solid results in 2017. As MENA's leading brand, Puck® continued to perform strongly with a strategic branded growth of 4.4 per cent in 2017.

Puck® also reached the number one market share this year in Saudi Arabia, an especially solid achievement given the turbulent macroeconomic environment in MENA in 2017.

MENA Effies 2017 award winners

Ending 2017 strongly, Puck® celebrated the success of its Ramadan Lend #AHelpingHand campaign. The effectiveness of this campaign was recognised at the prestigious MENA Effies of 2017, where it won two silver awards and a bronze.

Revenue
339
MILLION EUR

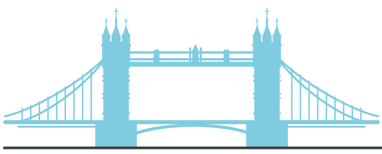
Revenue development
6.8%

Strategic branded volume driven revenue growth
4.4%
2016: 10.6%

Europe

The Europe zone, representing 63 per cent of total revenue, continued its Good Growth journey in 2017. It grew its branded milk and yogurt business against a backdrop of volume declines and adverse currency effects. The zone delivered significant sales price increases, which contributed to an increase in revenue of 3.9 per cent, also reflecting the rising fat price market.

Despite these volatile and challenging conditions, we maintained our brand position in Europe and even saw the Arla brand grow and take market share in the UK, Netherlands and Germany. Cross-Europe big bets contributed significantly to growth, with Arla® skyr and Protein continuing their successful growth across Europe and our Lactofree and organic product lines delivering sustained growth. We followed consumers into new channels like e-commerce, working with existing customers and online retailers like Amazon in the UK and Germany. The European food services market continued to grow. This year we stepped up our food services businesses and established Arla Pro which delivered strong growth, mainly driven in the Netherlands, Finland and the UK.



UK

Arla® was the fastest growing brand among large manufacturers in the UK and our Arla® BoB (Best of Both) white milk was voted product of the year. Our farmer-owned model was key to winning a significant contract to supply liquid milk to Morrisons. The weak GBP, a consequence of Brexit, challenged the business' profitability. However, we continue to develop robust plans to deal with the eventual outcome of the Brexit negotiations. Refer to page 50 for more detail.

Germany

The German business continued to mature as we executed our strategy and lifted profitability. It was a challenging year, especially regarding price evolution, but we saw significant growth in the Arla® and Starbucks™ brands in retail. Arla® skyr won several awards and our strong position in organic fresh milk with the Arla® Bio brand was reinforced.

Denmark

Our Danish business continued to develop positively despite a challenging domestic dairy market. The business delivered innovations such as launching white milk based on non-GMO feed and new Arla Baby and Me® products. We also had record positive reputation scores that reflect the high level of consumer trust in Arla.

Revenue split by country

"We ended the year stronger as a zone and leveraged our scale, allowing us to roll out innovations quickly. We lifted revenue across the board through significant sales price increases, whilst maintaining our brand positions and growing our market share with the Arla® brand. A weakened GBP put pressure on our business and rising market prices for fat slowed growth in branded fat products."

Peter Giørtz-Carlsen, Executive Vice President

Revenue, MILLION EUR
6,568
2016: 6,321

Strategic branded volume driven revenue growth
-0.1%
2016: 3.2%

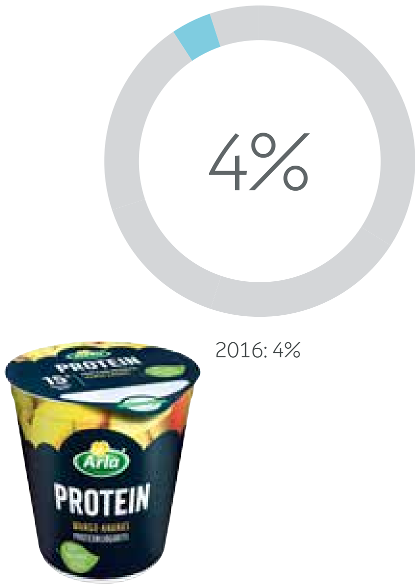
Brand share
48.3%
2016: 47.6%

Revenue development
3.9%
2016: -6.9%

Sweden
Arla's reputation continued to improve throughout the year, which contributed to the long-term health of our brands. Sweden was a key market for our Arla® Lactrofree products, which tapped into a growing consumer trend for lifestyle dairy products.

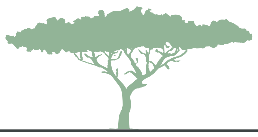
Netherlands and Belgium
Our market share in fresh dairy reached the highest level ever and is now running above 10 per cent. Our growth was achieved with a leading position in organic, innovations such as Arla® skyr, Protein and Lactofree and close cooperation with our customers. Our focus in Belgium was to build the business to deliver at a similar pace as the Netherlands.

Finland
Despite a long-term trend of decreasing dairy consumption, the key focus brands, Arla® Luonto+ in yoghurt and Lempi in cooking, kept growing. In yellow cheeses, both Arla® family cheeses gained market share and the Castello® launch into the category exceeded expectations.

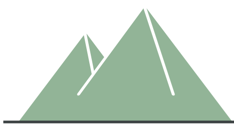


International

The International zone, which comprises 16 per cent of total revenue, continued its journey of delivering profitable growth in 2017. We achieved double digit growth with our strategic and local brands. We continued to seek new opportunities and in 2017 we expanded into new markets in the Sub Saharan Africa, North Africa and South East Asia regions. The zone was challenged by volatile global market conditions, but we successfully executed our growth strategy and delivered on our big bets.



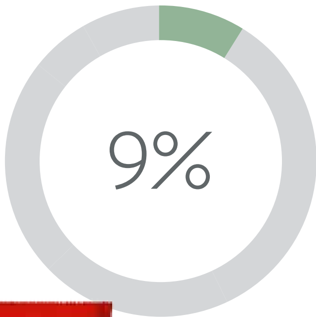
Sub-Saharan Africa
Our business in Sub-Saharan Africa continued to grow. We navigated a challenging currency environment in Nigeria, our main market, in the first half of the year and the business almost doubled its revenue in 2017. The increase in revenue was driven by the growth of the Arla® Dano Milk Powder brand. We also strengthened our footprint across the region, opening operations in Ghana and increasing our capacity in Lagos. And we invested in our next generation product portfolio for the West Africa region.



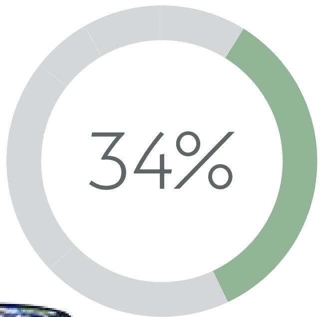
Middle East and North Africa
Our strategic agenda in the Middle East and North Africa progressed well in 2017, despite low economic growth and political uncertainty affecting the region. Revenue grew and we continued to develop new opportunities, including launching the Arla® Organic Brand in the UAE and locally produced cheese in Egypt. We strengthened our branded positions on Puck® and Lurpak® in the region throughout 2017. Our focus on growth, particularly in high-margin product ranges through innovation, gave us a great foundation to build on going forward.

Americas
2017 was a big year for Arla in the US. We entered the market by positioning Arla as a challenger in the cheese category, leveraging our brand proposition and high-quality natural products. Our products are performing strongly and we created great brand awareness with our marketing investment. Alongside this, Canada drove strong profit growth. We also divested our shares in Vigor in Brazil, and continued to develop our cooperation with Dairy Farmers of America as part of our strategy to grow in the US.

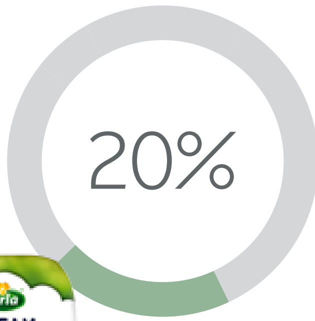
Revenue split by region



2016: 6%



2016: 36%



2016: 24%

"We had strong performance this year, building on the gains we made last year. We achieved a solid strategic volume driven revenue growth, grew our branded market share in key markets and delivered strong price management which drove profitability in a year of volatile market conditions. Investments in markets such as Africa and China are paying off and give us a strong foundation to deliver in 2018 and beyond."

Tim Ørting Jørgensen, Executive Vice President

Revenue, MILLION EUR
1,616
2016: 1,428

Strategic branded volume-driven revenue growth
10.5%
2016: 10.7%

Brand share
83.9%
2016: 81.4%

Revenue development
13.2%
2016: 5.9%

Russia and others

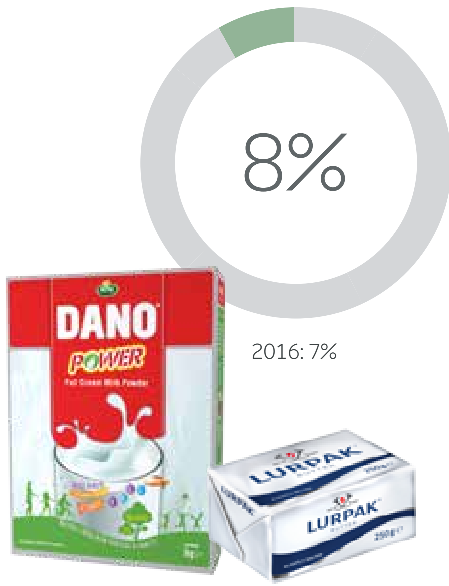
There was a strong turnaround in our Russian business which delivered profitable growth despite the ongoing embargo. We continued to drive branded positions and saw very strong growth of Lurpak® in distributor sales markets, Australia and Greece. Castello® showed good growth in Australia and Norway. Our milk-based beverages business, under the brands of Arla® Protein and Starbucks, grew significantly in Spain and Greece in retail and convenience channels. Our foodservice business continued to develop and we will continue this journey next year under the Arla® Pro brand.

China

We almost doubled our revenue in China during 2017 and the business improved its profitability. Our partnership with Mengniu is progressing well. We continued to strengthen our branded position, particularly with Infant Milk Formula and organic products, but saw imported UHT move towards European price levels. Our reorganisation of the Asia business into two separate regions, China and South East Asia, will go live in January 2018.

South East Asia

Bangladesh continued to grow through the Arla® Dano brand and our businesses in Singapore, Japan and Korea delivered profitable growth. We continued to expand our footprint in the region, including signing a partnership agreement with Indofood, one of the leading FMCG companies and dairy players in Indonesia. This gives us a significant platform to grow in this market.



Arla Foods Ingredients

Arla Foods Ingredients (AFI) is a 100 per cent owned subsidiary of Arla and a global leader in whey-based ingredients used in a wide range of categories from bakery, beverages, dairy and ice cream to clinical, infant and sports nutrition. AFI contributes 6 per cent of total revenue. The products, which are produced in Denmark or by one of AFI's three joint ventures in Argentina and Germany, are sold in more than 90 countries.

2017 was another successful year for AFI, delivering 19.6 per cent revenue growth compared to last year, largely driven by a strategic focus on value-added ingredients and a strong Third Party Manufacturing (TPM) business. In 2017, Arla's child nutrition plant was transferred to AFI. For more than 20 years, AFI has delivered double digit annual growth rates by pushing the boundaries of technology and innovation, growing our volume and revenue.

The whey industry is entering a new phase

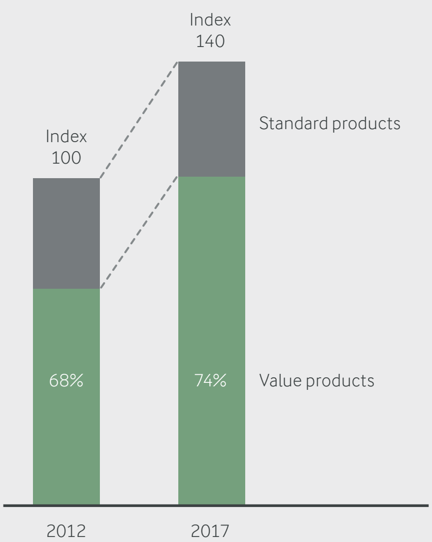
Significant changes are impacting the industry in which AFI operates. In the past, whey was regarded as a simple by-product from cheese production. Today whey is treated as an ingredient in its own right, and in the future, AFI's core markets will need even more product differentiation. Whey is no longer a commodity product where one size fits all. Our customers and consumers are the most demanding in the dairy industry, and they want specialised products of the highest quality.

AFI aims to take full advantage of the developing industry

In order to succeed in becoming the global supplier of value added whey, AFI seeks to grow its raw material pool in the coming years through sourcing, partnerships and joint ventures. AFI will deliver an ambitious innovation agenda, by continuing to grow and refine the existing products and implement new innovative concepts.

- AFI's growth will be based on value-added sales, refining our products for our strategic business segments: Infant Nutrition, Clinical Nutrition, Sports Nutrition, and Food. We will increase our value-add ratio compared to standard products, delivering more value to our customers and creating more value for our farmer owners. Over the past five years, we invested approximately EUR 220 million in our value-add business, by amongst others, increasing our capacities.

Volume of standard products and value-add products



- In our TPM business, we conducted large investments to increase our supply of infant formula. Arla's Child Nutrition plant, ARINCO, was transferred to AFI, realising synergies between sales and supply chain and enabling us to continue to grow the infant formula business even stronger in the coming years.

- We worked hard in 2017 to address the future demands to quality and food safety performance in collaboration with our customers. AFI intend to be recognised as a market leader in food safety and quality, and we will invest heavily in both people and infrastructure to implement it.

"Through a strong innovation agenda, we continuously push the boundaries of what technology can bring to whey. In 2017, we addressed future demands for quality and food safety in collaboration with our customers, and invested heavily in our child nutrition business."

Henrik Andersen, Group Vice President

Revenue split by regions,
MILLION EUR

651*

2016: 545

	2017	2016
Europe, the Middle East and Africa	49%	47%
Asia	41%	40%
Americas	10%	13%

Revenue development

19.6%

2016: 5.0%

**A large part of Arla Foods Ingredients activities are carried out in joint ventures, which are not included in the consolidated financial statements. Revenue including joint ventures amounts to EUR 766 million.*

AFI'S MISSION

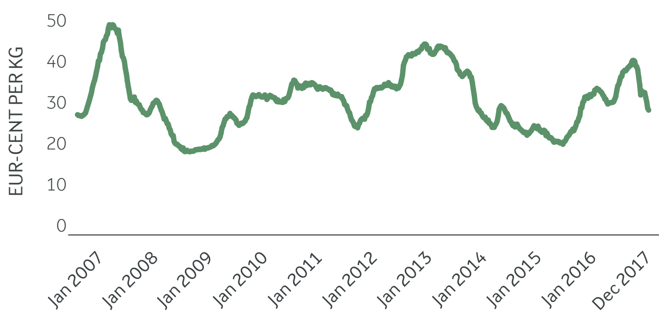
To discover and deliver all the wonders whey can bring to people's lives.

Trading

In addition to our main sales channels, Arla conducts business-to-business sales to other companies for use in their production, as well as industry sales of cheese, milk powder and butter. Trading activities contribute 15 per cent of total revenue, and although this is not a core business segment for Arla, it is critical to our success.

The market for dairy has become increasingly volatile, especially since the abolition of the EU quota system in 2015 in Europe, making it difficult to predict milk volumes. Trading allows us to manage seasonal and geographical availability in milk intake. Trading and other sales increased 18.0 per cent in 2017 to EUR 1,503 million, versus EUR 1,273 million last year. The average value of commodities was higher in 2017 compared to last year and for the first time in history, fat was more valuable than protein. The adjacent graph illustrates the extreme volatility cycle in the dairy industry.

Combined fat and protein prices, three year cycle showing volatility in the dairy industry



OUR COOPERATIVE

Through continuous innovation and uncompromising standards for the highest quality, our milk powder products provide the reassurance of a strong heritage and proudly display our Farmer Owned marque.

Arla Dano® milk powder provides the essential energy and nutrition families need for growth and strong health, especially in developing countries.

Our business model

Arla is the fourth largest dairy company in the world based on milk intake and the world's largest and leading organic dairy producer. Our farmer owners are at the core of our business model, true to our cooperative structure. Rooted in our mission, it is our objective to secure the highest value for our farmer owners' milk while creating opportunities for growth and fulfilling the needs of our consumers and customers with our natural and innovative products and brands.

Creating value, from cow to consumer

Arla is a farmer-owned cooperative. Creating value for our farmer owners' milk is embedded throughout the value chain, from cow to consumer. We continuously seek growth opportunities worldwide, strive for sustainable market leadership and improve value creation through investment in innovation and our brands. We operate our entire value chain with a continuous focus on quality, efficiency and optimisation of our raw materials, capital and human resources. This promotes growth among our current farmer owners and inspires new members to pursue their future with Arla.

Proudly farmer-owned

As the world's oldest dairy cooperative, our philosophy of producing natural, healthy and high quality dairy products dates back to the 1880s when dairy farmers joined forces with one common goal: to produce and provide the best dairy products. Our heritage has laid the foundation for our cooperative today, empowering Arla to drive innovation for dairy.

ONE milk pool

As a dairy cooperative, our primary raw material is the raw milk delivered by our farmer owners. Having ONE milk pool irrespective of the origin of the milk, allows a holistic use of our raw milk across Arla. In the pursuit of securing the highest value for our farmer owners' milk in accordance with our mission. Operating as ONE ensures that milk can flow to markets with the best opportunities. We want to create the maximum value for all collected raw milk: ONE milk pool, with the same quality requirements through our quality assurance programme, Arlagården®, together with an efficient supply chain, enables Arla to balance the raw milk volumes in the most profitable way in support of our ambition.

ONE milk price

Our farmer owners farm across seven countries and are all paid ONE milk price, i.e. the prepaid milk price for raw milk delivered during the year, with the exception of limited transition periods following the entry of new members. The prepaid milk price is set with the ambition to reach a targeted range of 2.8 to 3.2 per cent annual result net profit. As part of the annual profit appropriation subject to approval by the Board of Representatives, our farmer owners receive a supplementary payment based on their annual milk volumes.

Milk flow across legal entities

In our cooperative, all raw milk from our farmer owners is purchased by the parent company, Arla Foods amba. Subsequently, the parent company sells the raw milk to relevant Group entities at the same price paid to our farmer owners – a price based on the average earnings generated across all markets and product categories. Our dairy activities are global and earnings are different in individual markets and across product categories. Earnings in some markets and legal entities may be higher or lower than average. However, based on the cooperative principle, it is the average of all earnings that determines the milk price paid to farmer owners. The profitability of the Group entities may differ significantly between markets and year to year, but all entities contribute positively to our cooperative.

Consumers and customers

With our unique brands and products we are able to provide our consumers and customers the opportunity to live a healthy and balanced lifestyle. Our extensive product portfolio caters to a broad range of consumer preferences and needs.

Production and logistics

With 18,973 employees across 120 countries, we work to achieve efficient and streamlined operations - from ensuring world-class food safety standards in our production line, to reaching worldwide markets in our supply chain.

Innovation

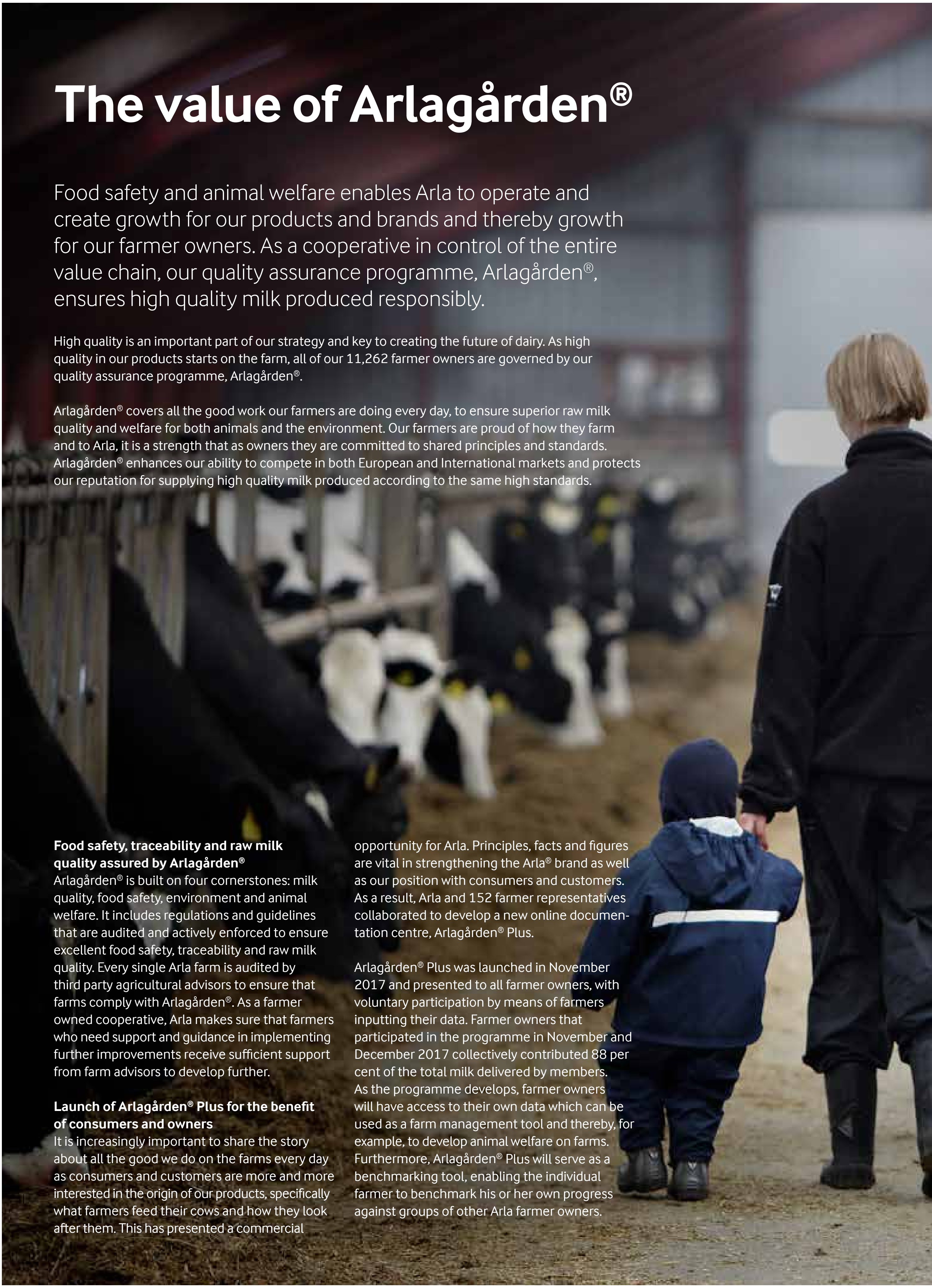
We aim to fulfil the growing demand for more and better natural dairy products by using all our knowledge in dairy farming, milk expertise, nutrition science, product and packaging design to bring new and exciting products to market. These innovations build our strong brands and create the future of dairy.

Farmer owner

As both owners and suppliers, our farmers are at the centre of our business. As a cooperative, Arla is obliged to collect all of our farmer owners' milk, at ONE milk price, with a commitment to add value to it.

Value creation

A competitive milk price creates sustainable growth improvements for our farmer owners. In order to achieve this, Arla creates value per kg of milk through proactive price management, innovation, brands, cost programmes, international growth and economies of scale.



The value of Arlagården®

Food safety and animal welfare enables Arla to operate and create growth for our products and brands and thereby growth for our farmer owners. As a cooperative in control of the entire value chain, our quality assurance programme, Arlagården®, ensures high quality milk produced responsibly.

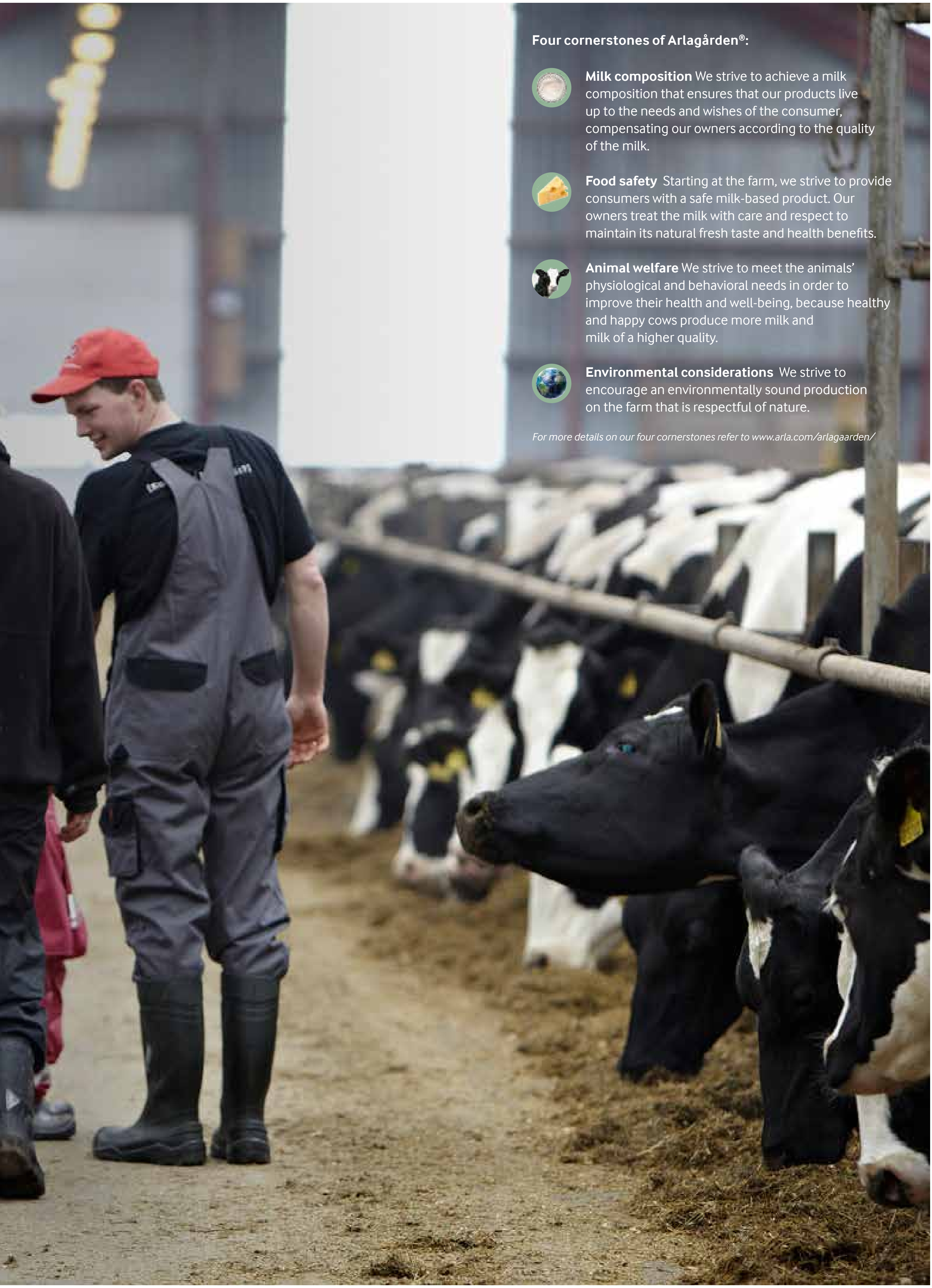
High quality is an important part of our strategy and key to creating the future of dairy. As high quality in our products starts on the farm, all of our 11,262 farmer owners are governed by our quality assurance programme, Arlagården®.

Arlagården® covers all the good work our farmers are doing every day, to ensure superior raw milk quality and welfare for both animals and the environment. Our farmers are proud of how they farm and to Arla, it is a strength that as owners they are committed to shared principles and standards. Arlagården® enhances our ability to compete in both European and International markets and protects our reputation for supplying high quality milk produced according to the same high standards.

Food safety, traceability and raw milk quality assured by Arlagården®
Arlagården® is built on four cornerstones: milk quality, food safety, environment and animal welfare. It includes regulations and guidelines that are audited and actively enforced to ensure excellent food safety, traceability and raw milk quality. Every single Arla farm is audited by third party agricultural advisors to ensure that farms comply with Arlagården®. As a farmer owned cooperative, Arla makes sure that farmers who need support and guidance in implementing further improvements receive sufficient support from farm advisors to develop further.

Launch of Arlagården® Plus for the benefit of consumers and owners
It is increasingly important to share the story about all the good we do on the farms every day as consumers and customers are more and more interested in the origin of our products, specifically what farmers feed their cows and how they look after them. This has presented a commercial opportunity for Arla. Principles, facts and figures are vital in strengthening the Arla® brand as well as our position with consumers and customers. As a result, Arla and 152 farmer representatives collaborated to develop a new online documentation centre, Arlagården® Plus.

Arlagården® Plus was launched in November 2017 and presented to all farmer owners, with voluntary participation by means of farmers inputting their data. Farmer owners that participated in the programme in November and December 2017 collectively contributed 88 per cent of the total milk delivered by members. As the programme develops, farmer owners will have access to their own data which can be used as a farm management tool and thereby, for example, to develop animal welfare on farms. Furthermore, Arlagården® Plus will serve as a benchmarking tool, enabling the individual farmer to benchmark his or her own progress against groups of other Arla farmer owners.



Four cornerstones of Arlagården®:

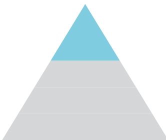
Milk composition We strive to achieve a milk composition that ensures that our products live up to the needs and wishes of the consumer, compensating our owners according to the quality of the milk.

Food safety Starting at the farm, we strive to provide consumers with a safe milk-based product. Our owners treat the milk with care and respect to maintain its natural fresh taste and health benefits.

Animal welfare We strive to meet the animals' physiological and behavioral needs in order to improve their health and well-being, because healthy and happy cows produce more milk and milk of a higher quality.

Environmental considerations We strive to encourage an environmentally sound production on the farm that is respectful of nature.

For more details on our four cornerstones refer to www.arla.com/arlagaarden/



Our Code of Conduct

Responsibility is part of Arla's DNA. This is why we continue to maintain high standards for our healthy, safe and natural products, the environment, and the people we employ and do business with. We are committed to constant improvement, combining tradition and world-class innovation, and incorporating nature into the entire value chain from cow to consumer. The Code of Conduct applies to all Arla employees and at all our sites worldwide and forms the foundation for how we act and operate.

Responsible company
In Arla, it is a given that profitability and ethical business practices go hand in hand. This is achieved through commitment, know-how, willpower and hard work.

Business principles
We comply with our Code of Conduct and the local laws in all the countries in which we operate.

Operational principles
We manage our business in a responsible and cooperative way that promotes the financial interests of our farmer owners. We enable our farmer owners' participation in important decisions.

Market conduct
We have a transparent and ongoing dialogue with consumers and customers, and we support competition on equal terms.

Procurement and supplier relations
We expect our suppliers to assume social and environmental responsibility as we do ourselves, so we can achieve our objective of purchasing goods and services in a sustainable manner.

Confidence in products
Supplying safe products is our top priority. And we strive to do even more- we aim to make it possible for consumers to make their own informed and healthy choices of products based on clear information and knowledge.

Food safety
Food safety cannot be compromised. This is why we have certified food safety systems, quality programmes and committed employees which ensure safe products of high quality throughout our global supply chain. We ensure our products are safe, no matter where they are manufactured.

Nutrition and health
We are committed to meeting our consumers' demand for natural and healthy products and reliable labelling of nutritional information and ingredients, helping consumers make well-informed decisions.

Care for the environment and animal welfare
As a dairy company, we have a natural interest in good environmental and dairy farming practices. We work to continuously reduce our adverse environmental impact, and maintain high animal welfare standards.

Environment and climate
Our ambition is to reduce our environmental impact from cow to consumer through food production and transportation of goods. We continually improve our environmental performance by applying sound and sustainable principles throughout our entire value chain.

Dairy farming
We actively support the development of sustainable dairy farming. Healthy cows on well-kept farms give better milk. Together with our farmer owners, we formed the quality assurance programme Arlagården®, which covers aspects such as animal welfare, milk quality and the environment. Refer to page 40 for more detail.

Responsible relations
We have relationships with people, organisations and communities in many countries. No matter what the relationship is, we are committed to maintaining mutual respect and understanding.

Workplace
We provide safe and healthy working conditions, for our competent, committed and engaged employees, creating a workplace that is inclusive, stimulating and respectful.

Human rights
Arla not only provides food products but also a culture that upholds internationally recognised human rights, respecting the human rights of all people.

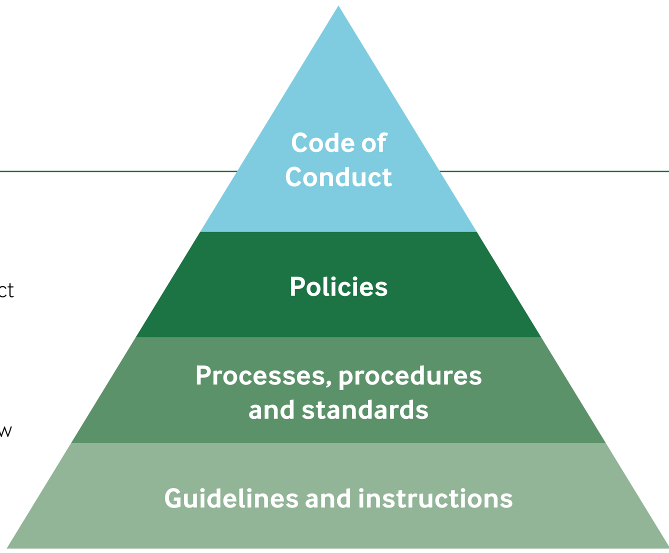
Society and community relations
We engage in open, respectful and constructive community relations and establish long-term relationships to contribute to both local and global development.

Our compliance activities

Responsible business conduct comes from living our Code of Conduct and strong company values through a culture of honesty and integrity. We expect all employees to act ethically and in compliance with Arla's Code of Conduct. Our corporate policies are built on this foundation and are business principles that address critical aspects of individual or business conduct. Our corporate policies guide us to act responsibly and with integrity, and help us govern our ways of working as ONE aligned and efficient Arla.

Through our compliance framework we drive compliance with our Code of Conduct by ensuring that adequate policies, processes and guidelines are established, embedded and enforced throughout the business. All white-collar employees are trained in our Code of Conduct and asked to complete the mandatory policy awareness e-learning. Other high risk compliance training courses are also provided, such as global security and competition law.

High risk compliance areas are monitored continuously through review and audit activities. Furthermore, all employees are encouraged to speak up and voice any concerns or violations to the Code of Conduct, including corporate policies, for example, through our whistleblower service.



Examples of our compliance activities

Safeguarding of assets
Arla works continuously to develop a robust internal control environment, by strengthening and automating existing internal controls and establishing new controls to mitigate identified significant risks. Risk assessments are performed to identify and prioritise high risk areas for detailed compliance reviews and self-assessments. This provides Arla with a transparent overview of financial and operational risks and highlight areas of weakness or with significant control gaps, which are addressed with mitigating activities.

IT security
Arla continuously assesses the increasing threats from the online world to ensure that we have proper and adequate IT security and internal controls in place. Our employees are the first line of defence and we prioritise education in cyber-security whereby all Arla employees are educated in cyber security in a mandatory 'Are you cyber-safe?' e-learning. Our stronger focus on the increased IT security risks that we face means that we continuously assess our IT controls and governance around access to our systems, including our SAP platform, to secure that we are strengthening our resilience towards IT security risks and cyber threats.

Data protection
In 2018, the new General Data Protection Regulation (GDPR) will come into force imposing new and stricter obligations on Arla when processing personal data relating to employees, members, business partners and consumers. In 2017, Arla initiated a GDPR compliance project and put in place a project team that will ensure compliance going forward.

Fraud and Bribery
It is Arla's policy to conduct business in an honest and ethical manner and we have a zero-tolerance to fraud and bribery. We are committed to acting professionally, fairly and with integrity in all our business dealings, transactions and relationships and we systematically implement and enforce effective systems to counter corruption and fraud.

Our responsibility

We operate our business in a sustainable and responsible manner based on our Code of Conduct. We believe that in developing our operations in this way, we are able to respond to the increased demand for accessible and sustainable food options as the population of the world grows. Working in this manner safeguards and develops Arla's reputation and profitability, while caring for people and delivering growth. In 2017, we divided our activities into four main strategic areas: health, inspiration, natural and human rights.

Health

As one of the world's largest dairy companies, Arla has the opportunity to influence millions of consumers' food habits. We make dairy available in a variety of tasty products, and enable consumers to live healthier lives.

Highlights 2017

93 per cent of Arla® branded products in the milk, yogurt and everyday cheese categories now comply with the Arla® Nutrition Criteria.

Arla has joined 21 other major food companies in signing up to the voluntary EU Pledge initiative on responsible food marketing to children.

Arla Foods Ingredients is engaged in a project with NGOs to increase the general health of Ethiopia's children by making better use of the milk from the country's 11 million cows.

Inspiration

Inspiration is evident in all parts of Arla, and we aim to inspire through our farmer owners sharing experiences on new farming practices, and consumers feeling inspired to cook different recipes or try new products.

Highlights 2017

Many consumers were engaged in 2017 through our wide range of digital networks, for example through social media or recipes on our website. Our digital sites had 148 million interactions.

With our 'little farmer programmes' we invited 70,000 school children to our farmer owners' farms, educating more than a million children to date about life on the farm and the origin of their food.

Arla Next, our farmer owner training programme , involved 60 participants in 2017 from Denmark, Sweden, the UK and Central Europe.

"Authentic socially responsible brands and businesses are winning the world over as more people are using their purchasing power to create change and to support issues and causes they believe in. As a cooperative, Arla will create greater awareness of our Good Growth identity and strategy and show how we will create the future of dairy."

Peder Tuborgh, CEO

Read more about our commitments and achievements for 2017 in Arla's Corporate Responsibility Report on http://www.arla.com/csr-reports/ in accordance with section 99a in the Danish Financial Statements Act.

Natural

Together with our farmer owners, we are in the unique position of being able to work with every step in the whole value chain, to make a positive contribution to a more sustainable future.

Highlights 2017

Increased use of biogas at our dairies with 5.7 per cent of Arla's total use of energy derived from biogas, and 24 per cent from renewable sources in total in 2017.

Focus on operations, packaging and transport with Arla's total climate impact decreasing by 18 per cent since 2005, despite increased production.

Launch of a digital documentation centre, Arlagården® Plus, which is a database that details information about the farm, animals and animal welfare. Refer to page 40 for more detail.

Human rights

We contribute to the UN sustainability goals through job creation, responsible sourcing, and competencies on quality, food safety and product innovation. We are committed to meeting international human rights principles.

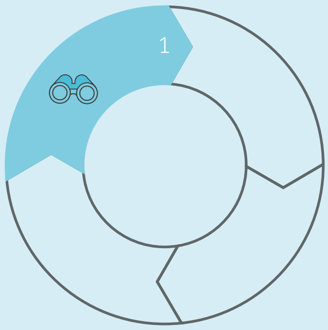
Highlights 2017

During 2017, we published a Modern Slavery statement, outlining our commitment to tackling modern slavery and human trafficking, and adapted our procurement tendering process to secure that suppliers comply with the Modern Slavery Act.

In our strengthened focus on human rights impacts, we conducted human rights due diligences in Indonesia and Ghana, both in terms of country assessments and partner assessments.

Promoting and supporting risk awareness

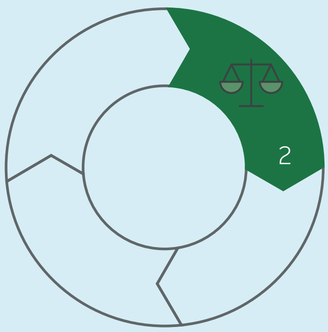
The potential of our strategy, Good Growth 2020, is promising, but there are also a number of areas where Arla faces increased risks and uncertainty in pursuit of growth. In 2017, we significantly enhanced our risk management processes throughout the organisation and reorganised our set-up to elevate strategic risk management (SRM) in our business. Our goal is to promote and support risk awareness for braver decision-making, to seize key business opportunities and ensure more effective execution.



Risk and opportunity identification

To identify risks and opportunities at Arla, we continuously monitor the global market situation as well as internal processes, ensuring early and proactive decision making.

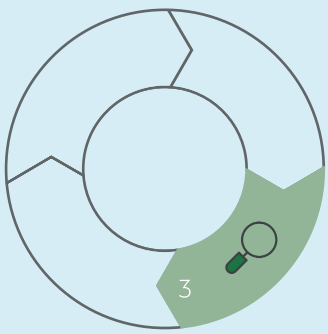
Our SRM process is designed to identify major risks using the insights of leaders from all major areas across the Group. Furthermore, certain expert functions such as Global Tax, Treasury, Legal and Procurement also monitor their specific risk profiles on a regular basis during the year. In 2017, we revised our risk and opportunity categorisation into either events or trends. including new areas such as cyberattack and changing consumer demands etc. We also integrated it to our annual business planning process on all levels of organisation to ensure incorporation into daily decision-making .



Risk and opportunity assessment

Risk and opportunities are assessed both individually and systematically, allowing adequate prioritisation and allocation of resources.

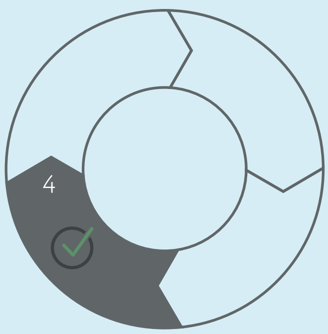
Assessment is performed based on two dimensions: Potential financial impact on profit and likelihood of occurrence. The former includes quantitative and qualitative measurements such as reputation, impairment to brand value, impact on market position and media coverage. The likelihood aspect considers if a given risk or opportunity materialises within the next three to five years. During 2017, we enhanced our focus on building risk management capabilities and held a number of work and training sessions across the global Arla organisation.



Risk and opportunity management

We continuously manage our risks and opportunities by developing and implementing appropriate mitigating actions and exploring opportunities within our business.

Our SRM function is focused on integrating risk efforts into existing processes, as well as developing harmonised methodologies and tools. This process is supported by a common language and a clear methodology for assessing risks and defining opportunities. In 2017, we completed a one year collaboration with external consultants to ensure that we had implemented best practice SRM. We also established task forces to manage mitigation plans for key focus areas, for example, Brexit and General Data Protection Regulation.



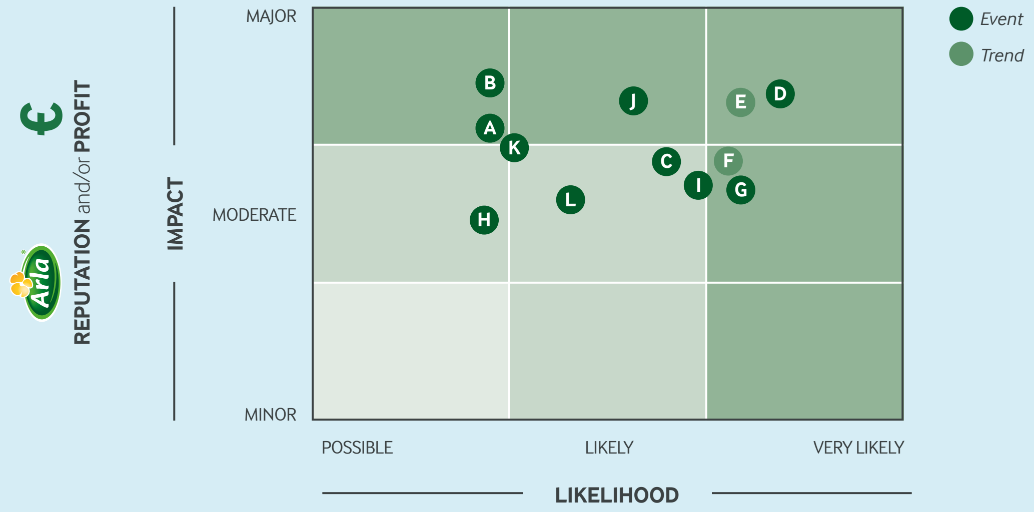
Risk and opportunity monitoring and reporting

As both risks and opportunities are subject to constant change, we aim to increase their transparency.

Risk owners monitor development in risk trends and identified or emerging opportunities in their respective business areas. They are also responsible for consistently ensuring the adequacy and effectiveness of our risk mitigation and resolution strategies. To enable a real value creation, in 2017 we aligned reporting timelines across all functions and integrated risk and opportunity management throughout our performance management reporting procedures and tools. The result is a summary of top risks and mitigating actions, which is revised formally to the Board of Directors twice a year.

Our risk landscape

Arla's risk landscape highlights our top emerging, strategic and operational risks, characterised as either event or trend risks. Our increased risk awareness through 2017 is reflected in the risk landscape. We assess risks based on the potential impact on Arla's reputation and/or profit, as well as the likelihood of the risk to occur within the next three to five years. The assessment is based on the net effect after all current mitigating actions.



Supply and production disruptions

Being in control of the entire value chain gives Arla a major foundation to manage our risks well. Guaranteeing food safety is our key priority. Besides clear and professional crisis management processes, upgraded in 2017, and active application of analyses to improve product quality and prevent reoccurring failures, our focus is on adherence to the Arlagården® quality assurance programme and our comprehensive quality, health, environment and safety model to safeguard the highest quality for all our products. Furthermore, failure or breakdown of our vital production facilities, or any hazard risks like explosions or strikes could affect business operations. An emergency programme exists across all production sites and lessons from historical incidents are continuously incorporated. In 2017, an explosion and fire occurred in a section of a drying facility, which did not impact the business. Crisis plans were in place and damages were repaired within a month. Deliveries were covered by safety stock and processes have been adapted accordingly.

Risk	Risk scenario
A	Major product recall damaging the Arla brand and image
B	Major breakdown at key production site

Milk price and volume volatility

Continued milk volume and price volatility strongly influence our sales volumes and profit respectively. Arla's Good Growth 2020 strategy focuses on value creation through our strong brands and products, which continually reduces exposure to commodity pricing. Nevertheless, to reduce these risks, we significantly enhanced our price and performance management in 2017. Market milk prices increased in 2017 in comparison to last year, leading to a more sustainable financial situation for our farmer owners.

Risk	Risk scenario
G	Milk price and volume volatility

Market risks and global instability

Having sales and production across the world means that we are exposed to both specific country risk as well as most macroeconomic developments. Economic turmoil in emerging markets, volatility in commodity prices and political instability increase our risk exposure, leading to thorough monitoring of developments and trends, and continuous internal agility to changes. We review both external factors and internal levers as a part of our business review process, plan mitigation steps and monitor the developments.

Brexit will have inevitable consequences for Arla and was determined as our most critical risk. Hence, we undertook extensive study and scenario planning to understand Brexit implications and secure a robust plan for Arla for the different possible Brexit outcomes. For more information on Brexit, refer to page 50.

Risk	Risk scenario
C	Political instability and economic turmoil in emerging markets
D	Consequences of Brexit and further EU exits and protectionism

Financial and IT risks

Arla's main financial risks relate to exchange rates, tax disputes, interest rate changes and pension liability valuations. Due to exposure to international markets, our sales occur in a range of currencies. To manage this risk, the Group hedges expected future cash flows for selected key currencies. Furthermore, we constantly monitor and review worldwide tax matters to ensure our compliance in all locations.

Based on external incidents in 2017, as well as the expansion of our operations to new markets, we assessed that risks relating to cyber security have increased. To minimise cyber security risks, we continuously review our activities. Furthermore, in 2017 we rearranged our task force to strengthen our work on IT control requirements and in monitoring compliance in this area across the global organisation.

Risk	Risk scenario
H	Taxation and transfer pricing risks
I	Currency, interest and pensions risks
J	Major cyber attack

Changing consumer demands and digital disruption

The increasing role of our branded business requires a higher risk awareness regarding reputational and social media impacts to protect the brand value of our company. In 2017, we distinguished changing consumer demands and digital disruption risks as trends. Hence, we dramatically increased our digital engagements with consumers, allowing us to improve our understanding of consumers and continuously monitoring behavioral trends and hereby supporting product innovations, exploring new technologies and digital business models.

Furthermore in 2017, we experienced a rising popularity of alternative eating trends like flexitarian, vegan and vegetarian, and saw animal welfare concerns in social media. Based on our quality assurance programme, Arlagården®, our focus on natural and healthy products and being the world's largest organic milk producer, we proactively position ourselves at the forefront of natural food options.

Risk	Risk scenario
E	Digital disruption and new competitors or retailers
F	Growing anti-dairy and vegan movements

Business ethics, legal and HR risks

Negative impacts on human rights and a violation of business ethics could severely harm Arla's and our brands' reputation. These risks are part of our major risks due to our geographical exposure combined with increased societal expectations. To minimise business ethics and legal risks, a number of activities are performed by our Legal, IT and Corporate Responsibility departments. During 2017, we significantly increased our resources on data privacy to ensure compliance with upcoming EU General Data Protection Regulation.

The loss of key personnel in strategic positions and the inability to recruit and retain sufficiently qualified people also pose risks to our business performance. To mitigate this risk, we create the right corporate culture and work environment, as well as provide employees development and global career opportunities. In 2017, we set a new record achieving an engagement score of 84 per cent in our annual employee survey.

Risk	Risk scenario
K	Negative impact on human rights and/or non-compliance
L	Loss of key personnel in strategic positions and recruiting and retaining the best talent

Preparing for Brexit

The effects of Brexit are our biggest risk. As negotiations progress, Arla continues to make our position clear, as a company in favour of the free movement of goods and people. The future trading relationship between the EU and the UK remains uncertain and we are preparing to handle a variety of Brexit scenarios.

It is important for Arla's customers and consumers that our products can move freely across the markets in which we operate to optimise the utilisation of our ONE milk pool and global supply chain. With 3,203 farmer owners based in the UK, the country is Arla's biggest commercial market, accounting for approximately 25 per cent of the total revenue. A recent CEBR Economic Impact Assessment valued Arla's total economic footprint in the UK at more than GBP 6 billion in Gross Value Added terms once direct and indirect impacts are factored in. Successful and loved brands in the UK market, including Lurpak®, Arla® Lactofree and skyr, are imported to the UK, with some others such as Castello® yellow cheeses being exported from the UK, and changes to the EU-UK trade relationship may significantly challenge this business. The Arla Brexit Task Force has been appointed to assess the impact of Brexit from a total value chain perspective, focusing on three possible outcomes:

- Free Trade Agreement (FTA), our preferred outcome, without tariffs for dairy products;
- World Trade Organisation (WTO) relationship, under which certain quotas would be apportioned without any tariff impacts; and
- 'No-deal scenario', under which dairy would be traded under WTO most-favoured-nation tariffs with a significant impact on our business as well as the UK dairy industry.

We want the final trade deal between the UK and EU to be free from tariff and non-tariff barriers in milk and dairy and are collaborating with partners in the dairy industry and the wider food and farming community. Arla has contributed to dairy being the first industry to reach a public united position on the best future EU-UK relationship for our industry. We have advocated a positive solution for the future trading relationship in high level engagements with the UK government and the EU.

As the negotiations progress, we will continue to deliver strong, evidence-based arguments to politicians and policy makers hand in hand with our farmer owners and peers in the dairy industry. And as the UK government begins developing its post Brexit agricultural policy, we will work closely with them to protect the competitiveness of the UK dairy industry within the EU and the global dairy market.

Brexit negotiations: key dates

Jan 2018
Negotiations directive for the transitional agreement

Mar 2018
Guidelines for the framework of the future relations negotiations

Oct 2018
Agreement on withdrawal agreement and transitional agreement, plus a political declaration on defining the scope of the future relationship

Nov 2018 - Mar 2019
Ratification of the agreement (European Council, European Commission and European Parliament plus UK)

Mar 2019 - end 2020
Detailed negotiations of the FTA, and transition period

Our tax affairs

In recent years, multinationals have experienced a growing interest from media, non-governmental organisations and the public in general in how their tax matters are organised. As a globally operating company, Arla acknowledges the key role of taxes in the budgets of the countries in which we operate. Our approach to taxes conforms with Arla's global Code of Conduct and is founded on a set of key tax principles approved by the Board of Directors.

The BEPS project of the OECD led to the development of new tax principles and increased reporting and documentation requirements for multinationals. We are fully committed to meeting the new requirements for reporting and transparency. As we have always done, we will continue to strive for an open dialogue with tax authorities around the world, regarding our business and our tax reporting.

Accountability and governance

The complexity of our business requires a significant focus on tax management. Our global tax function is organised and driven to ensure that, as a business, we have the right policies, people and procedures in place to adhere to the key tax principles and ensure a transparent and strong tax management setup.

We continuously work on establishing the internal standards and control mechanisms required to adhere to our key tax principles. Accountability for tax processes, with a few exceptions, resides within the global tax function.

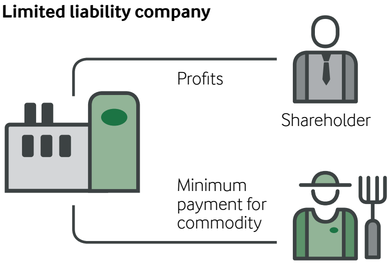
Operating under a cooperative tax scheme

As a cooperative based in Denmark, our activities are governed by the Danish tax rules for cooperatives. Arla's members are also our suppliers, and earnings do not accrue in the company but go back to the members in the form of the highest possible payment for their milk. The cooperative's earnings can therefore be viewed as the farmer owners' personal income.

The members of Arla will generally pay income tax on the amount received for their milk. Danish cooperative tax rules reflect the fact that the cooperative acts as its members' extended arm, and as such, Arla pays income tax in Denmark based on our assets, namely equity.

Arla holds a number of subsidiaries globally. Our subsidiaries are typically limited liability and private limited companies subject to regular corporate taxation just like all other similar companies.

Limited liability company



Cooperative

Our key tax principles

Arla's strategic ambition is to act as a responsible citizen in all tax matters, achieving a balance between managing tax costs, driving efficiencies and ensuring optimisation in a responsible way. Our key tax principles are aligned with this ambition and are the cornerstones for all tax-related matters in Arla.

Our key tax principles are:

- Arla aims to report the right and proper amount of tax according to where value is created
- Arla is committed to pay taxes legally due and to ensure compliance with legislative requirements in all jurisdictions in which the business operates
- Arla does not use tax havens to reduce the Group's tax liabilities
- Arla will not set up tax structures intended for tax avoidance which have no commercial substance and do not meet the spirit of the law
- Arla is transparent about our approach to tax and our tax position. Disclosures are made in accordance with relevant regulations and applicable reporting standards such as International Financial Reporting Standards
- Arla builds on good relations with tax authorities and trusts that transparency, collaboration and proactiveness minimises the extent of disputes.

OUR GOVERNANCE

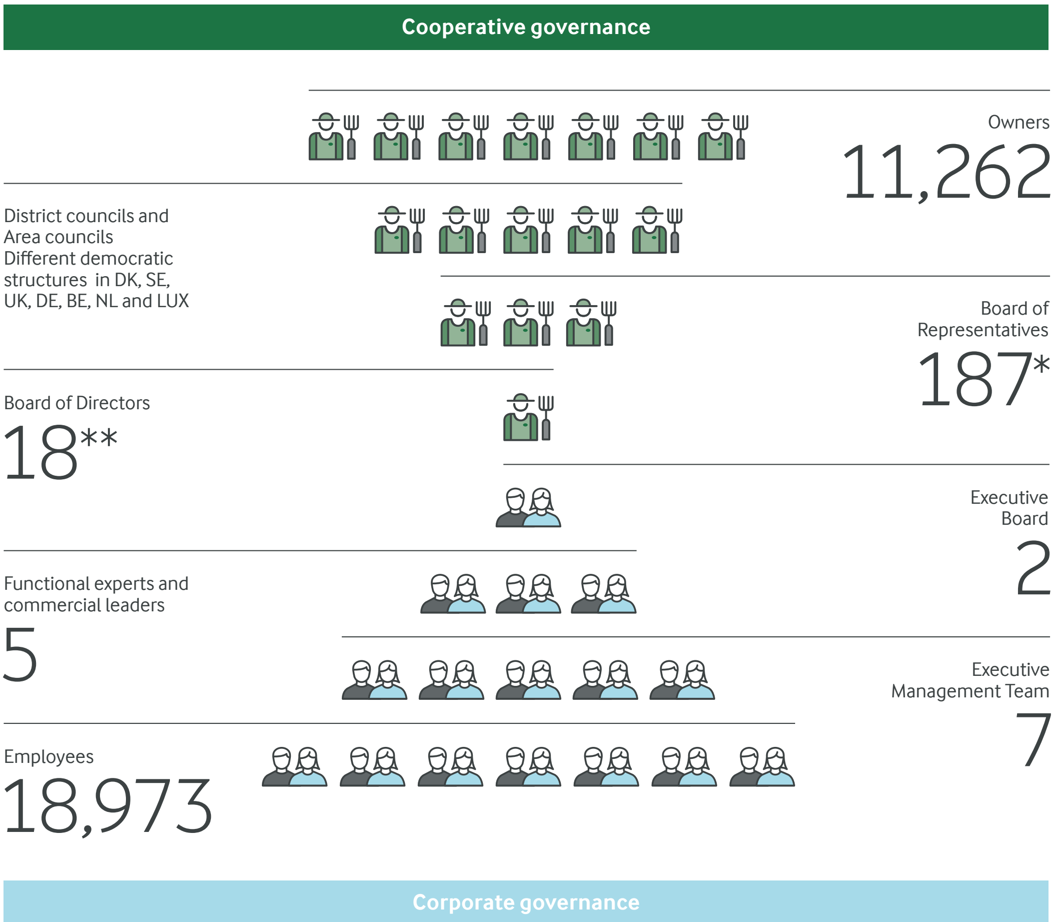
Puck® offers a wide range of dairy products right across the Middle East and is a perennial favourite in the region for its cream cheese.

As consumers are seeking better choices with health being of growing importance in the region, we are expanding our range to include low fat and low salt variants to help consumers make better choices.

Governance framework

Arla appreciates the value of sound governance as a fundamental base in achieving trusting relations with our farmer owners, employees and other key stakeholders. Good governance represents responsible and transparent management and corporate control. As a cooperative owned by dairy farmers in seven countries, good governance is essential for achieving success and enhances the confidence placed in our cooperative.

Arla's governance model



Including 12 employee representatives.
*** Including three employee representatives.*

Cooperative governance

Arla's democratic structure gives decision-making authority to the Board of Directors and to the Board of Representatives. Their primary tasks are the development of the ownership base, safeguarding the cooperative democracy, embedding decisions and developing competencies.

Owners
In 2017, 11,262 milk producers in Denmark, Sweden, the UK, Germany, Belgium, Luxembourg and the Netherlands were joint owners of Arla. Last year, the cooperative had 11,922 joint owners. Refer to page 12 for more detail. As a cooperative, all cooperative owners have the opportunity to influence significant decisions.

District councils
Each year, the cooperative owners convene for a local annual assembly in Denmark, Sweden, the UK and Central Europe (Germany, the Netherlands, Belgium and Luxembourg) to ensure democratic influence of the cooperative owners in the seven owner countries. The members in the district council elect members to represent their district on the Board of Representatives.

Board of Representatives
The Board of Representatives is the supreme body comprising 187 members of whom 175 are cooperative owners, while 12 are Arla employees. Cooperative owners are elected every other year in odd years. Following the 2017 election, over 20 per cent of the members are new and the diversity of the Board has improved. The Board of Representatives makes decisions including appropriation of profit for the year and elects the Board of Directors. The Board of Representatives meets at least twice a year.

Board of Directors
Appointed by the Board of Representatives, the Board of Directors is responsible for decisions relating to long-term strategies, major investments, as well as mergers and acquisitions. The Board of Directors consists of 15 elected Arla farmer owners and three employee representatives. Two new members joined the Board for the period 2017 to 2019, replacing two members not seeking re-election. Following the election this year, the Board reappointed Åke Hantoft as Chairman and Jan Toft Nørgaard as Vice Chairman. The composition of the Board of Directors reflects Arla's ownership. The Board of Directors is responsible for monitoring the company's activities and asset management, maintaining the accounts satisfactorily and appointing the Executive Board. The Board of Directors is also responsible for ensuring that Arla is managed in the best interest of the farmer owners and making decisions concerning the ownership structure.

Area councils
Arla has four area councils that are sub-committees of the Board of Directors and consists of members of the Board of Directors, as well as members of the Board of Representatives. The area councils are established in the four democratic areas: Sweden, Denmark, Central Europe and the UK; to take care of the matters that are of special interest to the farmer owners in each geographic area.

Owner strategy
As a thriving cooperative democracy, we are developing an owner strategy to further evolve and prepare Arla as a cooperative for the future. The strategy will ensure the organisational structure and processes are more uniform and transparent across all seven owner countries.

In March 2017, the Board of Representatives decided to adopt a new governance structure, eligibility and election procedures, as well as an annual meeting cycle. The first elections in the new governance structure took place during spring and the new aligned meeting structure across all areas, for example two rounds of Area Forum meetings, was implemented successfully.

The owner strategy will continue to progress into 2018. The next step will be considering amendments to the Articles of Association to support the new structure, which the Board of Representatives will decide on in February. Furthermore, the UK and Central European cooperative members will make a decision in May regarding potential direct membership. These decisions are part of the owner strategy and aim to achieve harmonisation following the mergers in 2011-2015.

Corporate governance

Corporate governance in Arla is shared between the Executive Management Team and the Board of Directors. Together they define the company's strategic direction and ensure adherence thereof, organise and manage the company, supervise management and ensure compliance.

Executive Board
The Executive Board, appointed by the Board of Directors, is responsible for managing the company, ensuring the proper long-term growth of the company from a global perspective, driving the strategic direction, following up on targets for the year and defining company policies, while striving for a sustainable increase in company value. Furthermore, the Executive Board ensures appropriate risk management and risk controlling, as well as compliance with statutory regulations and internal guidelines. This is where the Group's ambitions are defined for cross-disciplinary efforts. In the first quarter of 2018, Povl Krogsgaard, Vice CEO and Executive Vice President Supply Chain, is retiring after a longstanding career with Arla.

Executive Management Team
The Executive Management Team is responsible for Arla's day-to-day business operations, preparing strategies and planning the future operating structure. The Executive Management Team consists of the Executive Board plus three functional experts and two commercial leaders: Europe and International. In addition to their overall responsibility, the members of the Executive Management Team are individually responsible for managing their respective business areas. The members of the Executive Management Team keep each other informed on all significant developments in their business area and align on all cross-functional measures. In 2018, further increasing the diversity of the team, Sami Naffakh, a French national, will join Arla as an Executive Vice President and Head of Supply Chain.

Functional experts and commercial leaders
The leadership teams within the functional areas and commercial zones are Arla's other executive bodies and focus on ensuring that Arla is result-oriented across organisational units, while also defining policies and sharing and implementing best practices.

Employees
Arla has 18,973 employees globally, compared to 18,765 last year. Our employees are represented by three members in the Board of Directors and 12 members in the Board of Representatives.

Executive Mangagement Team

The Executive Management Team consists of the Executive Board plus three functional experts and two commercial leaders: Europe and International. With a range of different backgrounds and expertise, the Executive Management Team is responsible for Arla's day-to-day business operations, preparing strategies and planning the future operating structure. In addition to their overall responsibility, the members of the Executive Management Team are individually responsible for managing their respective business areas.

Executive Board

1
Peder Tuborgh
CEO

Head of Milk, Members and Trading
Head of Arla Foods Ingredients

Year of birth: 1963
Nationality: Danish

Peder has been with Arla for 30 years, formerly under MD Foods, and has held various senior management and executive positions including Marketing Director, Divisional Director and Executive Group Director. He has worked in Germany, Saudi Arabia and Denmark as part of his longstanding career with Arla. He is also the Chairman of the Board of Pandora and the Vice Chairman of Aarhus University. Above all, he enjoys spending time with his wife, son and four daughters. His favourite product is an Arla classic, Castello®.

2
Povl Krogsgaard*
Vice CEO

Executive Vice President, Supply Chain

Year of birth: 1950
Nationality: Danish

Povl has been with Arla for more than 30 years, and has served as Vice CEO since 2004 with the responsibility for Arla's supply chain and CAPEX. In his longstanding career at Arla, Povl has also held various senior management and executive positions from Product Manager to Executive Group Director. Povl is known for his constant focus on increasing profitability everywhere in the company. His big passion is reading about history, bird watching and his family, which includes his wife and their three grown-up sons. His favourite Arla product would have to be Castello® Danablu cheese.

Other Executive Management Team

3
Natalie Knight
CFO

Executive Vice President, Finance, IT and Legal

Year of birth: 1970
Nationality: American

Natalie joined Arla Foods as CFO in 2016, following 17 years at adidas where she held several senior finance positions, including SVP Group Functions Finance, SVP Brand and Commercial Finance, CFO of adidas North America and VP Investor Relations and M&A. Prior to adidas, Natalie held Investor Relations roles in BASF and Bankgesellschaft Berlin. After having lived and worked in five countries, Natalie is now based in Aarhus, Denmark with her husband and teenage daughter. Her favourite product is Arla® Protein, which she loves as a healthy follow-up to a variety of sport activities.

4
Ola Arvidsson
CHRO

Executive Vice President, HR and Corporate Affairs

Year of birth: 1968
Nationality: Swedish

Ola joined Arla in 2006 as Corporate HR Director, and has been the Chief HR Officer of Arla since 2007. He previously came from Unilever, where he held various director positions across Europe and the Nordics, with his last position as Vice President in HR. Prior to Unilever, Ola served as an Officer in the Royal Combat Engineering Corps in the Swedish Army. Ola dedicates his free time to his wife and three children. His favourite product is a cold glass of Arla® Mellanmjölk together with one of his children's homemade cinnamon buns.

5
Hanne Søndergaard
CMO

Executive Vice President, Marketing and Innovation

Year of birth: 1965
Nationality: Danish

Hanne has been with Arla for 28 years, first joining under MD Foods and then moving to the UK where she played a leading role in developing the Arla UK business. She became the Vice CEO for Arla UK before moving back to Denmark in 2010. With a natural ability for marketing, Hanne was responsible for Global Categories and Brands before taking on her current role. She lives in Aarhus with her partner and enjoys kayaking and cooking. If she were an Arla product, it would have to be Arla® skyr with its Nordic heritage, and strong and healthy characteristics.

6
Peter Giørtz-Carlsen
Executive Vice President, Europe

Year of birth: 1973
Nationality: Danish

Peter joined Arla in 2003 as Vice President of Corporate Strategy, and has held various senior positions in Arla, including Managing Director of Cocio Chokolademælk and Executive Vice President of Consumer DK and most recently Consumer UK. He has been Executive Vice President of Europe since 2016. Outside of Arla, Peter has also served as the Vice CEO at Bestseller China Fashion Group (Tianjin). Peter is currently an executive advisor at FSN Capital Partners AS since 2012. He enjoys road biking, skiing and golfing, and spending time with his partner their two children. His favourite product is Unika® rød løber.

7
Tim Ørting Jørgensen
Executive Vice President, International

Year of birth: 1964
Nationality: Danish

Tim joined Arla in 1991 under MD Foods. He has worked in many senior and executive positions across Denmark, Saudi Arabia, Brazil and Germany before becoming the Executive Vice President for International. Tim has been part of the team since 2007. When he is not working, Tim loves spending time with his wife and four children. When he gets the chance, he enjoys hunting and music. If he was an Arla product, Tim would be Lillebror®, he is the youngest brother, and after 26 years in Arla, his favourite product is the staple Danish summer dessert, Koldskål®.

** In January 2018, Povl Krogsgaard retired after a longstanding career with Arla. Sami Naffakh joined Arla as an Executive Vice President and Head of Supply Chain.*


1
2
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Board of Directors

Our Board of Directors has a wealth of knowledge, consisting of 15 elected Arla farmer owners and three employee representatives. In 2017, we welcomed two new members to the Board, Inger-Lise Sjöström and Simon Simonsen. The composition of the Board of Directors reflects Arla's ownership. One of the Board of Directors' responsibilities is to ensure that Arla is managed in the best interest of all farmer owners.

1
Åke Hantoft
Chairman
Year of birth: 1952
Nationality: Swedish
Member of the board since 2000

2
Jan Toft Nørgaard
Vice Chairman
Year of birth: 1960
Nationality: Danish
Member of the board since 2000

3
Manfred Sievers
Year of birth: 1955
Nationality: German
Member of the board since 2013

4
Harry Shaw
Employee representative
Year of birth: 1952
Nationality: British
Member of the board since 2013

5
Heléne Gunnarson
Year of birth: 1969
Nationality: Swedish
Member of the board since 2008

6
Johnnie Russell
Year of birth: 1950
Nationality: British
Member of the board since 2012

7
Viggo Ø. Bloch
Year of birth: 1955
Nationality: Danish
Member of the board since 2003

8
Markus Hübers
Year of birth: 1975
Nationality: German
Member of the board since 2016

9
Steen Nørgaard Madsen
Year of birth: 1956
Nationality: Danish
Member of the board since 2005

10
Simon Simonsen
Year of birth: 1970
Nationality: Danish
Member of the board since 2017

11
Ib Bjerglund Nielsen
Employee representative
Year of birth: 1960
Nationality: Danish
Member of the board since 2013

12
Bjørn Jepsen
Year of birth: 1963
Nationality: Danish
Member of the board since 2011

13
Inger-Lise Sjöström
Year of birth: 1973
Nationality: Swedish
Member of the board since 2017

14
Torben Myrup
Year of birth: 1956
Nationality: Danish
Member of the board since 2006

15
Manfred Graff
Year of birth: 1959
Nationality: German
Member of the board since 2012

16
Håkan Gillström
Employee representative
Year of birth: 1953
Nationality: Swedish
Member of the board since 2015

17
Jonas Carlgren
Year of birth: 1968
Nationality: Swedish
Member of the board since 2011

Not pictured: Thomas Johansen and Palle Borgström, served until May 2017; Jonathan Ovens, served until December 2017; and Arthur Fearnall, appointed in February 2018.

Management remuneration

Arla's executive remuneration policy is designed to encourage high performance and support value creation. The policy supports alignment with our strategic direction and the interests of our farmer owners. We have a structured approach to remuneration, ensuring that salaries are unbiased towards gender, nationality and age.

Our philosophy

We want our executives and senior management to share our farmer owners interest. The remuneration package is constructed to ensure attraction, engagement and retention of the best senior leaders, at the same time driving strong performance by means of both short and long-term business results. This is achieved by offering a benchmarked remuneration package with the right balance of fixed and variable pay. The competitive remuneration package is reviewed annually by external advisors using market data sources.

Bringing together the interests of our farmer owners and top management

Supporting the growth of the business

Retaining senior executives in critical positions

Making sure we offer a competitive remuneration package

Our performance measures

Arla's remuneration is designed to enable us to recruit and retain individuals with the expertise and ability required to run a growing international company, and to do so in a way that drives our business success and rewards executives and senior management when farmer owners are rewarded. Levels of fixed remuneration are set based on individuals' experience, contribution and function.

Board of Directors

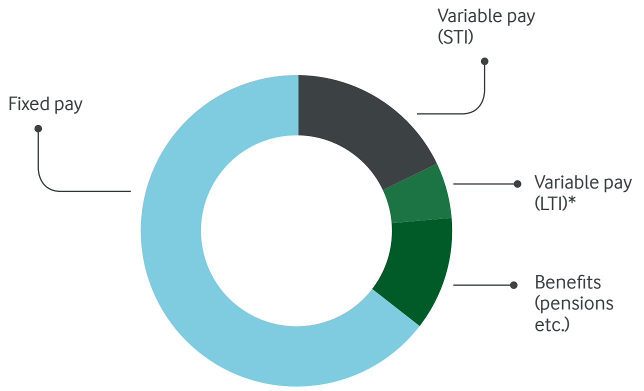
The remuneration of the Board of Directors comprises a fixed fee and is not incentive-based. This ensures that the Board pursues the cooperative's long-term interests without taking into consideration what this may mean in terms of the value of incentive-based remuneration. The Chairman and the Vice Chairman receive a fee that is three times and two times the base fee respectively, and the remaining members of the Board receive equal compensation. Beyond a minimal travel per diem, no additional compensation is paid for meeting attendance or committee services. In 2017, the Board of Directors received a three per cent fee increase, in line with the by-laws. The Board of Directors' remuneration for the year is approved annually by the Board of Representatives.

Executive Board, Executive Management Team and other senior management

The Executive Board consists of Arla's CEO and Vice CEO, appointed by the Board of Directors and elevated from the Executive Management Team. During 2017, other senior management included 92 employees defined as Vice Presidents and above. The Board of Directors seeks to incentivise executives and senior management to ensure the continued positive development of Arla and, as a result, good value creation for our farmer owners. The Board of Directors finds that the best results are achieved when a relatively high proportion of an executive's or senior leader's total remuneration is dependent on achieving Arla's financial, social and environmental targets.

The remuneration package is based on external benchmarks against European and international FMCG companies, providing a competitive and sustainable mix of fixed and variable pay. The majority of the package is fixed pay and consists of an annual base salary, as well as a matching benefit package including a pension contribution. The variable pay component consists of both an annual short-term variable incentive (STI) plan, as well as a three-year long-term variable incentive (LTI) programme. During 2017, the STI was based on internally measured profitability, strategic branded revenue growth, net working capital and leadership index, and the LTI was based on strategic branded revenue growth and performance according to peer group index. The Board of Directors assesses the fees paid to the Executive Board annually, based on recommendations from the Chairmanship. In making its recommendations, the Chairmanship is guided by relevant benchmarks, including Arla's peers and for 2017, the salary was maintained on par with last year. Refer to Note 5.3.a. The Board of Representatives is regularly updated on variable pay parameters and the development in variable pay for executives and senior management.

All executives and members of senior management are employed on terms according to international standards, including adequate non-compete restrictions, as well as confidentiality and loyalty restrictions.



*LTI only applies to a small number of senior and executive management.

Diversity and inclusion

In Arla, we believe that no matter who you are, you can be yourself. Diversity and inclusion are imperative to the success of our business and a diverse and inclusive workforce creates energy, innovation and results. We define diversity broadly as differences between people with a diverse range of backgrounds, while inclusion is about valuing differences among individuals to create synergies.

Promoting diversity and inclusion

As an organisation, we strive for an inclusive and welcoming culture for all employees. To achieve a diverse and inclusive workforce, the 30 to 70 per cent ambition guides our initiatives and targets. Our aim is that all teams have a representation of a minimum of 30 per cent and no more than 70 per cent of the same gender, nationality and age group. This is to secure diversity of thought in all teams and an environment of inclusivity, creativity engagement and performance across Arla.

In our recruitment processes, we have a strong focus on ensuring high predictive validity in our assessment tools. We apply a competency-based approach when assessing candidates to ensure decisions are data-based, thereby removing the bias in the selection process. All recruiters are continuously trained in securing unbiased processes and being close to our hiring managers is also a way of making sure that we hire based on sound arguments not led by intuition.

As men are highly overrepresented in our industry, the gender composition in our owner group reflects the composition among our farmer owners. Similarly, the demographics of the Board of Representatives is representative of the owner group due to democratic elections every other year.

Our workforce

Nationality

Arla has employees from a total of 74 countries. We focus on non-core nationality parameters to ensure continuous progress towards a diverse workplace regarding nationality. In 2017, the majority of our workforce originated from Denmark, Sweden, the UK and Germany, with other countries including Poland, the Netherlands, Finland, India, Saudi Arabia and the US, amongst various others.

	White collar	Blue collar
	33%	40%
	11%	21%
	19%	14%
	9%	10%
Other	28%	15%

Age

Our employees have a wide range of ages and we believe that a workforce diverse in age groups helps us better fulfil the wishes and multi-faceted demands of our consumers around the world. In 2017, the average employee age across Arla as a whole was 40 years. Across all main age brackets, Arla had balanced distribution of employees.

	Total Arla
<30	22%
30-39	25%
40-49	24%
50-59	22%
>60	7%

Gender

Gender is another important element of diversity, however, we believe that experience, background, knowledge, skills and insight are equally important.

Total Arla

Women comprise 28 per cent of Arla's entire workforce, consistent with last year.

2017 28% 72%

2016 28% 72%

Executive Management Team

In 2017, the Executive Management Team is unchanged from last year, having a female representation of 29 per cent.

2017 29% 71%

2016 29% 71%

Our owners

In accordance with section 99b of the Danish Financial Statements Act, Arla has set a medium-term target to achieve a female representation in the Board of Directors of at least 20 per cent, to be reviewed going forward. In order to work towards this target, members of the underrepresented gender are put forward in the elections for the Board of Representatives.

Board of Directors

2017 12% 88%

2016 7% 93%

Board of Representatives

2017 8% 92%

2016 13% 87%

OUR FINANCIAL REVIEW

We add the natural power of milk to the best branded products in the world, making it easier to live a healthy life.

The new doubleshot espresso with no added sugar offers coffee lovers the opportunity to experience coffee with a great Starbucks™ experience when on-the-go.

Market overview

High market and farmer milk prices, as well as significant volatility characterised 2017 both on a European and global scale, mainly driven by record-high fat price increases. 2017 again proved that milk price fluctuations remain a fundamental reality within the dairy industry. Worldwide milk production increased only modestly compared to last year on the back of higher market prices. Whilst the overall macroeconomic environment was healthy, the GBP remained under significant pressure as uncertainty continues to strain the UK economy during Brexit negotiations.

Healthy macroeconomic environment
Macroeconomic development was positive by nearly all measures during 2017, with stock markets up at record levels globally. Gross Domestic Product (GDP) increased in all major regions, with Europe and the US growing 2.2 per cent and China up 6.8 per cent. The development across emerging markets varied, with oil producing countries such as Saudi Arabia and Nigeria being impacted by continued relatively low oil prices.

Ongoing discussions about increased protectionism and potential negative impacts on international trade from political events abated following major elections in France and Germany, signalling a lessening of nationalist agendas throughout Europe. Despite positive macroeconomic indicators, exchange rates for the GBP remained low and the USD deteriorated when measured against the EUR. The GBP averaged 10.6 per cent below average rates of the last three years due to ongoing Brexit negotiations and open scenarios of negotiation outcomes. For currency development and risk mitigation measures refer to Note 4.3.2.

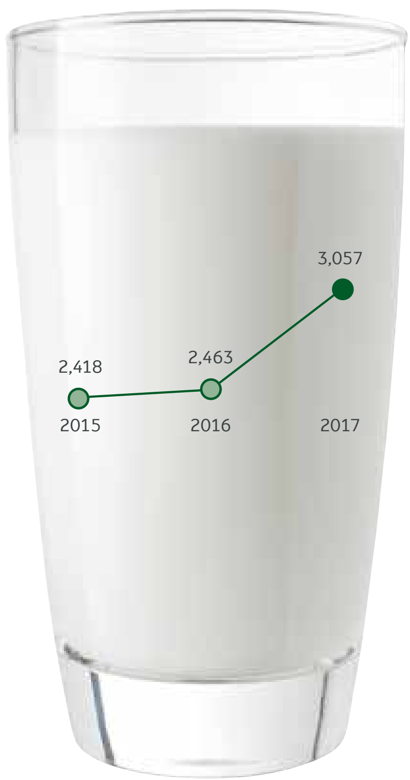
Strong milk price development driven by historic increases in fat prices
Following milk price increases in late 2016, markets were characterised by significant volatility throughout 2017. European and global prices diverged, which became most obvious with European cheese prices increasing significantly and then dropping again towards the end of the year. This was in contrast to Global Dairy Trade prices, which remained relatively stable in 2017. In Europe, prices of fat and protein, the two main components in milk, deviated significantly. Fat moved from a 27 per cent discount in 2016 to a 47 per cent premium versus protein in 2017, due to a lack of supply and increasing demand for fat-rich products versus plant-based alternatives. As a result, fat reached an all-time high price level at EUR 6,371 per tonne in the autumn of 2017.

This led to a unique market situation, where prices paid to farmers hit three-year highs at year-end, driven exclusively by the value of fat, while skim milk products continued to sell at or near intervention prices throughout the year. The market for organic milk is relatively more stable than the market for conventional milk, therefore, given the increases in conventional milk prices, the price difference between organic and conventional milk became smaller.

Milk production increases in the second half of the year due to higher milk prices
Since the removal of milk production quotas in 2015, European milk production has followed price changes with a time lag of approximately six to nine months. Milk production followed the same pattern in 2017, with lower volumes in the first half of the year, followed by an increase in the second half. This development is the opposite of the market price and production patterns of 2016. As a result, European milk production increased 1.5 per cent in 2017, driven strongly by a surge in production late in the year. Milk production in other regions also increased in the second half of 2017, however only moderately due to unfavourable weather conditions in Oceania. New Zealand and US full-year milk volumes grew by 2.5 per cent and 1.5 per cent respectively.

Global dairy demand grows modestly driven by emerging markets
In a pattern similar to the last five years, increasing demand for dairy products continued to be driven largely by emerging markets, where expanded distribution and increasing consumption ensured demand growth at levels at or above GDP growth rates. Two examples were Nigeria and China, where dairy demand grew 2.6 per cent and 8.7 per cent respectively. Dairy demand remained solid in Europe and the United States, driven mainly by cheese and

Global Dairy Trade development, average, Whole Milk Powder
USD/TONNE



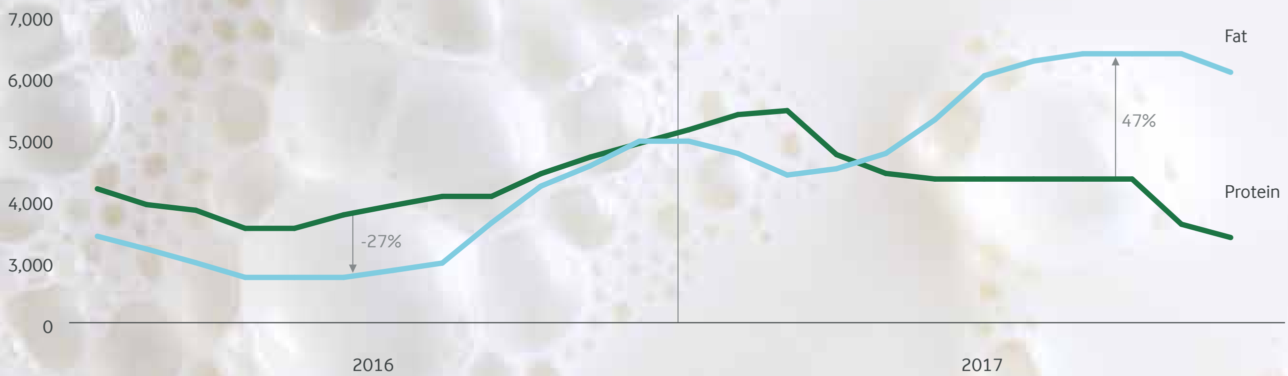
butter, while relatively low oil prices in MENA resulted in continued subdued demand.

Milk price volatility a fundamental reality for the dairy industry

The paradigm of milk price volatility highlighted in recent years is now a fundamental reality for the dairy industry. While milk prices and volumes both grew in 2017, this development masks the strong movements, up and down, that were now largely caused by changes in market supply. Global markets moved from a supply deficit in the first half of 2017 to a growing surplus towards the end of the year. The growing farmer milk supply towards the end of 2017 was driven by high milk prices. Hence, global market milk prices revealed the shifting supply and demand balance throughout 2017. More concrete signs of sustained supply growth from major exporters indicated that global prices had peaked for the current cycle and hence prices eased towards year-end.

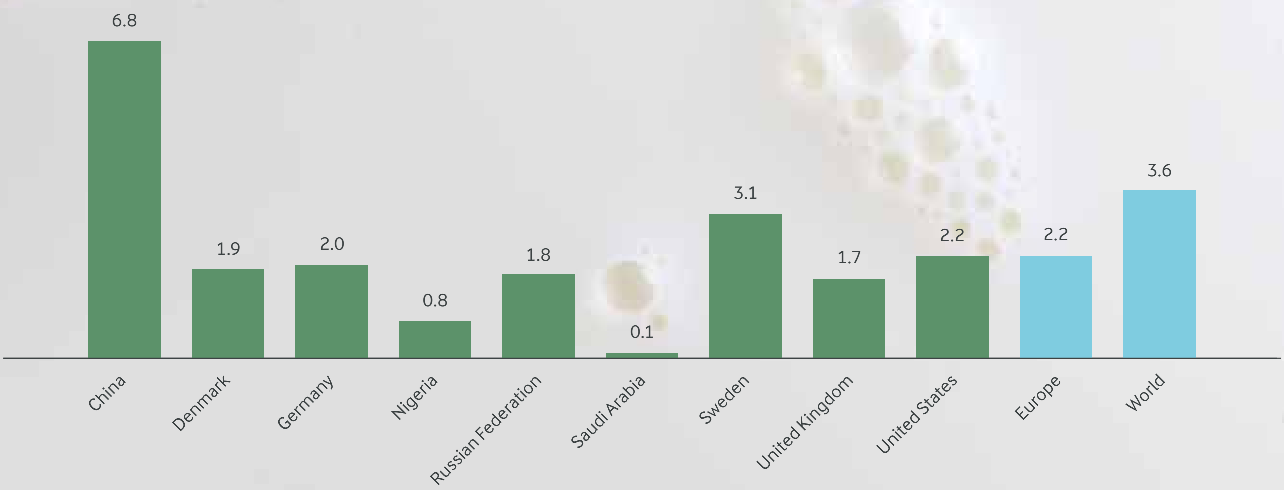
Monthly average protein and fat prices

EUR/TONNE



Real GDP growth 2017

ANNUAL PER CENT CHANGE



Financial review

In 2017, Arla delivered a 27.4 per cent increase in milk prices to our farmer owners with a performance price of 38.1 EUR-cent/kg. Our commercial efforts in 2017 focused on converting increasing market prices for milk into tangible sales price increases while also delivering strategic branded volume growth. These efforts were rewarded with both an increase of EUR 1 billion in sales prices and nearly achieving our Good Growth 2020 share of strategic branded sales target of 45 per cent three years ahead of schedule.

In 2017, revenue grew to EUR 10.3 billion despite unchanged sales volumes, and a leverage of 2.6 underlined our strong financial position and cash flow. All key performance indicators developed positively, with the exception of conversion cost and working capital, which were negatively impacted by scale challenges in supply chain to accommodate growth in consumer demand for new milk types and an increasingly complex brand and product portfolio, as well as higher underlying raw material prices respectively.

Milk price to farmer owners increases due to strong commercial execution

Arla's mission is to secure the highest value for our farmers' milk while creating opportunities for their growth. This commitment to maximise both short- and long-term value for our farmer owners requires strong commercial execution on all levels of our business. This is achieved by constantly honing our price management practices to succeed in increasingly volatile markets, delivering favourable branded growth to improve our product mix and profitability for the future and always delivering firm cost control. In most years, our development tends to favour either high milk prices for our farmer owners or taking important steps to enhance the shape of our business going forward. In 2017, however, we were able to deliver on both of these important objectives.

The performance price is the most relevant KPI for Arla, measuring the value Arla creates per kg of owner milk. In 2017, the average performance price increased by 23.3 per cent versus the prior year to 38.1 EUR-cent/kg, compared to 30.9 EUR-cent/kg in 2016. The drivers of this increase were higher sales prices, as well as improving geographical and product mix.

The prepaid milk price represents the on-account payment farmer owners receive per kg of milk delivered during the settlement period. The prepaid price increased to 35.8 EUR-cent/kg during the 2017 year versus 28.1 EUR-cent/kg during last year, which represents a 27.4 per cent increase for our farmer owners.

Arla milk intake in 2017 grew by 0.5 per cent compared to 2016 levels. The overall year-on-year stability masks a significant seasonality in milk intake throughout the year. During the first and second quarter of 2017, milk intake contracted by -4.5 and -1.2 per cent year-on-year in the aftermath of the low milk prices of 2016. During the third and fourth quarter of 2017, milk intake grew by 2.2 and 4.1 per cent year-on-year, driven by the significant milk price increases over the last 12 months.

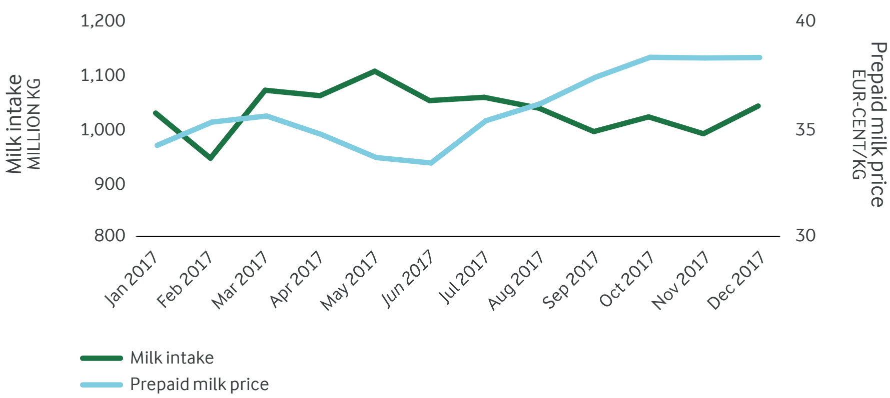
Strong revenue growth due to higher sales prices and product mix improvements

In 2017, revenue increased by 8.1 per cent to EUR 10.3 billion, compared to EUR 9.6 billion in 2016. At Arla, there are four components of revenue development: sales prices, volumes and product mix, exchange rates, as well as changes due to acquisitions and/or divestments. Sales prices and to a lesser extent product mix were the drivers of sales growth in 2017 despite negative development of exchange rates and lost revenues from divestments. As a result, the underlying revenue development, excluding foreign exchange effects and prior year divestments, was 11.6 per cent.

The biggest impact on revenue development in 2017 was higher sales prices. Our strategic decision to focus on increasing sales prices to allow us to maximise milk prices paid to our farmer owners resulted in EUR 1 billion in sales price increases. We are especially proud that in a year with significant price increases, we achieved unchanged sales volumes and a favourable volume/mix effect.

Improving product mix, especially the continued strategic branded volume driven revenue growth, representing an increase of 3.0 per cent compared to last year, versus private label business, which declined 4.1 per cent compared to last year, also contributed positively to revenue development in 2017. As a result, the share of branded business at Arla

Milk volumes from farmer owners versus prepaid milk prices

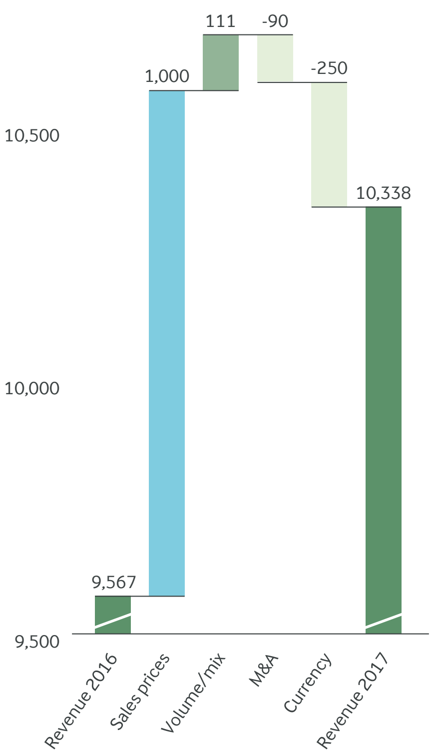


reached 44.6 per cent. This is already very close to our Good Growth 2020 long-term ambition of 45 per cent and represents our most important quality of business indicator within the Group.

Due to our increasing share of sales outside the eurozone, Arla is also exposed to currency fluctuations. In 2017, these negatively impacted our revenue by EUR 250 million, primarily due to the weakened GBP in the UK.

Revenue development

MILLION EUR



In 2017, revenue were also negatively impacted with a full-year effect of EUR 90 million, due to the sale of the Rynkeby juice business in 2016, which was Arla's last remaining non-dairy business unit. For more detail on revenue development please refer to Note 1.1.

Brand growth and innovation journey continues

Our brands are at the heart of our business and drive the majority of Arla's profitability, and we are committed to strengthening and growing them further. In May, we opened the doors to our new Innovation Centre, which will now serve as the home to many product and brand developments. Increasing branded sales is critical for us to achieve stronger relative profitability on a medium- and long-term basis. We also know that branded revenue is less volatile and drives a fundamentally strong connection with consumers. For this reason, Arla continues to focus on growing our branded share of volume and increasing our investments in product innovation.

Strategic branded volume driven revenue grew 3.0 per cent, a significant achievement in an inflationary price environment. This development was led by Nigeria in Sub-Saharan Africa, as well as China and South-East Asia for International, and Germany, the UK, the Netherlands and Belgium for Europe. Brand share for 2017 was 44.6 per cent, compared to 44.5 last year, illustrating continued growth in our brands despite significant raw material price increases, which impact non-branded revenue significantly more and faster than branded revenue. At constant prices, the brand share has improved to 46.4 per cent, which represents a very positive development.

In 2017, we identified an opportunity to strengthen the positioning of the Arla® brand with a renewed focus on innovation. We formalised how we capture Arla's innovation pipeline and measure, monitor closely and increase the value of products during the three years following commercial launch. Arla's innovation pipeline focuses on strategic growth areas, with particular focus in 2017 placed on Arla® Lactofree and Organic products, as well as dairy products to be consumed on-the-go.

In recognition of increasing digital interfaces with consumers, we began to officially measure digital engagement for our brands in 2017. Digital engagement measures interactions on digital platforms such as Google, YouTube and Facebook, through actions such as number of likes, shares, comments, clicks, as well as website and video viewing based on a predefined time, as is an important indicator in measuring our digital reach. 2017 was the year of step change for digital engagement of our brands. With increased media investment into prioritised channels, our brands achieved an impressive digital engagement of 148 million interactions versus 87 million in 2016. As a result of this increased brand prioritisation throughout the Group, our brand recognition equity and market share increased in 2017. In particular, the Arla® brand won over 21 awards during the year, based on campaigns and new product launches, and ranked as the fastest growing FMCG brand in many countries, for example the Netherlands and the UK.

Sales increase for all strategic brands

Strategic branded revenue by brand

Arla®

The Arla® brand is at the heart of our global business and is the key driver of our branded growth. In 2017, Arla® brand sales grew 10.1 per cent to EUR 3,026 million. This development was largely driven by sales price increases. Nevertheless, Arla® branded volumes grew by 3.4 per cent. This improvement was primarily a result of the expansion in the milk-based beverages, family and child nutrition and mozzarella categories. It was also strongly impacted by new growth platforms such as Arla® BoB (Best of Both), Arla Baby & Me®, Arla® skyr and Arla® Protein. The Arla® brand also gained market share in most markets. In Europe, we recorded market share gains in the UK, Germany, and the Netherlands. In our International commercial segment, Arla market share grew most significantly in Nigeria, Saudi Arabia, and China.

Arla® 66%

Lurpak®

Revenue for Lurpak®, our leading brand for butter and spreads, increased 8.3 per cent to EUR 528 million in 2017. This was driven by sales price increases at double-digit rates in all core markets. However, in maximising these revenue gains, volumes decreased by 2.7 per cent. Nevertheless, Lurpak® remains the world's biggest global butter brand. We believe that we are the industry leader in innovation for this category.

Lurpak® 12%

Castello®

Sales of our Castello® specialty cheese brand grew 3.1 per cent to EUR 181 million. However, volumes increased 2.7 per cent, and product mix also improved through good growth in Australia and Norway.

Castello® 4%

Puck®

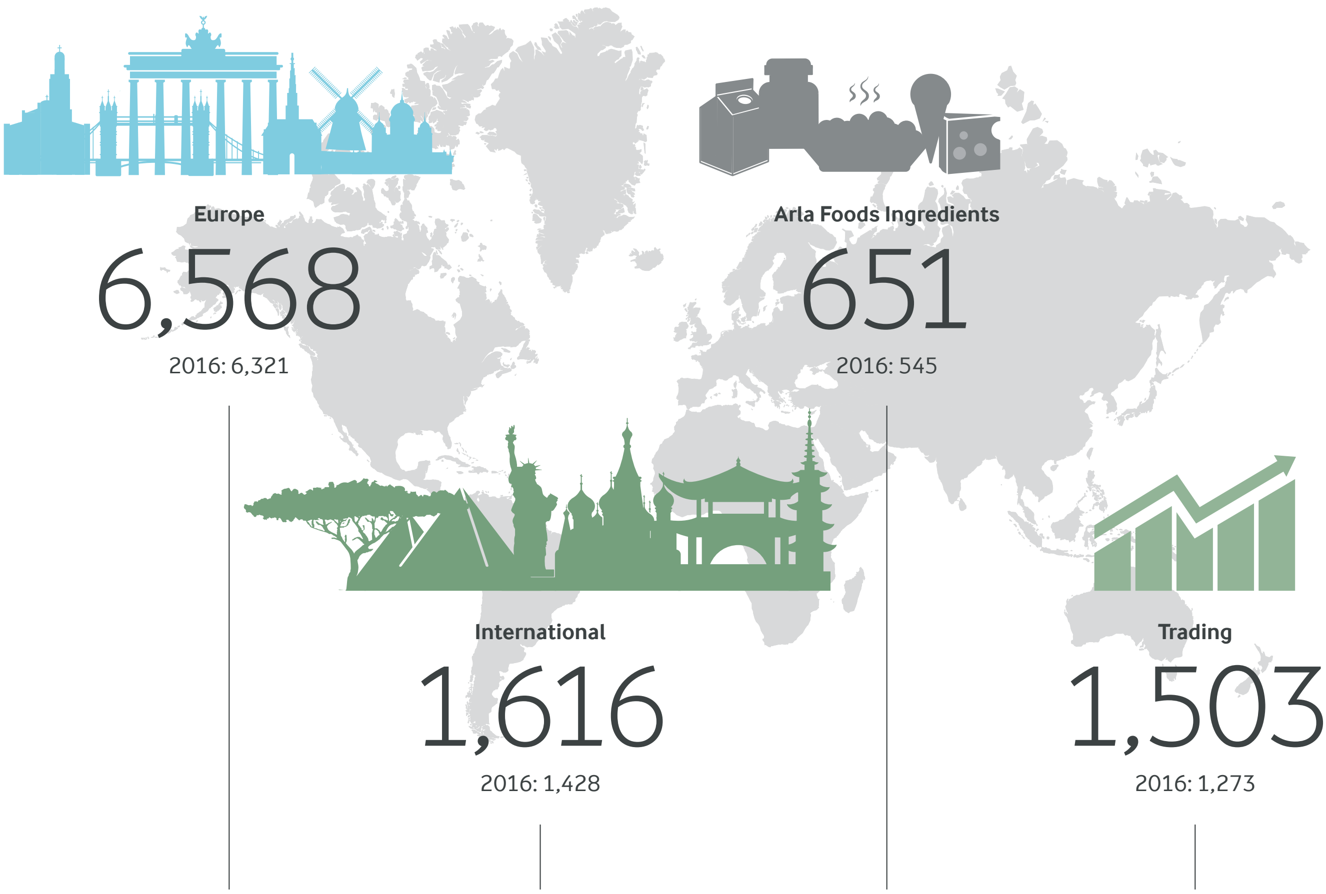
MENA's leading brand, Puck®, continued to perform strongly for Arla in 2017. This multi-faceted brand is core to our sales in our largest international commercial region. Puck® revenues grew 6.8 per cent in 2017 to EUR 339 million. In line with all of Arla's brands, higher sales prices were the biggest contributor to sales growth for the Puck® brand. Volumes increased by 4.4 per cent in 2017. Puck® also made strong market share gains in all markets where it is sold, and achieved the number one position in Saudi Arabia.

Puck® 8%

Other supported brands: 10%

Revenue by commercial segment

MILLION EUR



Sales grow in all commercial segments

Europe
Sales to European retail and foodservice comprise our largest commercial segment, accounting for 63 per cent of total revenue during 2017, and excludes European revenue from Arla Foods Ingredients and Trading. Sales in Europe grew 3.9 per cent to EUR 6,568 million compared to EUR 6,321 million last year, driven by higher sales prices and an improved product mix. Despite volume declines, adverse currency effects and declining consumption for the entire industry, we maintained our position with unchanged volumes of strategic branded products. This proves that we were able to deliver the optimal mix of maximum sales price increases while avoiding volume trade-offs for our big brands. In the European market, the branded business grew approximately one per cent, driven by butter and yoghurt. For developments of each of our strategic European markets please refer to page 30.

International
Our International commercial segment comprised 16 per cent of total revenue during 2017. This business focuses on sales to retail and foodservice partners in countries outside Northern and Central Europe, and excludes the International revenue from Arla Foods Ingredients and Trading. International sales grew 13.2 per cent to EUR 1,616 million, compared to EUR 1,428 million last year. This development was the result of strong volume increases and to a lesser extent price increases. In this high-margin segment, volumes of our strategic brands grew by 10.5 per cent despite challenging market dynamics in the Middle East, our largest International commercial region. China and Nigeria, where sales grew 49.5 per cent and 55.6 per cent respectively, performed particularly well. For more detail on the performance of each of our strategic International markets please refer to page 32.

Arla Foods Ingredients
Arla Foods Ingredients (AFI) was our fastest growing commercial segment and delivered 6 per cent of Arla sales in 2017. This subsidiary, which is separately managed and 100 per cent owned by Arla, excels in producing highly specialised whey-based ingredients and child nutrition products for Arla and third parties. In 2017, sales grew 19.6 per cent to EUR 651 million versus EUR 545 million last year. This strong revenue development was driven by the sale of higher volumes in our third party manufacturing business, as well as strong price and volume growth in the value-added protein segment. Refer to page 34 for more on our AFI journey.

Trading
Trading encompasses our business-to-business sales to other companies for use in their production, as well as industry sales of cheese, butter or milk powder. Although this is not a core business segment, it is critical to our success because it allows us to better manage seasonal and geographical availability in milk intake. Trading and other sales increased 18.0 per cent to EUR 1,503 million versus EUR 1,273 million last year as a direct result of higher market prices. This represents 15 per cent of total revenue for Arla in 2017. However, the trading share of overall milk intake volumes remained stable at 20.2 per cent compared to 20.1 per cent last year, a result of our continued focus on growing the strategic branded portion of our business.

Net profit hitting target range

At Arla we target an annual net profit share in the range of 2.8 to 3.2 per cent of revenue. This allows us to balance the retained capital for future investments, and provide supplementary payment for our farmer owners while continuing to pay out the largest possible share of our profit to our farmer owners via the prepaid milk price. To maximise overall prepaid prices to farmer owners, which also helps drive increased sales prices towards retail and foodservice customers, we prioritised prepaid prices throughout the year and thereby achieved a profit share of 2.8 per cent for 2017. This compares to a profit level of 3.6 percent last year, when the sale of our Rynkeby subsidiary impacted profit by 1.2 percentage points or EUR 120 million. Net profit achieved in 2017 was positively influenced by 0.4 percentage points or EUR 44 million, as a result of the sale of shares in the Brazilian-based associate, Vigor. The divestment was a strategic choice to reduce our position in markets not driving sizeable growth, as part of our ambition to focus on continually expanding into growth markets as the preferred dairy company for consumers.

Cost development in supply chain challenged by growing complexity

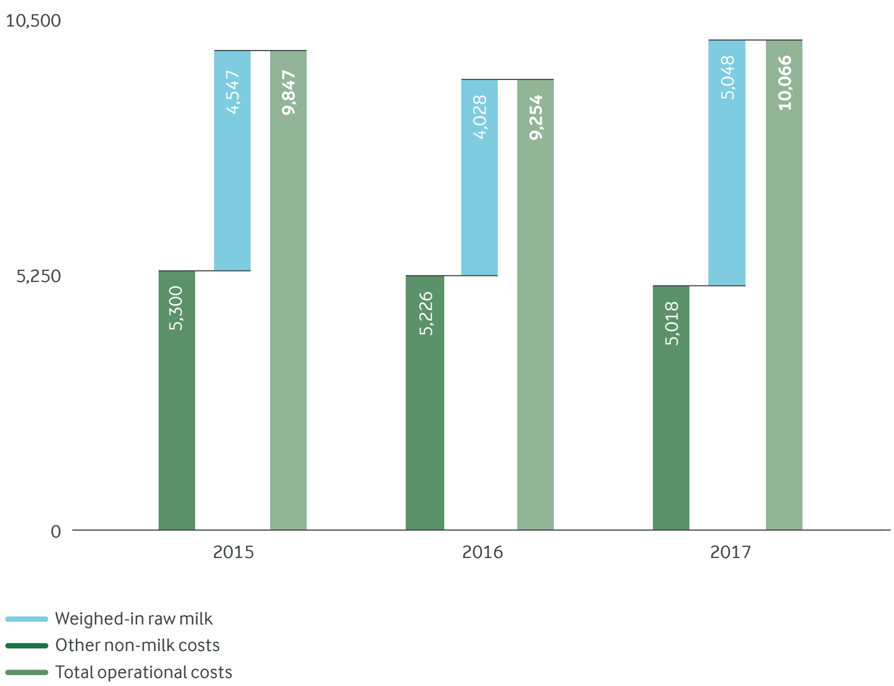
Costs for Arla include four major areas: milk, production, sales and distribution, as well as administration. Operating expenses increased 8.8 per cent in 2017 to EUR 10.1 billion compared to EUR 9.3 billion last year. However, the majority of this increase was in the form of higher milk prices paid to our farmer owners. Costs excluding milk prices decreased by 3.9 per cent due a strong focus on cost management, as well as due to the valuation of inventory on the basis of the prepaid milk price and currency translation rates. Read more in Note 1.2.

As part of our efforts to prioritise sales prices over volumes in 2017, sales volumes to retail and foodservice customers declined slightly. This meant scale efficiencies, which are only possible with increasing volumes could not be achieved in 2017. In addition, consumer demand for a diverse range of dairy products meant increased complexity caused by a broader and more diverse portfolio of branded products and use of different milk types, and corresponding supply chain production costs. As a result, our conversion cost index, which measures the total cost of supply chain per kg of processed milk, increased to an index of 103.9 compared to 99.2 last year. Supply chain efficiency was especially challenged in Germany, where strategic commercial decisions throughout 2017 to step out of significant UHT private label contracts negatively impacted supply chain costs in this region.

We have a strong focus on monitoring cost developments. In 2017, scalability became a

Composition of total operational costs

MILLION EUR



less relevant cost performance indicator for our business, as it measures the relationship between retail and foodservice volume growth and capacity costs. With increased volatility in the dairy industry, the ability to manage an optimal trade-off between retail and foodservice and more trading-related products becomes increasingly important and we therefore need a core value driver that holistically reflects our cost development. The capacity cost index exemplifies the cost of running our general business as a suitable performance driver. In 2017, we reached a capacity cost index of 101.9, primarily driven by Arla Foods Ingredients and International to support the strong commercial growth.

Strong financial leverage proves increasing cash generation capabilities in 2017

Our balance sheet is a critical lever for success. It provides Arla the financial strength to invest in delivering our strategy, Good Growth 2020, and continually developing to create the future of dairy. Arla is considered to be a robust investment grade company, and we continually strive to uphold this status, which requires a strong balance sheet.

Financial leverage is calculated as the ratio of net interest-bearing debt to profitability, i.e. EBITDA. The ratio measures Arla's ability to generate profit compared to our net financial debt. Financial leverage is our most important balance sheet performance indicator, and we have therefore defined a long-term target range of 2.8 to 3.4 for this key ratio.

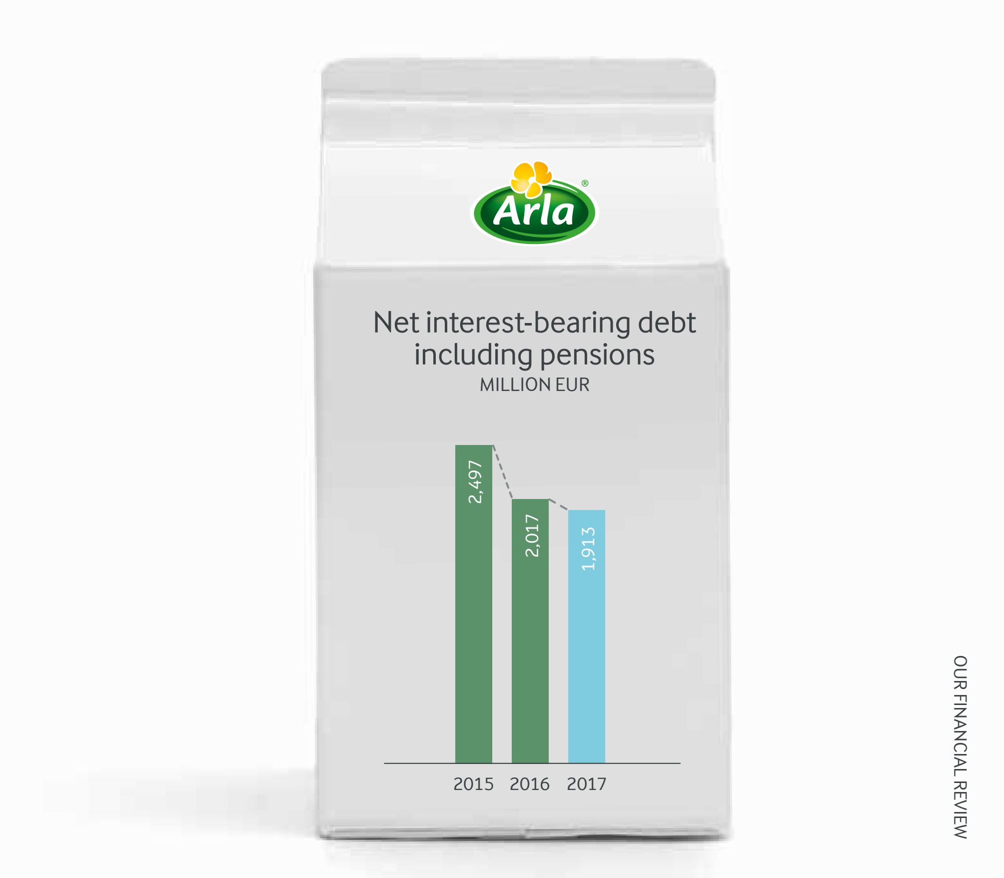
In 2017, financial leverage was successfully delivered below our target range at 2.6. The underlying performance excluding gains from one-offs, Rynkeby in 2016 and Vigor in 2017, was stable at approximately 2.8. Net interest-bearing debt, excluding pension liabilities, was unchanged at EUR 1.6 billion in 2017, compared to EUR 1.6 billion last year. EBITDA was EUR 738 million in 2017 versus EUR 839 million in the prior year.

The increase in milk prices negatively impacted working capital. Inventory values on our balance sheet grew 18.5 per cent to EUR 1,126 million versus EUR 950 million last year, driven by higher underlying raw material prices and slightly higher stock on hand. Receivables, also impacted by higher sales prices, further increased 7.5 per cent to EUR 942 million versus EUR 876 million last year, and reduced our absolute cash position. Working capital in days also slightly deteriorated compared to last year despite significant improvements in trade payables and trade receivables due to the increased use of our supply chain financing programme as well as a continued focus on cash collection and overdue reduction. However, the slightly increased stock on hand, to improve delivery accuracy as well as a change in product mix, partly offset these improvements.

Approved capital expenditure, also referred to as CAPEX, for 2017 was EUR 335 million in 2017, increasing by 46.9 per cent from EUR 228 million last year. Actual spend of EUR 298 million was incurred in 2017 due to the timing of finalising investment projects. Major CAPEX focus areas in 2017 included new production methods, production capacity expansions, and investments based on non-GMO feed milk and organic.

Solid cash flow in 2017

Cash flow from operating activities decreased to EUR 386 million compared to EUR 806 million last year, mainly due to the increase in milk price and the corresponding increase in trade receivables and inventory values. Consequently, free operating cash flow for 2017 was EUR 100 million, compared to EUR 501 million last year. Cash flow from investing activities was EUR -219 million compared to EUR -167 million in 2016. The difference was mainly driven by the sale of Rynkeby in 2016. Furthermore, our increased approved CAPEX volume did not fully materialise in 2017 due to the timing of projects. As a consequence of the reduced free cash flow, less debt was paid off in 2017 resulting in cash flow from financing activities of EUR -155 million compared to EUR -624 million last year. A supplementary payment of EUR 120 million was made in line with the Board of Representative's decision to pay out 1 EUR-cent/kg of member milk to our farmer owners.



Financial outlook

In 2018, we will continue our journey of branded transformation and are committing our investments into areas that deliver the most growth to our business, guided by our strategy, Good Growth 2020. The dairy industry remains volatile, and market price declines in the first quarter of the year are creating further uncertainty in the marketplace. However, demand for our products continues to be strong as we shape and shift our global strategic brands to create the future of dairy.

Solid underlying economic growth continues, driven by emerging economies

We enter 2018 with the expectation of slightly higher GDP growth in most markets compared to 2017. Demand signals for dairy products also look positive. Underlying growth is again expected to be predominantly driven by a growing demand from emerging economies where rising business investment, increasing disposable incomes, better infrastructure, and growing access to the Internet have contributed to strong growth rates in markets like China, Nigeria, Ghana, and Bangladesh. Despite solid macroeconomic signals overall, uncertainty remains in several European and global countries where recent and pending elections have the potential to impact trade as well as fiscal and monetary policies. We do not currently foresee significant changes in global consumption trends or big shifts in global trade patterns during 2018. Continuous monitoring and ensuring our ability to react and adapt quickly will be imperative in the year ahead, and beyond.

Continued focus on managing sales prices and margins across our portfolio

Within Arla, we will continue to focus on delivering the highest possible milk price for our farmers, and a competitive milk price in the market. As volatility in the underlying commodity market continues, we are strengthening our efforts in price management with our retail and foodservice customers.

Managing an increasingly diverse milk pool to meet the demand for a broad range of lifestyle dairy products, we aim to implement gross margin-enhancing initiatives to optimise the balance between complexity and customer requirements, short-term price volatility and long-term market positions. After a very successful 2017, where we achieved sales price increases of EUR 1 billion across our portfolio, we expect revenue in 2018 to be at a similar level of between EUR 10 to 10.5 billion. This will result from higher milk volumes and improving product mix being at least partially offset by lower milk prices and negative exchange rate developments.

Market milk price environment declining from a high level

Market milk prices have begun to decline as we enter 2018. However, even if price declines persist, we continue to expect reasonable price levels in 2018. In response to strong market and farmer milk price increases in 2017, Arla expects a growing milk supply in 2018 as farmer owners react to higher prices and increase their production on the farm.

Accelerated focus on branded growth

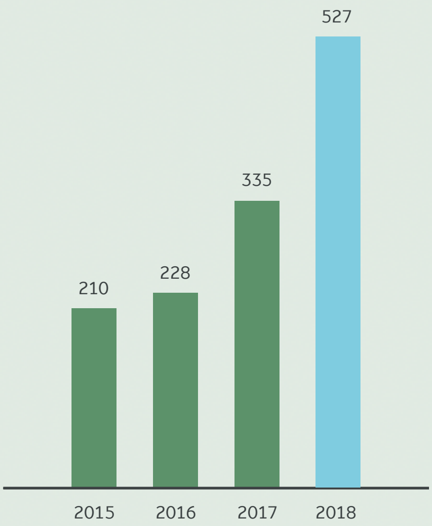
In 2018, we will continue to expand the value of our business by accelerating and sharpening the profile of our strategic brands Arla®, Castello®, Lurpak® and Puck®. We will introduce new sub-brands to our broad product portfolio and continue to invest in our brands to increase the share of branded sales, thereby ensuring our future growth and profitability. We plan to deliver a strategic branded volume driven revenue growth of 1 to 3.5 per cent, and a brand share greater than 45 per cent as we invest in areas where we see the most growth potential, supported by exciting new marketing initiatives.

International growth remains a firm focus

As part of our ambition to secure a high milk price for our farmer owners in the long-term, we will focus on driving growth in high-profit areas, including many of our International markets. In 2018, we plan to launch new and innovative products in profitable categories across the globe. This includes boosting our milk-based beverages business, building infant formula, relaunching our successful Arla Dano® brand, driving Arla® Organic into International markets, and accelerating our foodservice business. Also, we are planning to strengthen our local partnerships and production footprint in International markets to provide a sustainable base supporting our growth. As a result, we aim to achieve an International share of our business greater than 20 per cent in 2018.

Approved CAPEX investments
MILLION EUR

527



Significantly investing in marketing and CAPEX

Safely within our leverage target range of 2.8 to 3.4, in 2018, we will increase our CAPEX significantly, enabling further growth and value creation by investing in innovative technology and new, expanded and improved production capacity. We will focus on increasing our European production capacity in 2018. A large part of investments targets projects aimed at growing Arla's business outside of Europe, where our strategic growth markets include the MENA, China and Southeast Asia, Sub-Saharan Africa and the US. With a continued investment in healthy and natural lifestyle dairy products, a new Lactofree production will be established in the UK. In addition, Arla Foods Ingredients will drive value-add speciality products by investing in groundbreaking technology and capacity expansions. Furthermore, we will pursue renewable energy sources, helping to reduce our carbon emissions and achieve our goal of having at least half the energy we use derived from renewable sources like biomass, wind and water by 2020.

Profit share expected within target range of 2.8 to 3.2 per cent

As we continue to focus on paying out the largest possible share of our profit via the prepaid milk price to our farmer owners, we continue to target a profit share for 2018 in the range of 2.8 to 3.2 per cent of revenue. More visibly than in previous years, we expect to see seasonality in our operations impacting the 2018 half-year results. Our net profit target range is a full-year target, and results at half-year 2018 are expected to be below the annual target range.

Committed to our strategy Good Growth 2020

We are committed to our strategy Good Growth 2020, and will continue to focus management attention where we believe it adds most value for our farmer owners. In a volatile market and an uncertain geopolitical environment, we will build the strength of our brands and business. In 2018, we will also focus energy to realise efficiencies through our transformation programme, Calcium. Calcium will cover activities throughout Arla and our ambition is to achieve a bottom line impact of EUR 30 million in 2018. Moving forward, we anticipate even greater savings and plan to reinvest significantly into areas that fuel future growth. The Executive Management Team has presented eight essential business priorities for 2018. Read more on page 22.

Expectations for 2018

Revenue
10-10.5
BILLION EUR

Profit share
2.8-3.2%
OF REVENUE

Brand share
>45%

International share
>20%

Strategic branded volume driven revenue growth
1-3.5%

Calcium
30
MILLION EUR

Leverage
2.8-3.4

CONSOLIDATED FINANCIAL STATEMENTS

Whatever moves you, Arla® skyr brings you further. Arla® skyr is a great source of go-to goodness being low fat, high in protein and low in sugar.

Arla® skyr has been hugely successful in Europe. In Germany, for example, sales nearly doubled in 2017, making an important contribution to achieving our Good Growth 2020 strategy.

Income statement

(EURm)	Note	2017	2016	Development
Revenue	1.1	10,338	9,567	*8%*
Production costs	1.2	-8,063	-7,177	*12%*
Gross profit		**2,275**	**2,390**	*-5%*
Sales and distribution costs	1.2	-1,584	-1,642	*-4%*
Administration costs	1.2	-419	-435	*-4%*
Other operating income	1.3	71	91	*-22%*
Other operating costs	1.3	-39	-29	*34%*
Gain from sale of enterprise	3.6	44	120	*-63%*
Share of results after tax in joint ventures and associates	3.4	37	10	*270%*
Earnings before interest and tax (EBIT)		**385**	**505**	*-24%*
Specification:				
EBITDA excluding gain from sale of enterprise		694	719	*-3%*
Gain from sale of enterprise	3.6	44	120	*-63%*
Depreciation, amortisation and impairment losses	1.2	-353	-334	*6%*
Earnings before interest and tax (EBIT)		**385**	**505**	*-24%*
Financial income	4.1	13	7	*86%*
Financial costs	4.1	-77	-114	*-32%*
Profit before tax		**321**	**398**	*-19%*
Tax	5.1	-22	-42	*-48%*
Profit for the year		**299**	**356**	*-16%*
Minority interests		-14	-9	*56%*
Arla Foods amba's share of profit for the year		**285**	**347**	*-18%*

Profit appropriation

(EURm)	2017	2016
Profit for the year	299	356
Minority interests	-14	-9
Arla Foods amba's share of net profit for the year	**285**	**347**
Proposed profit appropriation:		
Supplementary payment for milk	124	121
Interest on contributed capital	3	3
Total supplementary payment	**127**	**124**
Transferred to equity:		
Reserve for special purposes	120	193
Contributed capital	38	30
Total transferred to equity	**158**	**223**
Appropriated profit	**285**	**347**

Significant increase in performance price

A key measure expressing Arla's overall performance is the performance price. This measures the value added to each kg of milk supplied by our farmer owners. The performance price is calculated as the standardised prepaid milk price, included in production costs, plus Arla Foods amba's share of profit for the year, divided by milk volume supplied. In 2017, the performance price was 38.1 EUR-cent/kg owner milk, compared to 30.9 EUR-cent/kg owner milk last year. For more detail, please refer to the financial review on page 66.

The higher sales prices achieved during 2017 significantly impacted both revenue and our ability to increase the payment for milk from farmer owners and thereby our cost. Furthermore, the income statement was again impacted negatively by effects from currencies this year.

Revenue was adversely impacted by EUR 250 million, while operational costs were reduced by EUR 192 million. For more detail refer to Note 1.

Net profit of the Group was EUR 299 million compared to EUR 356 million last year, corresponding to a 16 per cent decrease, due to the effect from the divestment of Rynkeby in 2016. Net profit allocated to the farmer owners of Arla Foods amba amounted to EUR 285 million, which constitutes 2.8 per cent of revenue compared to 3.6 per cent last year.

The proposed supplementary payment is EUR 127 million, including interest, corresponding to 1 EUR-cent/kg owner milk.

Comprehensive income

(EURm)	Note	2017	2016
Profit for the year		**299**	**356**
Other comprehensive income			
Items that will not be reclassified to the income statement:			
Actuarial gains and losses on defined benefit plans	4.7	58	-132
Income tax on actuarial gains and losses on defined benefit plans		-10	21
Items that may be reclassified subsequently to the income statement:			
Value adjustments of hedging instruments	4.4.b	48	-22
Value adjustments of financial assets classified as available for sale		14	-2
Adjustments related to foreign currency translation		-77	-40
Income tax on items that may be reclassified to profit or loss		-1	-5
Other comprehensive income, net of tax		**32**	**-180**
Total comprehensive income		**331**	**176**
Allocated as follows:			
Owners of Arla Foods amba		321	169
Minority interests		10	7
Total		**331**	**176**

Comprehensive income
Total comprehensive income amounted to EUR 331 million, compared to EUR 176 million last year. Other comprehensive income amounted to EUR 32 million and was affected by a positive development in defined benefit plans amounting to EUR 58 million, compared to a loss of EUR 132 million last year. Read more about pension liabilities in Note 4.7. Adjustments related to currency translation had a negative effect of EUR 77 million, while the value adjustment of hedging instruments had a positive impact of EUR 48 million.

Other comprehensive income explained
Other comprehensive income includes revenue, expenses, gains and losses that are excluded from the income statement. Typically, they have not yet been realised and mainly relate to adjustments related to currency translation, actuarial gains and losses on pension plans and unrealised value adjustments on hedging activities to secure future cash flow.

Balance sheet

(EURm)	Note	2017	2016	Development
Assets				
Non-current assets				
Intangible assets	3.1	811	825	*-2%*
Property, plant and equipment	3.3	2,212	2,310	*-4%*
Investments in associates	3.4	401	434	*-8%*
Investments in joint ventures	3.4	53	51	*4%*
Deferred tax	5.1	43	74	*-42%*
Other non-current assets		31	20	*55%*
Total non-current assets		**3,551**	**3,714**	*-4%*
Current assets				
Inventory	2.1	1,126	950	*19%*
Trade receivables	2.1	942	876	*8%*
Derivatives		19	31	*-39%*
Current tax		1	1	*0%*
Other receivables		181	222	*-18%*
Securities		511	504	*1%*
Cash and cash equivalents		91	84	*8%*
Total current assets		**2,871**	**2,668**	*8%*
Total assets		**6,422**	**6,382**	*1%*
Equity and liabilites				
Equity				
Common capital		1,781	1,595	*12%*
Individual capital		502	503	*0%*
Other equity accounts		-77	-65	*18&*
Proposed supplementary payment to owners		127	124	*3%*
Equity attributable to the parent company's owners		**2,333**	**2,157**	*8%*
Minority interests		36	35	*3%*
Total equity		**2,369**	**2,192**	*8%*
Liabilities				
Non-current liabilities				
Pension liabilities	4.7	277	369	*-25%*
Provisions	3.5	12	12	*0%*
Deferred tax	5.1	59	80	*-26%*
Loans	4.2	1,206	1,281	*-6%*
Total non-current liabilities		**1,554**	**1,742**	*-11%*
Current liabilities				
Loans	4.2	1,013	947	*7%*
Trade payables	2.1	1,098	995	*10%*
Provisions	3.5	11	13	*-15%*
Derivatives		87	168	*-48%*
Current tax		11	18	*-39%*
Other current liabilities		279	307	*-9%*
Total current liabilities		**2,499**	**2,448**	*2%*
Total liabilities		**4,053**	**4,190**	*-3%*
Total equity and liabilities		**6,422**	**6,382**	*1%*

Changes in equity

(EURm)	Common capital		Individual capital			Other equity accounts					
	Capital account	Reserve for special purposes	Delivery-based owner certificates	Contributed capital	Proposed supplementary payment to owners	Reserve for value adjustment of hedging instruments	Available for sale reserve	Reserve for foreign exchange adjustments	Total	Minority interests	Total equity
Equity at 1 January 2017	**829**	**766**	**87**	**416**	**124**	**-122**	**3**	**54**	**2,157**	**35**	**2,192**
Suplementary payment for milk	-	-	-	-	124	-	-	-	124	-	124
Interest on contributed capital	-	-	-	-	3	-	-	-	3	-	3
Reserve for special purposes	-	120	-	-	-	-	-	-	120	-	120
Contributed capital	-	-	-	38	-	-	-	-	38	-	38
Minority interests	-	-	-	-	-	-	-	-	-	14	14
Profit for the year	**-**	**120**	**-**	**38**	**127**	**-**	**-**	**-**	**285**	**14**	**299**
Other comprehensive income	48	-	-	-	-	47	14	-73	36	-4	32
Total comprehensive income	**48**	**120**	**-**	**38**	**127**	**47**	**14**	**-73**	**321**	**10**	**331**
Capital issued to new owners	3	-	-	-	-	-	-	-	3	-	3
Payments to owners	-	-	-7	-21	-	-	-	-	-28	-	-28
Dividend to minority shareholders	-	-	-	-	-	-	-	-	-	-9	-9
Supplementary payment to owners	-	-	-	-	-120	-	-	-	-120	-	-120
Foreign exchange adjustments	15	-	-1	-10	-4	-	-	-	-	-	-
Total transactions with owners	**18**	**-**	**-8**	**-31**	**-124**	**-**	**-**	**-**	**-145**	**-9**	**-154**
Equity at 31 December 2017	**895**	**886**	**79**	**423**	**127**	**-75**	**17**	**-19**	**2,333**	**36**	**2,369**
Equity at 1 January 2016	**909**	**573**	**94**	**422**	**113**	**-95**	**5**	**92**	**2,113**	**35**	**2,148**
Suplementary payment for milk	-	-	-	-	121	-	-	-	121	-	121
Interest on contributed capital	-	-	-	-	3	-	-	-	3	-	3
Reserve for special purposes	-	193	-	-	-	-	-	-	193	-	193
Contributed capital	-	-	-	30	-	-	-	-	30	-	30
Minority interests	-	-	-	-	-	-	-	-	-	9	9
Profit for the year	**-**	**193**	**-**	**30**	**124**	**-**	**-**	**-**	**347**	**9**	**356**
Other comprehensive income	-111	-	-	-	-	-27	-2	-38	-178	-2	-180
Total comprehensive income	**-111**	**193**	**-**	**30**	**124**	**-27**	**-2**	**-38**	**169**	**7**	**176**
Capital issued to new owners	-	-	-	5	-	-	-	-	5	-	5
Payments to owners	-	-	-6	-16	-	-	-	-	-22	-	-22
Dividend to minority shareholders	-	-	-	-	-	-	-	-	-	-8	-8
Disposal of non-controlling interests	-	-	-	-	-	-	-	-	-	1	1
Supplementary payment to owners	-	-	-	-	-108	-	-	-	-108	-	-108
Foreign exchange adjustments	31	-	-1	-25	-5	-	-	-	-	-	-
Total transactions with owners	**31**	**-**	**-7**	**-36**	**-113**	**-**	**-**	**-**	**-125**	**-7**	**-132**
Equity at 31 December 2016	**829**	**766**	**87**	**416**	**124**	**-122**	**3**	**54**	**2,157**	**35**	**2,192**

Understanding equity
Equity accounts regulated by the Articles of Association can be split into three main categories: common capital, individual capital and other equity accounts. The characteristics of each account are explained in detail:

Common capital

Common capital is by nature undivided and consists of the capital account and the reserve for special purposes. The capital account represents a strong foundation for the cooperative's equity, as the non-impairment clause, described on page 81, ensures that the account cannot be used for payment to owners. The reserve for special purposes is an account that in extraordinary situations can be used to compensate owners for losses or impairments affecting the profit for appropriation. Amounts transferred from the annual profit appropriation to common capital are booked to this account.

Individual capital

Individual capital is capital allocated to each owner based on their delivered milk volume. Individual capital consists of delivery-based owner certificates and contributed capital. Amounts registered to these accounts will, subject to approval by the Board of Representatives, be paid out when owners leave the cooperative. Amounts allocated to individual capital as part of the annual profit appropriation are interest-bearing. Also characterised as individual capital is the account for proposed supplementary payment to owners that will be paid out following the approval of the annual report.

Other equity accounts

Other equity accounts include accounts prescribed by IFRS that are disclosed separately and cannot be used for payment to owners. These include reserves for value adjustment of hedging instruments, the available for sale reserve and the reserve for foreign exchange adjustments.

Minority interests

Minority interests include the share of Group equity attributable to holders of minority interests in Group companies.

Equity improved

During 2017, equity increased by EUR 177 million compared to last year.

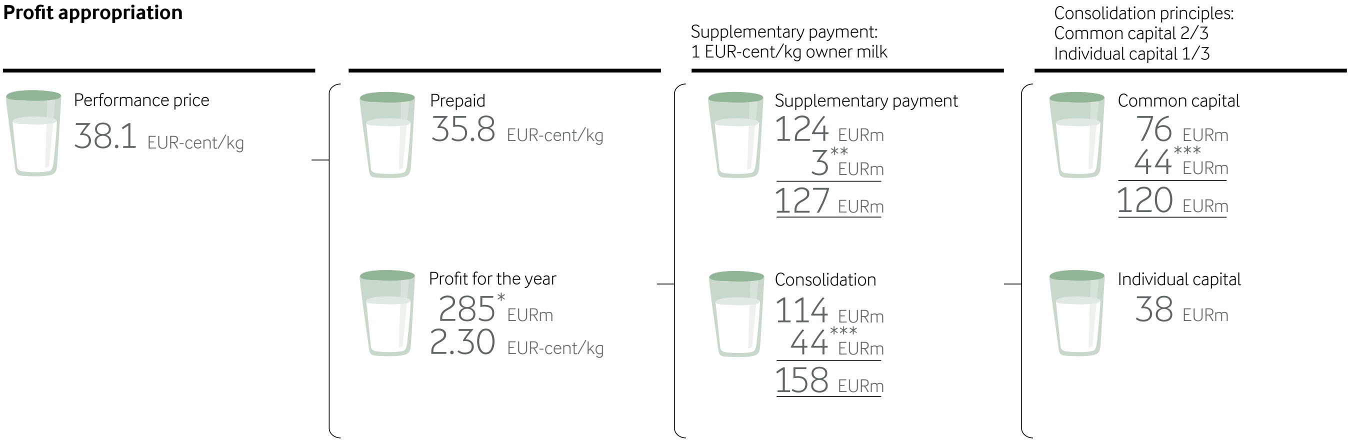
Profit appropriation
Proposed supplementary payment is EUR 124 million, corresponding to 1 EUR-cent/kg owner milk. Interest on consolidated contributed capital amounts to EUR 3 million, which gives rise to a proposed supplementary payment of EUR 127 million. The average supplementary payment of 1 EUR-cent/kg owner milk is unchanged compared to last year.

The gain on the divestment of the associated company Vigor, amounting to EUR 44 million, was transferred to the reserve for special purposes in accordance with the consolidation policy approved by the Board of Representatives. The basis for consolidation, after adjusting for the gain on divestment, is EUR 114 million. This is split into 1/3 to individual capital (contributed capital), amounting to EUR 38 million, and 2/3 to common capital (reserve for special purposes), amounting to EUR 76 million.

Other comprehensive income
Other comprehensive income amounting to a gain of EUR 32 million is primarily attributable to actuarial gains on pension liabilities, value adjustments on hedging instruments and net assets measured in foreign currencies.

Payments to and from owners
A supplementary payment relating to 2016 totalling EUR 120 million was paid out in March 2017. Additionally, EUR 28 million was paid out to owners resigning or retiring from the cooperative. It is expected that EUR 30 million will be paid out in 2018 to owners resigning or retiring.

Profit appropriation



** Based on profit allocated to owners of Arla Foods amba ** Interest on contributed capital: 0.04 EUR-cent/kg owner milk *** Gain on the divestment of associated company Vigor*

Regulations according to Articles of Association and IFRS

Recognised within the *capital account* are technical items such as movements on actuarial gains or losses on defined benefit pension schemes, effects from disposal and acquisitions of non-controlling interests in subsidiaries and exchange rate differences in the owners' equity instruments. Furthermore, the account is impacted by agreed contributions from new members of the cooperative.

Recognised within *the reserve for special purposes* is the annual profit appropriation to common capital. It may, upon the Board of Director's proposal, be applied by the Board of Representatives for the full or partial off-setting of material extraordinary losses or impairment in accordance to article 21(iii) of the Articles of Association.

Delivery-based owner certificates are established in accordance with article 21(1)(ii) of the Articles of Association and related regulations. Consolidation on this account was suspended from 2010.

Contributed capital is established in accordance with article 21(1)(iii) of the Articles of Association and regulation. Amounts consolidated as contributed capital via the annual profit appropriation carry interest at CIBOR 12 months + 1.5 per cent. Amounts paid into the contributed capital in connection with mergers carry no interest. Interest is paid out along with the supplementary payment.

Individual owners' balances on delivery-based owner certificates and on contributed capital can be paid out over three years upon termination of membership of Arla Foods amba in accordance with the Articles of Association, subject to the Board of Representatives' approval. Balances on individual accounts are denominated in the currency relevant to the country in which the members are registered. Foreign currency translation adjustments are calculated annually, the amount of which is then transferred to the capital account.

Proposed supplementary payment to owners is recognised separately in equity until approved by the Board of Representatives.

Reserve for value adjustments of hedging instruments comprises the fair value adjustment of derivative financial instruments classified as and meeting the conditions for hedging of future cash flows and where the hedged transaction has not yet been realised.

Available for sale reserve comprises value adjustments on securities classified as held for sale.

Reserve for foreign exchange adjustments comprises currency translation differences arising during the translation of the financial statements of foreign companies, including value adjustments relating to assets and liabilities that constitute part of the Group's net investment, and value adjustments relating to hedging transactions that hedge the Group's net investment.

Non-impairment clause
Under the Article of Association, no payment may be made by Arla Foods amba to owners that impair the sum of the capital account and equity accounts prescribed by law and IFRS. The non-impairment clause is assessed on basis of the most recent annual report presented under IFRS. Individual capital accounts and reserve for special purposes are not covered by the non-impairment clause.

Minority interests
Subsidiaries are fully recognised in the consolidated financial statements. Minority interests' share of the results for the year and of the equity in the subsidiaries that are not wholly owned are recognised as part of the consolidated results and equity, respectively, but are listed separately.

On initial recognition, minority interests are measured at either the fair value of the equity interest or the proportional share of the fair value of the acquired companies identified assets, liabilities and contingent liabilities. The measurement of minority interests is selected on a transactional basis, and disclosure is made in the note pertaining to business combinations.

Cash flow

(EURm)	Note	2017	2016
EBITDA		738	839
Gain from sale of enterprise	3.6	-44	-120
EBITDA excluding gain from sale of enterprise		694	719
Share of results in joint ventures and associates	3.4	-37	-10
Change in net working capital	2.1	-200	138
Change in other working capital		8	-3
Other operating items without cash impact		-10	22
Dividends received, joint ventures and associates		7	12
Interest paid		-52	-59
Interest received		5	5
Tax paid	5.1	-29	-18
Cash flow from operating activities		**386**	**806**
Investment in intangible fixed assets	3.1	-50	-58
Investment in property, plant and equipment	3.3	-248	-263
Sale of property, plant and equipment	3.3	12	16
Operating investing activities		-286	-305
Free operating cash flow		*100*	*501*
Acquisition of enterprises	3.6	-7	-
Sale of enterprises	3.6	74	138
Financial investing activities		67	138
Cash flow from investing activities		**-219**	**-167**
Free cash flow		*167*	*639*
Supplementary payment regarding the previous financial year		-120	-108
Paid out from equity regarding terminated membership contracts		-28	-22
Loans obtained, net	4.2	32	-449
Payment to pension liabilities		-39	-45
Cash flow from financing activities		**-155**	**-624**
Net cash flow		**12**	**15**
Cash and cash equivalents at 1 January		84	70
Exchange rate adjustment of cash funds		-5	-8
Transferred to asset held for sale		-	7
Cash and cash equivalents at 31 December		**91**	**84**

Solid cash flow

Cash flow from operating activities was EUR 386 million, significantly impacted by additional cash tied up in working capital due to higher milk prices. This represents a reduction compared to last year, where lower milk prices had a positive effect on working capital.

After operating investments of EUR 286 million, the free operating cash flow was EUR 100 million. Free operating cash flow is a measure of the amount of cash generated by normal business operations.

As a result of our financial investing activities, primarily related to sale of the investment in Vigor, the free cash flow was EUR 167 million. Free cash flow is a measure of the amount of cash generated after investing activities.

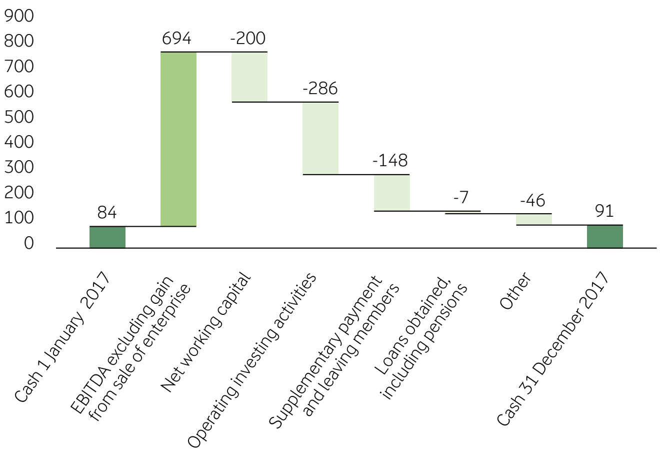
A supplementary payment of EUR 120 million was made in relation to the 2016 profit allocation. Further payments, representing EUR 28 million in individual capital, were paid out to owners who resigned or retired.

Combined cash and cash equivalents as at 31 December 2017 were EUR 91 million, compared to EUR 84 million last year.

Accounting policies

The consolidated cash flow statement is presented according to the indirect method, whereby the cash flow from operating activities is determined by adjusting EBITDA for the effects of non-cash items such as undistributed results in joint ventures and associates and the effects of changes in working capital items during the period.

Development in cash flow
(EURm)



Statement by the Board of Directors and the Executive Board

Today, the Board of Directors and the Executive Board discussed and approved the annual report of Arla Foods amba for the financial year 2017. The annual report was prepared in accordance with International Financial Reporting Standards as adopted by the EU and additional disclosure requirements in the Danish Financial Statements Act.

It is our opinion, that the consolidated financial statements and the parent company financial statements give a true and fair view of the Group's and the parent company's financial position as at 31 December 2017 and of the results of the Group's and the parent company's activities and cash flows for the financial year 1 January to 31 December 2017.

In our opinion, management's review of the annual report includes a true and fair view of the developments of the Group's and the parent company's financial position, activities, financial matters, results for the year and cash flow, as well as a description of the most significant risks and uncertainties that may affect the Group and the parent company.

We hereby recommend the annual report for adoption by the Board of Representatives.

Aarhus, 20 February 2018

Peder Tuborgh
CEO

Åke Hantoft
Chairman

Jan Toft Nørgaard
Vice Chairman

Viggo Ø. Bloch

Jonas Carlgren

Arthur Fearnall

Manfred Graff

Heléne Gunnarson

Markus Hübers

Bjørn Jepsen

Steen Nørgaard Madsen

Torben Myrup

Johnnie Russell

Manfred Sievers

Simon Simonsen

Inger-Lise Sjöstrom

Håkan Gillström
Employee representative

Ib Bjerglund Nielsen
Employee representative

Harry Shaw
Employee representative

Introduction

The following sections provide additional disclosures supplementing the primary financial statements. This section gives a summary of the basis for preparation, applied materiality, description of significant accounting estimates and assessments performed by management and currency translation exposure. Further detail can be found in the individual notes to the financial statements.

Basis for preparation
The annual report is based on the Group's monthly reporting procedures, where Group entities follow a structured process, providing consistent financial reports, which form a basis for both internal and external reporting purposes.

Group entities are required to report using standard accounting principles in accordance with the International Financial Reporting Standards (IFRS). At year-end, ordinary monthly reporting is supplemented with additional disclosures.

The Group uses a standard ERP system implemented in the majority of Group entities. Through standardised and harmonised processes and controls, there is a continuous focus on securing the reporting quality and avoiding surprises. EY, the Group's external auditors, conducts an annual audit, which is centralised and coordinated with the respective sub-entities. Consolidation also follows a standardised monthly process, supported by relevant controls.

The information in the annual report is presented in classes of similar items in the financial statements as required by IAS 1. For more detail on the basis for preparation and accounting policies applied, please refer to chapter 5.6.

Applying materiality
When preparing the annual report, management seeks to improve the value of the information in the report by focusing on information that will help the understanding of the Group's performance in the reporting period and the financial position at year end. The focus is on presenting information that is considered of material importance for our stakeholders, rather than generic descriptions.

Disclosures that are required by IFRS are included in the annual report, unless the information is considered of immaterial importance to the users of the annual report. Materiality is not applied for items where disclosures are required for control purposes.

Significant accounting estimates and assessments by management
Preparing the Group's consolidated financial statements requires management to make accounting estimates and judgements that affect the recognition and measurement of the Group's assets, liabilities, income and expenses. The performed estimates and judgements are based on historical experience and other factors. By nature, these are associated with uncertainty and unpredictability, which can have a significant effect on the amounts recognised in the consolidated financial statements.

The most significant accounting estimates relate to:

- *Measurement of revenue and rebates*

Revenue, net of rebates, is recognised when goods are transferred to customers. Estimates are applied when measuring the accruals for rebates and other sales incentives.

The majority of rebates are calculated using terms agreed with the customer. For some customer relationships, the final settlement of the rebate depends on future volumes, prices and other incentives. Thus, there is to some degree an element of uncertainty relating to the exact value. Read more in Note 1.1 Revenue.

- *Valuation of goodwill*

Estimates are applied in assessing the value in use of goodwill.

Goodwill is not subject to amortisation but is tested annually for impairment. Significant estimates are performed when assessing expected future cash flow and setting discount rates. The majority of our goodwill is allocated to the activitives in the UK. Following the Brexit vote, expected cash flows supporting the carrying value of goodwill are inherently more uncertain. Read more in Note 3.2 Impairment tests.

- *Classification of investment in associated companies*

To classify an investment as an associated company requires significant influence in the company. Judgement is necessary in determining when significant influence exists. The Group has exercised judgement in classifying the investments in COFCO Dairy Holdings Limited and Lantbrukarnas Riksförbund. Read more in Note 3.4 Joint ventures and associates.

- *Valuation of inventory*

Estimates are applied in assessing net realisable values of inventory. Most significantly, this includes the assessment of expected future market prices and the quality of certain products within the cheese category, some of which need to mature for up to two years. Read more in Note 2.1 Net working capital.

- *Valuation of pension liabilities*

The Group uses external and independent actuaries when determining the value of pension liabilities. When measuring the Group's defined benefit plans, judgements are performed when setting actuarial assumptions such as discount rate, expected future salary increases, inflation and mortality. The actuarial assumptions vary from country to country, based on national economic and social conditions. They are set using available market data and compared with benchmarks to secure that they are set consistently from year to year and in compliance with best practice. Read more in Note 4.7 Pension liability.

Currency exposure
The Group's financial reporting is significantly exposed to currencies, both due to transactions conducted in currencies other than the EUR, and due to the translation of financial reporting from entities not part of the eurozone. The most significant exposure relates to financial reporting from entities operating in GBP and SEK, and to transactions relating to sales in USD or USD-related currencies. Read more in Note 4.3.2 Currency risk.

NOTE 1
REVENUE AND OPERATIONAL COST

Note 1.1 Revenue

Higher sales prices and better brand positions

Revenue increased by 8.1 per cent to EUR 10,338 million, compared to EUR 9,567 million last year. The underlying revenue development, excluding foreign exchange effects and divestments, was 11.6 per cent. Milk intake was 13.9 billion kg in 2017, unchanged compared to the milk intake of 13.9 billion kg last year.

The strong increase in revenue was a direct result of higher sales prices in 2017 compared to last year. Arla's strategic decision to focus on achieving sales prices to allow us to maximise owner milk prices contributed to a EUR 1,000 million, or a 10 per cent increase in revenue. In a year with significant price increases, sales volumes were unchanged and a favourable volume/mix effect contributed to an increased revenue of EUR 111 million. Branded sales represented 44.6 per cent of total sales in 2017, compared to 44.5 per cent last year, and strategic branded volume revenue growth was 3.0 per cent.

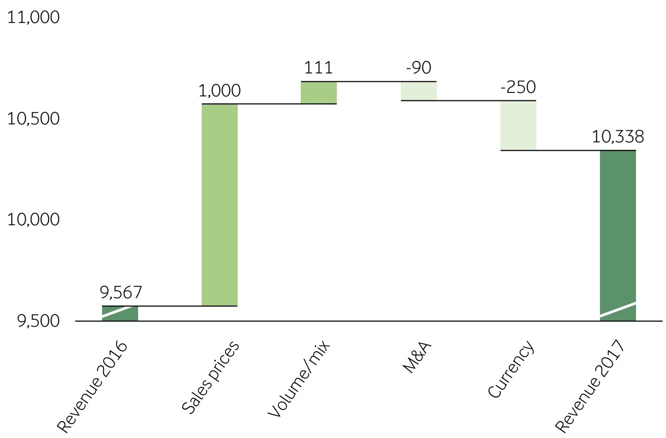
The increase in revenue was negatively impacted by exchange rate developments of EUR 250 million, driven primarily by the weakened GBP with the UK representing approximately 25 per cent of total revenue. The divestment of the Rynkeby juice business including the related distribution activities in 2016 attributed to a negative full-year impact of EUR 90 million. Rynkeby represented the last non-core business activity within Arla, thus enabling sole focus on the dairy sector.

In 2017, Arla divested Vigor. This has and will not impact revenue as it was an associated company.

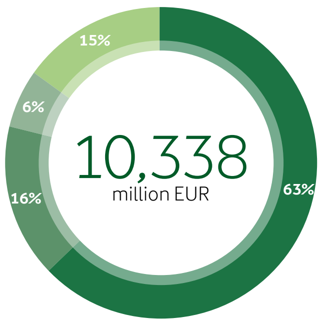
Europe is Arla's largest commercial segment, comprising 63 per cent of total revenue, compared to 66 per cent last year. International accounts for 16 per cent of Arla's revenue compared to 15 per cent last year. The increase in revenue for International reflects a revenue growth of 13.2 per cent and a retail and foodservice volume driven revenue growth of 8.4 per cent, primarily resulting from increased sales in China and Nigeria. The remaining part is contributed by Trading and other with 15 per cent, up 2 per cent due to price increases on the commodity market. Arla Foods Ingredients comprises 6 per cent of total revenue, remaining on the same level as last year.

The strategic branded revenue split by brand remains largely unchanged compared to last year. The four strategic brands, Arla®, Lurpak®, Castello® and Puck®, all achieved higher sales in 2017 as a result of the Group's strategic focus on branded sales. The cornerstone Arla brand contributed to 66 per cent of the overall branded revenue in 2017.

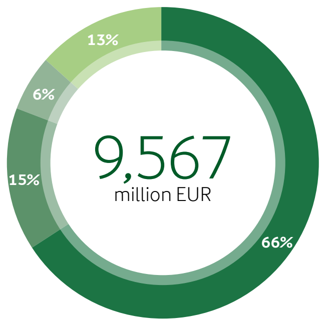
Development in revenue
(EURm)



Revenue split by commercial segment, 2017



Revenue split by commercial segment, 2016

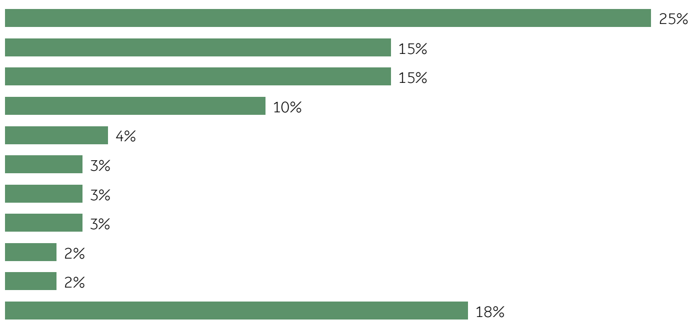


(EURm)	2017	2016
Europe	6,568	6,321
International	1,616	1,428
AFI	651	545
Trading and other	1,503	1,273

Table 1.1 Revenue split by country
(EURm)

	2017	2016
UK	2,614	2,532
Germany	1,525	1,302
Sweden	1,522	1,463
Denmark	1,031	1,062
Netherlands	460	373
Finland	304	329
China	302	202
Saudi Arabia	276	247
Belgium	215	197
USA	179	180
Other*	1,910	1,680
Total	**10,338**	**9,567**

Revenue split by country, 2017



**Other countries include, amongst others, Nigeria, Bangladesh, Oman, Canada, Spain, France, Australia and Russia.*

Table 1.1 represents the total revenue by country and includes all sales that occur in the countries, irrespective of organisational structure. Therefore, the figures cannot be compared to our commercial segment review on page 30 to 35.

Strategic branded revenue by brand

	Arla®	Lurpak®	Castello®	Puck®	Other supported brands
2017	66%	12%	4%	8%	10%
2016	65%	11%	5%	8%	11%

Accounting policies

Revenue is recognised in the income statement when the performance obligation was satisfied, meaning all obligations stated in the contract are fulfilled. This is defined at the point in time when all risks and rewards of the products have been passed on to the buyer, the amount of revenue can be measured reliably, and collection is probable. The transfer of risks and rewards to customers takes place according to the trade agreement terms, i.e. the Incoterms.

Revenue comprises invoiced sales for the year less customer specific payments such as sales rebates, cash discounts, listing fees, promotions, VAT and duties. Revenue by commercial segment/market and brand is based on the Group's internal financial reporting. Accumulated experience with customers is used to accurately estimate variable parts of contracts to correctly recognise revenue.

In general, contracts with customers have industry-wide payment terms with a short duration, therefore an adjustment of the transaction price with regards to a financing component in the contracts is not necessary.

Uncertainties and estimates

Revenue, net of rebates, is recognised when goods are transferred to customers. Estimates are applied when measuring the accruals for rebates and other sales incentives. The majority of rebates are calculated using terms agreed with the customer. For some customer relationships the final settlement of the rebate depends on future volumes, prices and other incentives. Thus, there is an element of uncertainty relating to the exact value.

Note 1.2 Costs

Tight cost control challenged by higher production complexity

Operational costs were EUR 10,066 million compared to EUR 9,254 million last year, representing an increase of 8.8 per cent.

Cost of production increased to EUR 8,063 million from EUR 7,177 million last year. Excluding costs of raw milk, production costs decreased to EUR 3,014 million compared to EUR 3,149 million last year primarily due to currency. Our strong focus on cost management was challenged by increased complexity caused by a broader and more diverse portfolio of branded products and use of different milk types. Thus, the conversion cost index, which measures the total cost of production per kg of milk processed, grew to an index of 103.9 compared to 99.2 in last year.

Sales and distribution costs decreased by 3.5 per cent, mainly due to currency effects and lower marketing spend. Research and development spend incurred amounted to EUR 37 million, compared to EUR 43 million last year. Additionally, EUR 20 million related to development activities was capitalised.

Administration costs decreased by EUR 16 million, primarily due to savings in salaries and the non-recurrence of one time expenses in 2016 related to the restructure programme, Organise-to-Win.

Cost of raw milk
The cost of raw milk increased by EUR 1,020 million or 25.3 per cent. This was primarily driven by higher milk prices to our owners.

Owner milk
Costs related to owner milk increased by EUR 975 million, representing an increase of 27.8 per cent. A higher average prepaid milk price increased the costs by EUR 949 million, and higher volumes attributed to an increase of EUR 26 million.

Other milk
Costs of other milk increased by EUR 45 million, equivalent to 8.6 per cent, due to higher market prices partly offset by currency effects. Other milk consists of speciality milk and other contract milk acquired to meet local market demands.

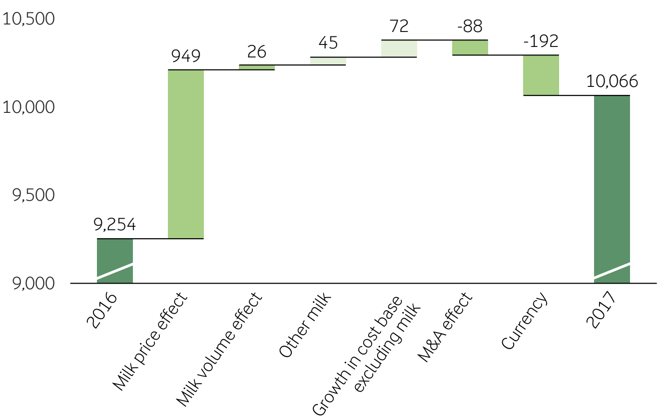
Staff costs
Staff costs amounted to EUR 1,218 million, a decrease of EUR 5 million compared to last year. Staff costs were positively impacted by the results of Organise-to-Win programme, the divestment of Rynkeby and currencies.

Within sales and distribution, as well as administration, staff costs decreased EUR 19 million, which were offset by increases within production to manage the more diverse product portfolio.

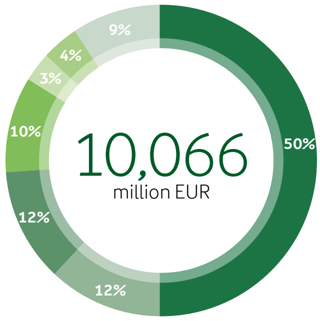
Marketing spend
EUR 300 million was spent on marketing activities in 2017, compared to EUR 309 million last year. Marketing spend increased in International due to new initiatives, for example, the launch of Arla® Organic Milk in MENA. In Europe, marketing spend was slightly lower than last year with the exception of Germany, where the marketing of especially Arla® skyr increased the spend.

Depreciation, amortisation and impairment
Depreciation, amortisation and impairment amounted to EUR 353 million, corresponding to an increase of EUR 19 million compared to last year. The increase in amortisation was mainly related to the investments in IT and other development projects.

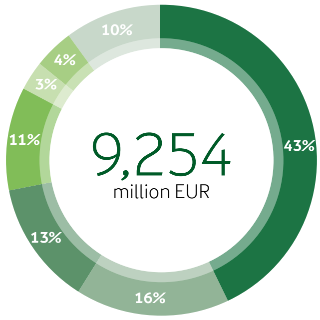
Development in costs
(EURm)



Cost split by type, 2017



Cost split by type, 2016



- Weighed-in raw milk
- Other production materials*
- Staff costs
- Transportation costs
- Marketing costs
- Depreciation, amortisation and impairment
- Other costs**

Table 1.2.a Operational costs split by functions
(EURm)

	2017	2016
Production costs	8,063	7,177
Sales and distribution costs	1,584	1,642
Administration costs	419	435
Total	**10,066**	**9,254**
Specification:		
Weighed-in raw milk	5,048	4,028
Other production materials*	1,231	1,463
Staff costs	1,218	1,223
Transportation costs	1,002	1,010
Marketing costs	300	309
Depreciation, amortisation and impairment	353	334
Other costs**	914	887
Total	**10,066**	**9,254**

*Other production materials includes packaging, additives, consumables and changes in inventory
**Other costs mainly includes maintenance, utilities and IT

Table 1.2.b Weighed-in raw milk

	2017		2016	
	Weighed in mio. kg.	EURm	Weighed in mio. kg.	EURm
Owner milk	12,373	4,478	12,320	3,503
Other milk	1,564	570	1,554	525
Total	**13,937**	**5,048**	**13,874**	**4,028**

Table 1.2.c Staff costs
(EURm)

	2017	2016
Wages, salaries and remuneration	1,034	1,038
Pensions - defined contribution plans	72	73
Pensions - defined benefit plans	4	3
Other social security costs	108	109
Total staff costs	**1,218**	**1,223**
Staff costs relate to:		
Production costs	691	677
Sales and distribution costs	336	346
Administration costs	191	200
Total staff costs	**1,218**	**1,223**
Average number of full-time employees	18,973	18,765

Table 1.2.d Depreciation, amortisation and impairment

(EURm)	2017	2016
Intangible assets, amortisation	54	42
Property, plant and equipment, depreciation	299	292
Total depreciation, amortisation and impairment	**353**	**334**
Depreciation, amortisation and impairment relate to:		
Production costs	280	269
Sales and distribution costs	36	32
Administration costs	37	33
Total depreciation, amortisation and impairment	**353**	**334**

Accounting policies

Production costs
Production costs comprise purchased goods, including the purchase of milk from cooperative owners, as well as direct and indirect costs including depreciation and impairment losses on production plant as well as payroll costs related to production. The purchase of milk from cooperative owners is recognised at prepaid prices for the accounting period and therefore does not include the supplementary payment, which is classified as distributions to owners and recognised directly in equity.

Sales and distribution costs
Costs incurred on the sale and distribution of goods sold in the course of the year, and for promotional campaigns are recognised as sales and distribution costs. Costs relating to sales staff, write-down of receivables, sponsorship, research and development, advertising and exhibits, depreciation and impairment losses, are also recognised as sales and distribution costs.

Administration costs
Administration costs incurred in the course of the year relate to management and administration, including administrative staff, office premises and office costs, as well as depreciation and impairment losses.

Note 1.3 Other operating income and costs

Positive hedging effects

Other operating income and costs consist of items outside the regular course of dairy business activities. It mainly includes items such as gains and losses relating to divestments of non-current assets, financial instruments and compensation from insurance contracts. Furthermore, it includes income and costs related to sales of surplus power from condensation plants.

Net other operating income amounted to EUR 32 million, compared to EUR 62 million last year. Gains on financial instruments used for hedging of sales in 2017 amounted to EUR 29 million.

NOTE 2
NET WORKING CAPITAL

Note 2.1 Net working capital

Higher milk prices drove an increase in net working capital

The increases in market and sales prices for milk increased the value of Arla inventory and receivable positions in 2017. Higher absolute valued inventory and receivables increased the net working capital position. Despite multiple initiatives which offset some of the increase. Net working capital increased by 17 per cent to EUR 970 million, compared to EUR 831 million last year. Working capital in days deteriorated slightly compared to last year with improvements in trade payables (DPO) and trade receivables (DSO) as a result of a continued focus on cash collection and payment terms. These improvements were more than offset by the increased inventory levels (DIO) due to slightly higher volumes on hand.

Excluding payables relating to owner milk, net working capital increased by EUR 173 million.

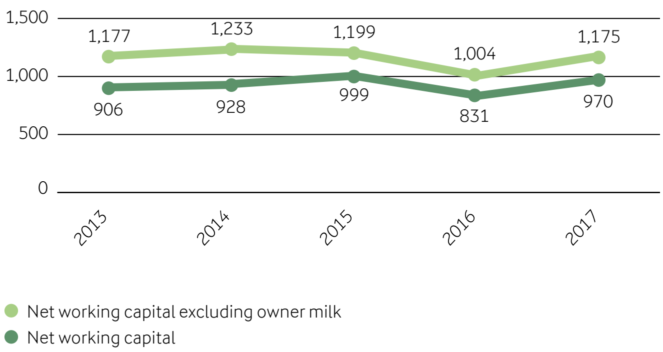
Inventory
Inventory increased by EUR 176 million to EUR 1,126 million, compared to EUR 950 million last year. Excluding currency effects, the inventory increased by EUR 217 million, attributable to the market milk price developments and increased volumes.

Trade receivables
Trade receivables increased to EUR 942 million, compared to EUR 876 million last year. The net movement, excluding currency effects, was an increase of EUR 100 million. The increase was mainly attributed to the significantly higher sales prices in 2017.

Exposure to credit risk on trade receivables is guided by Group-wide policies. Credit limits are set based on the customer's financial position and current market conditions. Generally, Arla does not hold collateral as security for trade receivables. The customer portfolio is diversified in terms of geography, industry sector and customer size. In 2017, the Group was not extraordinarily exposed to credit risk related to significant individual customers but to the general credit risk in the retail sector. Historically, amounts written off as irrecoverable have been relatively low, which was also the case in 2017. Trade receivable balances overdue above 90 days amounted to 1.3 per cent, compared to 1.5 per cent last year.

Trade payables
Trade payables increased by EUR 103 million to EUR 1,098 million, compared to EUR 995 million last year. The movement in trade payables, excluding owner milk and currency effects, was an increase of EUR 90 million. The increase was driven by Arla's continuous effort to improve payment terms. Payables related to owner milk increased by EUR 34 million as a result of a 3 per cent increase of member milk intake in December 2017, compared to the same month last year, as well as a significantly higher milk prices, representing an increase of 15 per cent.

Net working capital
(EURm)



Development in net working capital
(EURm)

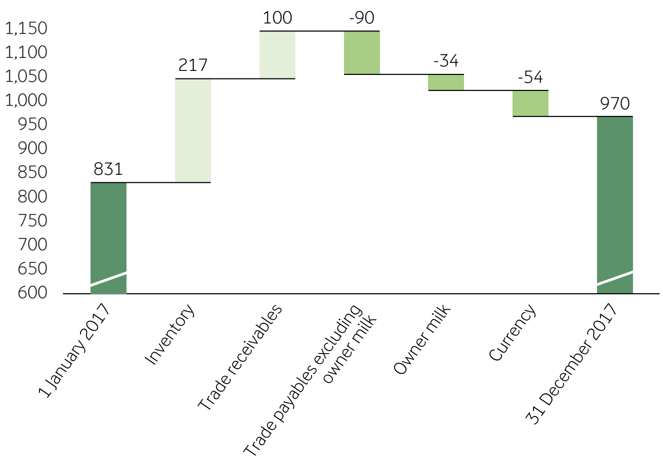


Table 2.1.a Net working capital
(EURm)

	2017	2016
Inventory	1,126	950
Trade receivables	942	876
Trade payables	-1,098	-995
Net working capital	**970**	**831**

Table 2.1.b Inventory
(EURm)

	2017	2016
Inventory before the write-downs	1,153	969
Write-downs	-27	-19
Total inventory	**1,126**	**950**
Raw materials and consumables	264	257
Work in progress	366	292
Finished goods and goods for resale	496	401
Total inventory	**1,126**	**950**

Table 2.1.c Trade receivables
(EURm)

	2017	2016
Trade receivables before provision for bad debts	954	887
Write-downs for bad debts	-12	-11
Total trade receivables	**942**	**876**

Accounting policies

Inventories
Inventories are measured at the lower of cost or net realisable value, calculated on a first-in, first-out basis. The net realisable value is established taking into account the inventories, marketability and estimate of the selling price, less completion costs and costs incurred to execute the sale.

The cost of raw materials, consumables as well as commercial goods includes the purchase price plus delivery costs. The prepaid price to Arla's owners is used as the purchase price for owner milk.

The cost of work in progress and manufactured goods also includes an appropriate share of production overheads, including depreciation, based on the normal operating capacity of the production facilities.

Trade receivables
Trade receivables are recognised at the invoiced amount less write-downs for amounts considered irrecoverable (amortised cost). Write-downs are measured as the difference between the carrying amount and the present value of anticipated cash flow. Write-downs are assessed on major individual receivables or in groups at portfolio level based on the receivables' age and maturity profile as well as historical records of losses.

Trade payables
Trade payables are measured at amortised cost, which usually corresponds to the invoiced amounts.

Uncertainties and estimates

Inventories
The Group uses monthly standard costs to calculate inventory and revises all indirect production costs at least once a year. Standard costs are also revised if they deviate materially from the actual cost of the individual product. A key component in the standard cost calculation is the cost of raw milk from farmers. This is determined using the average prepaid milk price that matches the production date of inventory.

Indirect production costs are calculated based on relevant assumptions with respect to capacity utilisation, production time and other factors characterising the individual product.

The assessment of the net realisable value requires judgement, particularly in relation to the estimate of the selling price of certain cheese stock with long maturities and bulk products to be sold in the world market.

Receivables
Receivables are written down based on individual assessment if signs of impairment regarding customers' insolvency are present and insolvency is anticipated. Furthermore, a mathematical computation is used based on several parameters including number of days overdue.

The financial uncertainty associated with write-downs for bad debt losses is usually considered to be limited. However, if a customer's ability to pay deteriorates in the future, further write-downs may be necessary.

Customer specific bonuses are calculated based on actual agreements with retailers, however, some uncertainty exists when estimating exact amounts to be settled and timing of these settlements.

NOTE 3
CAPITAL EMPLOYED

Note 3.1 Intangible assets

Intangible asset reduction driven by currency

Intangible assets amounted to EUR 811 million, representing a decrease of EUR 14 million compared to last year related to effects of changes in currencies.

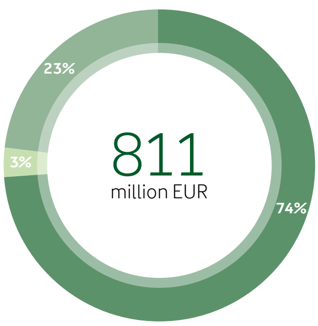
Goodwill
The carrying value of goodwill amounted to EUR 596 million compared to EUR 615 million last year. EUR 470 million hereof related to activities in the UK, compared to EUR 488 million last year. This decrease in goodwill was due to exchange rate adjustments. Refer to Note 3.2 for detail on the impairment test.

Licences and trademarks
Licences and trademarks recognised at a total carrying amount of EUR 26 million include Cocio®, Anchor® and Hansano®. Other brands including the strategic brands, Arla®, Lurpak®, Castello® and Puck®, are internally generated trademarks and are not recognised with any attributed value.

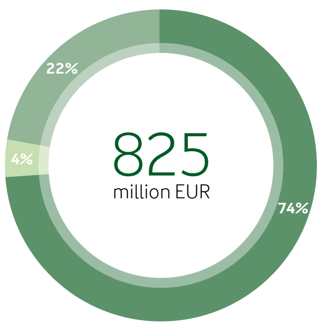
IT and other development projects
The Group continued to invest in the development of IT. During 2017, SAP was implemented in the Netherlands and in the UK at the Westbury dairy, thereby completing the integration into the Arla SAP platform. Furthermore, IT development projects in 2017 also included stregthened SAP access controls, Arlagården Plus, warehouse distribution and milk allocation projects. Other capitalised development costs relate to innovation activities and to the development of new products.

Table 3.1 Intangible assets (EURm)	**Goodwill**	**Licenses and trademarks**	**IT and other development projects**	**Total**
2017				
Cost at 1 January	615	100	327	1,042
Exchange rate adjustments	-19	-2	-2	-23
Additions	-	-	50	50
Mergers and acquisitions	1	1	-	2
Reclassification	-	-	7	7
Disposals	-	-	-2	-2
Cost at 31 December	**597**	**99**	**380**	**1,076**
Amortisation and impairment at 1 January	-	-70	-147	-217
Exchange rate adjustments	-	2	2	4
Amortisation and impairment for the year	-1	-5	-48	-54
Amortisation on disposals	-	-	2	2
Amortisation and impairment at 31 December	**-1**	**-73**	**-191**	**-265**
Carrying amount at 31 December	**596**	**26**	**189**	**811**
2016				
Cost at 1 January	678	102	281	1,061
Exchange rate adjustments	-63	1	-1	-63
Additions	-	-	58	58
Reclassification	-	-	-1	-1
Disposals	-	-3	-10	-13
Cost at 31 December	**615**	**100**	**327**	**1,042**
Amortisation and impairment at 1 January	-	-65	-123	-188
Exchange rate adjustments	-	-1	2	1
Amortisation and impairment for the year	-	-6	-36	-42
Amortisation on disposals	-	2	10	12
Amortisation and impairment at 31 December	**-**	**-70**	**-147**	**-217**
Carrying amount at 31 December	**615**	**30**	**180**	**825**

Intangible assets 2017



Intangible assets 2016



- Goodwill
- Licences and trademarks
- IT and other development projects

Accounting policies

Goodwill
Goodwill represents the premium paid by the Group above the fair value of the net assets of an acquired company. On initial recognition, goodwill is recognised at cost. Goodwill is subsequently measured at cost less any accumulated impairment. The carrying amount of goodwill is allocated to the Group's cash-generating units that follow the management structure and internal financial reporting. Cash-generating units are the smallest Group of assets which are able to generate independent cash inflows.

Licences and trademarks
Licences and trademarks are initially recognised at cost. The cost is subsequently amortised on a straight-line basis over their expected useful lives.

IT and other development projects
Costs incurred during the research phase in carrying out general assessments of the Group's needs and available technologies are expensed as incurred. Directly attributable costs incurred during the development stage for IT and other development projects relating to the design, programming, installation and testing of projects before they are ready for commercial use are capitalised as intangible assets. Such costs are only capitalised provided the expenditure can be measured reliably, the project is technically and commercially viable, future economic benefits are probable and the Group intends to and has sufficient resources to complete and use the asset. IT and other development projects are amortised on a straight-line basis over five to eight years.

Note 3.2 Impairment tests

Goodwill supported by market development and Good Growth 2020

Goodwill in the UK originated from the purchase of Express Dairies Limited in 2003 and 2007, the acquisition of AFF in 2009 and the merger with Milk Link in 2012. In Finland, goodwill arose in connection with the purchase of Ingman in 2007. The remaining goodwill arose primarily from the purchase of Tholstrup in 2006.

Goodwill is allocated to relevant business units, primarily to our activities in the UK and Finland within the Europe commercial segment. Impairment tests are performed at business unit level, being the lowest cash generating unit.

Basis for impairment test and applied estimates
Impairment tests are performed annually and based on expected future cash flow derived from forecasts and targets supporting the Good Growth 2020 strategy. The impairment tests do not include growth in the terminal value, as the growth rate has been set to the expected inflation rate.

Procedure for impairment tests
Milk costs are recognised at a milk price that corresponds to the price at the time the test is performed. In the applied forecasts, the key operational assumption is future profitability based on a combination of the impact from moving milk intake into value added products and more profitable markets. Other key assumptions are sustainable cost reduction initiatives.

Test results
Impairment testing showed that there was no need for impairment in 2017. In this regard, sensitivities to changes in milk prices and discount rates were calculated. The discount rate could rise up to 3 percentage points, compared to 4 percentage points last year, before the goodwill in the UK would be at risk of being impaired. The market conditions were challenging in Finland in 2017. Nevertheless, impairment testing performed showed that expected future cash flow can support the carrying value of our net assets, including goodwill.

Table 3.2 Impairment tests
(EURm)

		Applied key assumptions	
2017	Carrying amount, goodwill	Discount rate, net of tax	Discount rate, before tax
UK	470	6.9%	8.4%
Finland	40	6.3%	7.6%
Sweden	23	6.5%	8.3%
Other	63	6.4%	7.1%
Total carrying amount at 31 December	**596**		
2016			
UK	488	7.1%	8.9%
Finland	40	6.2%	7.6%
Sweden	23	6.4%	8.3%
Other	64	6.2%	6.9%
Total carrying amount at 31 December	**615**		

Accounting policies

Impairment occur when the carrying amount of an asset is greater than its recoverable amount through either use or sale. For impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use (cash-generating unit) that are largely independent of the cash inflows of other assets or cash-generating units.

The cash-generating units are determined based on the management structure and the internal financial reporting.
The cash-generating units are reassessed each year.

The carrying amount of goodwill is tested for impairment together with the other non-current assets in the cash-generating unit to which the goodwill is allocated. The recoverable amount of goodwill is recognised as the present value of the expected future net cash flows from the cash-generating unit to which the goodwill is allocated, discounted using a pre-tax discount rate that reflects the current market assessment of the time value of money and risks specific to the asset or cash-generating unit.

Any impairment of goodwill is recognised as a separate line item in the income statement and cannot be reversed. The carrying amount of other non-current assets is assessed annually to determine whether there is any indication of impairment. The assets are measured on the balance sheet at the lower value of the recoverable amount and the carrying amount.

The recoverable amount of other non-current assets is the higher value of the asset's value in use and the market value, i.e. fair value, less expected disposal costs. The value in use is calculated as the present value of the estimated future net cash flows from the use of the asset or the cash-generating unit of which the asset is part of.

An impairment loss on other non-current assets is recognised in the income statement under production costs, sales and distribution costs or administration costs, respectively. Impairment made is reversed to the extent that the assumptions and estimates that led to the impairment have changed. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Uncertainties and estimates

Goodwill is allocated to the cash-generating unit it concerns. The cash-generating units are defined based on the management structure and are linked to individual markets. Cash generating units are assessed each year.

The impairment test of goodwill is performed annually for each cash-generating unit to which goodwill is allocated.

The most important parameters in the impairment test include expectations on future free cash flow and assumptions on discount rates.

Anticipated future free cash flows
The anticipated future free cash flows are based on current forecasts and targets set in the strategy period 2018-2020 within the Good Growth 2020 strategy. These are based on management's best estimates and expectations, which are judgmental by nature. They include expectations in strategy period on revenue growth, EBIT margins and capital expenditures. This includes moving milk intake into value-added products, more profitable markets and cost reduction initiatives. The growth rate beyond the strategy period has been set to the expected inflation rate in the terminal period.

Following the Brexit vote, expected cash flow supporting the carrying value of goodwill in the UK is inherently more uncertain. This was reflected in our impairment test. Read more about Brexit on page 50.

Discounts rates
A discount rate, namely Weighted Average Cost of Capital (WACC), is applied for the specific business areas based on assumptions regarding interest rates, tax rates and risk premiums. The WACC is recalculated to a before-tax rate. Changes in the future cash flow or discount rate estimates used may result in materially different values.

Note 3.3 Property, plant and equipment

Strategic capital expenditure supporting innovation

Main tangible assets are located in Denmark, the UK, Germany and Sweden. The carrying value decreased by EUR 98 million to EUR 2,212 million in 2017, driven by higher depreciation than capital expenditures and changes in currencies.

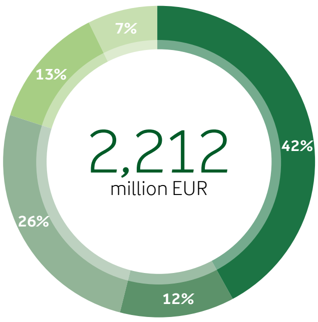
Capital expenditure decreased 5.7 per cent to EUR 248 million compared to EUR 263 million last year. This reflects our continued focus on the utilisation of our production capacity. In 2017, a higher CAPEX budget was approved, however due to the timing of projects, this approval has not yet materialised in higher CAPEX expenditure.

Major investments in 2017 included a general upgrade and expansion of production facilities with a particular focus on the child nutrition category, as well expenditure on existing sites and finalisation of the investment in our new global Innovation Centre.

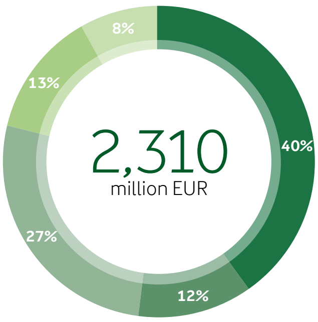
Table 3.3 Property, plant and equipment
(EURm)

	Land and buildings	Plant and machinery	Fixture and fitting, tools and equipment	Assets in course of construction	Total
2017					
Cost at 1 January	1,430	2,664	500	164	4,758
Exchange rate adjustments	-28	-41	-14	-2	-85
Additions	5	30	7	206	248
Mergers and acquisitions	2	4	-	2	8
Transferred from assets in course of construction	43	142	29	-214	-
Disposals	-36	-19	-13	-	-68
Reclassification	26	-14	-7	-4	1
Cost at 31 December	**1,442**	**2,766**	**502**	**152**	**4,862**
Depreciation and impairments at 1 January	-573	-1,499	-376	-	-2,448
Exchange rate adjustments	9	23	10	-	42
Depreciation for the year	-46	-209	-44	-	-299
Depreciation on disposals	30	13	13	-	56
Reclassification	-22	14	7	-	-1
Depreciations and impairment at 31 December	**-602**	**-1,658**	**-390**	**-**	**-2,650**
Carrying amount at 31 December	**840**	**1,108**	**112**	**152**	**2,212**
Of which assets held under finance lease	34	18	2	-	54
2016					
Cost at 1 January	1,466	2,547	519	255	4,787
Exchange rate adjustments	-64	-84	-34	-7	-189
Additions	2	41	12	208	263
Transferred from assets in course of construction	37	227	28	-292	-
Disposals	-11	-67	-25	-	-103
Cost at 31 December	**1,430**	**2,664**	**500**	**164**	**4,758**
Depreciation and impairment at 1 January	-553	-1,402	-375	-	-2,330
Exchange rate adjustments	20	45	22	-	87
Depreciation for the year	-43	-204	-45	-	-292
Depreciation on disposals	3	62	22	-	87
Depreciations and impairment at 31 December	**-573**	**-1,499**	**-376**	**-**	**-2,448**
Carrying amount at 31 December	**857**	**1,165**	**124**	**164**	**2,310**
Of which assets held under finance lease	37	13	1	-	51

Property, plant and equipment by country 2017

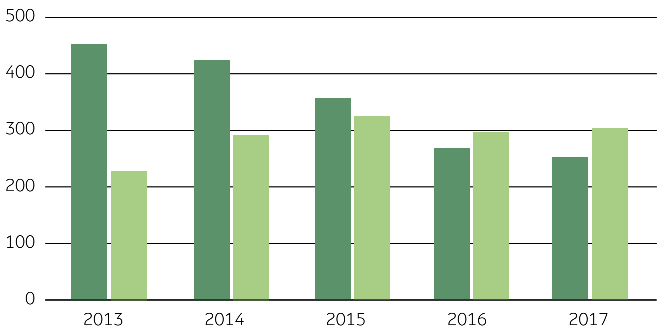


Property, plant and equipment by country 2016



● Denmark
● Sweden
● UK
● Germany
● Other

Investments and depreciation property, plant and equipment
(EURm)



● Investments property, plant and equipment
● Depreciation property, plant and equipment

Accounting policies

Property, plant and equipment are measured at cost less accumulated depreciation and impairment. Assets under construction, land and decommissioned plants are not depreciated.

Cost
Cost comprises the acquisition price as well as costs directly associated with an asset until the asset is ready for its intended use. For self-constructed assets, cost comprises direct and indirect costs relating to materials, components, payroll and the borrowing costs from specific and general borrowing that directly concerns the construction of assets. If significant parts of an item of property, plant and equipment have different useful lives, they are recognised as separate items (major components) and depreciated separately. When component parts are replaced, any remaining carrying value of replaced parts is removed from the balance sheet and recognised as an accelerated depreciation charge in the income statement. Subsequent expenditure items of property, plant and equipment are only recognised as an addition to the carrying amount of the item, when it is likely that incurring the cost will result in financial benefits for the Group. Other costs such as general repair and maintenance are recognised in the income statement when incurred.

Depreciation
Depreciation aims to allocate the cost of the asset, less any amounts estimated to be recoverable at the end of its expected use, to the periods in which the Group obtains benefits from its use. Property, plant and equipment are depreciated on a straight-line basis from the time of acquisition, or when the asset is available for use based on an assessment of the estimated useful life.

The estimated useful lives are as follows:
- Office buildings: 50 years
- Production buildings: 20 to 30 years
- Technical facilities and machinery: 5 to 20 years
- Other fixtures and fittings, tools and equipment: 3 to 7 years

The depreciation base is measured taking into account the residual value of the asset, being the estimated value the asset can generate through sale or scrappage at the balance sheet date if the asset was of the age and in the condition expected at the end of its useful life, and reduced by any impairment made. The residual value is determined at the date of acquisition and is reviewed annually. Depreciation ceases when the carrying value of an item is lower than the residual value. Changes during the depreciation period or in the residual value are treated as changes to the accounting estimates, the effect of which is adjusted only in the current and future periods. Depreciation is recognised in the income statement within production costs, sales and distribution costs or administration costs.

Uncertainties and estimates

Estimates are made in assessing the useful lives of items of property, plant and equipment that determine the period over which the depreciable amount of the asset is expensed to the income statement. The depreciable amount of an item of property, plant and equipment is a function of the asset's cost or carrying amount and its residual value. Estimates are made in assessing the amount that the Group can recover at the end of the useful life of an asset. An annual review is made with respect to the appropriateness of the depreciation method, useful life and residual values of items of property, plant and equipment.

Note 3.4 Associates and joint ventures

Investments in associates and joint ventures

COFCO Dairy Holdings Limited (COFCO) and China Mengniu Dairy Company Limited (Mengniu)
The Group has a 30 per cent investment in COFCO, which is considered an associated company based on a cooperation agreement extending significant influence, including the right of Board representation. The cooperation agreement with COFCO also entitles Arla to representation on the Board of Mengniu, a Hong Kong listed dairy company in which COFCO is a significant shareholder. It was agreed that Arla and Mengniu cooperate in relation to the exchange of technical dairy knowledge and expertise, and that Arla grants intellectual rights to Mengniu. Based on the underlying agreements, it is our assessment that Arla has significant influence in Mengniu.

The Group's proportionate share of the net asset value of COFCO including the investment in Mengniu is EUR 295 million, compared to EUR 309 million last year. The carrying amount of the investment in COFCO includes goodwill amounting to EUR 140 million, compared to EUR 160 million last year.

The fair value of the indirect share in Mengniu equals EUR 519 million, compared to EUR 383 million last year.

The investment in COFCO is part of the China business unit and is currently managed in China, along with sales activities with similar characteristics. A potential impairment of the investment is tested at the China business unit level, using expected future net cash flow. Impairment risks include substantial and long-term reductions in leading stock indexes in Asia, issue of import restrictions on dairy products in China, or an adverse and permanent reduction in the expected performance of Mengniu. As the fair value exceeds the carrying value of the investment, there is a no indication of impairment.

Mengniu reported a group revenue of EUR 7,317 million and a result of EUR -111 million in 2016. Consolidated figures are not available for the COFCO group. See table 3.4.b for more details on COFCO.

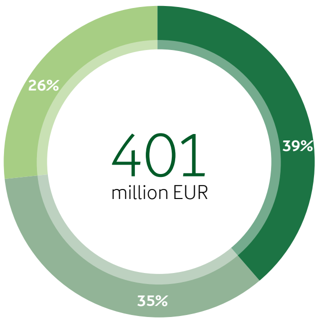
Lantbrukarnas Riksförbund, Sweden (LRF)
Arla has an ownership interest of 24 per cent in LRF, which is a politically independent professional organisation for Swedish entrepreneurs involved in agriculture, forestry and horticulture.

Based on a detailed analysis of the LRF arrangement, Arla's active ownership interest constitutes significant influence over LRF. This includes, but is not limited to, representation on the Board of Directors. Owners of Arla have represented the Swedish dairy industry at the Board of Directors in LRF and both Arla and our Swedish owners are individual members of LRF.

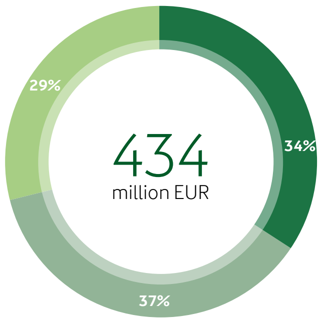
Vigor Alimentos S.A., Brazil
In October, the Group sold the investment in Vigor Alimentos S.A, realising a gain on EUR 44 million. Read more in Note 3.6.

Joint ventures
The carrying value of joint ventures amounted to EUR 53 million at year-end, compared to EUR 51 million last year. The carrying value does not include goodwill.

Recognised value of associates 2017



Recognised value of associates 2016



- Share of equity in COFCO/Mengniu
- Goodwill in COFCO/Mengniu
- Share of equity in non-material associates

Table 3.4.a Associates

Reconciliation of recognised value of associates (EURm)	**2017**	**2016**
Share of equity in COFCO/Mengniu	155	149
Goodwill in COFCO/Mengniu	140	160
Share of equity in non-material associates	106	125
Recognised value	**401**	**434**

Table 3.4.b Material associates

Financial information for associates that are considered material to the Group* (EURm)	**COFCO Dairy Holdings Limited 2017**	**COFCO Dairy Holdings Limited 2016**
Revenue	12	15
Results after tax	12	15
Non-current assets	656	789
Dividends received	2	4
Ownership share	30%	30%
Group share of result after tax	16	-6
Recognised value	295	309

COFCO has no other significant assets or liabilitites

* Based on latest available financial reporting.

Table 3.4.c Transactions with joint ventures and associates

(EURm)	**2017**	**2016**
Sales of goods to joint ventures	14	9
Sales of goods to associates	78	46
Total sale of goods to joint ventures and associates	**92**	**55**
Purchase of goods from joint ventures	57	52
Total purchase of goods from joint ventures and associates	**57**	**52**
Trade receivables joint ventures*	18	26
Trade receivables associates*	9	9
Total trade receivables joint ventures and associates	**27**	**35**
Trade payables joint ventures*	9	7
Total trade payables joint ventures and associates	**9**	**7**

* Included in other receivables and other payables

Accounting policies

Investments in which Arla exercises significant influence, but not control, are classified as associates. Investments in which Arla has joint control are classified as joint ventures.

The proportionate share of results of associates and joint ventures after tax is recognised in the consolidated income statement, after elimination of the proportionate share of unrealised intra-group profit or loss.

Investments in associates and joint ventures are recognised according to the equity method, and measured at the proportionate share of the entities' net asset values, calculated in accordance with Arla's accounting policies. The proportionate share of unrealised intra-group profits and the carrying amount of goodwill are added. Whereas the proportionate share of unrealised intra-group losses is deducted. Dividends received from associates and joint ventures reduce the value of the investment.

For investments held in listed companies, computation of the Group's share of profit and equity is based on the latest published financial information of the company, other publicly available information on the company's financial development, and the effect of reassessed net assets.

Investments in associates and joint ventures with negative net asset values are measured at EUR 0. If the Group has a legal or constructive obligation to cover a deficit in the associate or joint venture, the deficit is recognised under provisions. Any amounts owed by associates and joint ventures are written down to the extent that the amount owed is deemed irrecoverable.

An impairment test is performed when there is objective evidence of impairment, such as significant adverse changes in the environment in which the equity-accounted investee operates, or a significant or prolonged decline in the fair value of the investment below its carrying value. Where the equity-accounted investment is considered to be an integral part of a cash generating unit (CGU), the impairment test is performed at the CGU level, using expected future net cash flow of the CGU. An impairment loss is recognised when the recoverable amount of the equity-accounted investment (or CGU) becomes lower than the carrying amount. The recoverable amount is defined as the higher of value in use and fair value less costs to sell, of the equity-accounted investment (or CGU).

Uncertainties and estimates

Significant influence is defined as the power to participate in the financial and operating policy decisions of the investee, but does not constitute control or joint control over those policies. Judgement is necessary in determining when significant influence exists. When determining significant influence, factors such as representation on the Board of Directors, participation in policy-making, material transactions between the entities and interchange of managerial personnel are considered.

Note 3.5 Provisions

Provisions

Provisions amounted to EUR 23 million in 2017, compared to EUR 25 million last year. Provisions primarily pertain to insurance provisions for insurance incidents that occurred but have not been settled.

Insurance provisions primarily relate to occupational injuries. No major occupational incidents occurred during the year. A general provision for occupational injuries of EUR 8 million is recorded as a long-term provision.

Uncertainties and estimates

Provisions are particularly associated with estimates on insurance provisions. The scope and size of onerous contracts are also estimated. Insurance provisions are assessed based on historical records of, amongst other things, the number of insurance events and related costs considered.

Note 3.6 Purchase and sale of business or activities

Acquisitions and divestments

Gefleortens Dairy, Sweden
In December 2017, Arla acquired Gefleortens Dairy in Sweden, whereby 59 new owners with 30 million kg of milk joined Arla. The acquisition is in line with Arla's strategy on branded local products. Net assets acquired amounted to EUR 6 million. Consideration paid was EUR 8 million in cash and EUR 2 million was issued out of common capital. Additionally, EUR 4 million was received in cash as part of the acquisition. No goodwill was recognised as part of the transaction.

In 2017, the revenue contribution from the Gefleortens transaction was EUR 2 million. The effect on profit was insignificant.

Divestment of Vigor Alimentos S.A., Brazil
As a strategic choice to reduce our involvement in the Brazilian market, Arla divested its shares in the Brazilian based associate, Vigor Alimentos S.A, recognising a gain of EUR 44 million. The investment was previously classified as an associated company.

Divestment of Rynkeby Foods A/S
In May 2016, Arla concluded an agreement to divest Rynkeby Foods A/S. The company and its subsidiaries have juice activities primarily in Denmark, Sweden and Finland, and a production site in Denmark. The Rynkeby group had an annual revenue of EUR 130 million and 200 employees. This divestment represented the last non-core business activity within Arla, thus enabling sole focus on the dairy sector. The activities in Rynkeby Foods A/S were deconsolidated with effect from May 2016 and the divestment resulted in a gain of EUR 120 million. Certain distribution activities in Scandinavia continued until the end of 2016 and in total revenue was reduced by EUR 90 million compared to last year.

Table 3.6a Sale of business or activities
(EURm)

	2017	2016
Selling price on divestment of enterprise	74	145
Cash transferred as part of the transaction	-	-7
Net cash received	74	138
Other assets transferred	-30	-52
Liabilities transferred	-	34
Gain on divestment	**44**	**120**

Table 3.6b Mergers and acquisitions
(EURm)

Company / Country	Income statement consolidated from	Holding acquired	Revenue per year	No. of employees
Gefleortens / Sweden	1 December 2017	100 % of shares	35	90

Accounting policies

Recognition date and considerations
Newly acquired companies are recognised in the consolidated financial statements at the date when the Group obtains control. The purchase consideration is generally measured at fair value. If an agreement relating to a business combination requires that the purchase consideration be adjusted in connection with future events or the performance of certain obligations (contingent consideration), this portion of the purchase consideration is recognised at fair value at the date of acquisition. Changes in estimates relating to a contingent consideration are recognised in the income statement. Costs directly attributable to the acquisition are recognised in the income statement as incurred.

The acquired assets, liabilities and contingent liabilities are generally measured at their fair value at the date of acquisition.

Goodwill arises when the aggregate of the fair value of consideration transferred, previously held interest and the value assigned to non-controlling interest holders exceeds the fair value of the identifiable net assets of the acquired company. Any goodwill that arises, which is not amortised, is tested annually for impairment.

The methodology outlined above also applies to mergers with other cooperatives, where the owners of the acquired company become owners of Arla Foods amba. The purchase consideration is calculated at the acquisition date fair values of the assets transferred and equity instruments issued. Positive differences between the consideration and fair value are recognised as goodwill.

Divestment
Changes in the Group's interest in a subsidiary that do not result in a loss of control are recognised as equity transactions.

Enterprises divested are recognised in the consolidated income statement up to the date of disposal. Comparative figures are not restated to reflect disposals. Gain or losses on divestment of subsidiaries and associates are determined as the difference between the selling price and the carrying amount of the net assets, including goodwill, at the date of divestment and costs necessary to make the sale.

NOTE 4
FUNDING

Note 4.1 Financial items

Lower financial costs

Net financial cost decreased by EUR 43 million to EUR 64 million in 2017, mainly due to currency adjustments.

Net interest cost amounted to EUR 57 million, representing a decrease of EUR 6 million compared to last year.

Net interest cost decreased due to a lower level of net interest-bearing debt, while the average interest cost, excluding pension liabilities, totalled 2.6 per cent compared to 3.0 per cent last year. Interest cover amounts to 12.9 compared to 13.3 last year.

Interest cover is the ratio between EBITDA in 2017 of EUR 738 million and the net interest cost of EUR 57 million.

Exchange rate losses were at a lower level compared to last year mainly as a result of the Nigerian devaluation in 2016 with a negative effect of EUR 28 million. The majority of exchange rate losses relates to cost of converting funding currencies into currencies with funding needs.

Table 4.1 Financial income and financial costs
(EURm)

	2017	2016
Financial income:		
Interest securities, cash and cash equivalents	5	5
Fair value adjustments and other financial income	8	2
Total financial income	**13**	**7**
Financial costs:		
Interest on financial instruments measured at amortised cost	-53	-60
Net exchange rate losses	-18	-48
Interest on pension liabilities	-9	-8
Interest transferred to property, plant and equipment	6	7
Fair value adjustments and other financial costs	-3	-5
Total financial costs	**-77**	**-114**
Net financial costs	**-64**	**-107**

Accounting policies

Financial income and costs as well as capital gains and losses, are recognised in the income statement at amounts that can be attributed to the year. Financial items comprise realised and unrealised value adjustments of securities and currency adjustments on financial assets and financial liabilities, as well as the interest portion of financial lease payments. Additionally, realised and unrealised gains and losses on derivative financial instruments not classified as hedging contracts were included. Borrowing costs from general borrowing, or loans that directly relate to the acquisition, construction or development of qualified assets are attributed to the cost of such assets, and were therefore not included in financial cost.

Capitalisation of interest was performed by using an interest rate of three per cent, matching the Group's average external interest rate in 2017.

Financial income and costs relating to financial assets and financial liabilities were recognised using the effective interest method.

Note 4.2 Net interest-bearing debt

Lower pension liabilities resulting in reduced net-interest bearing debt

Net interest-bearing debt, excluding pension liabilities were reduced to EUR 1,636 million compared to EUR 1,648 million last year. A solid cash flow from the underlying business was partly offset by higher working capital position, as well as capital expenditure and the supplementary payment for 2016. Working capital increased due to a higher inventory value from the increase in milk prices to farmer owners, and a higher trade receivables balance, caused by higher sales prices.

The leverage ratio was 2.6, an increase of 0.2 compared to last year. This outperformed the Group's long-term target range of 2.8-3.4, underpinning the Group's strong financial position. Last year's leverage ratio was significantly impacted by the Rynkeby divestment. Leverage, excluding the gain form the divestment of Vigor was 2.8.

Pension liabilities decreased EUR 92 million to EUR 277 million mainly due to lower expected salary increases, contributions and currencies effects. As a result, net interest-bearing debt, including pension liabilities, amount to EUR 1,913 million compared to EUR 2,017 million last year.

The average maturity of the interest-bearing borrowings decreased by 0.2 years to 5.7 years. The average maturity is impacted by a lapse of time to maturity, refinancing of committed facilities, and the level of net interest-bearing debt.

The equity ratio measured 36 per cent, compared to 34 per cent last year, which gives Arla an adequate position to support the investments for the future growth.

Funding

The Group applies a diversified funding strategy in order to balance the liquidity and refinancing risk with the desire to achieve a low financing cost. Major acquisitions or investments are funded separately.

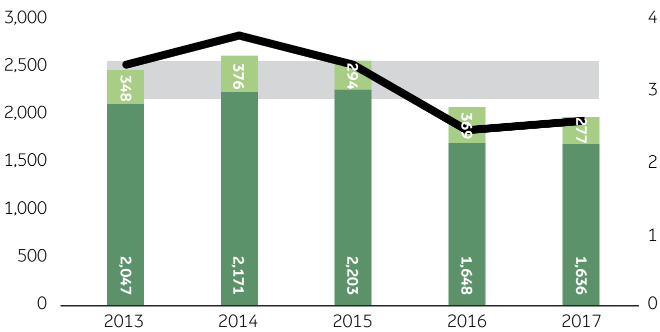
A diverse funding strategy includes diversification of markets, currencies, instruments, banks, lenders and maturities in order to secure access to funding to ensure that the Group is independent of a single creditor or a single market. All funding opportunities are measured against EURIBOR 3 months and derivatives are applied to match the currency of our funding needs. The interest profile is managed with interest rate swaps independent of the single loan.

The credit facilities contain financial covenants on equity/total assets and minimum equity, as well as standard non-financial covenants. The Group did not default on or fail to fulfil any loan agreements in 2017.

During 2017, the Group raised the following mix of funding:

- Bank and credit institutions: exercised extension options in our revolving credit facilities for an amount of EUR 768 million, increasing maturity by 1 year.
- European Investment Bank: Arla was able to obtain a new 7 year credit facility from the European Investment Bank
- Commercial papers: the Group has a commercial paper programme in Sweden denominated in SEK and EUR. The average utilization in 2017 was EUR 232 million. Arla obtained debt with a negative interest including the credit margin.
- Repo: the Group entered into a sale and repurchase arrangement based on its investment in listed AAA-rated Danish Mortgage Bonds. This sale and repurchase agreement is described in further detail in Note 4.6.

Net interest-bearing debt
(EURm)



Net interest-bearing debt consists of current and non-current liabilities, less interest-bearing assets. The definition of leverage is the ratio between net interest-bearing debt including pension liabilities amounting to EUR 1,913 million and EBITDA amounting of EUR 738 million, and expresses the Group's capacity to service the debt. The Group's long-term target range for leverage is between 2.8 and 3.4.

Table 4.2.a Net interest-bearing debt
(EURm)

	2017	2016
Securities, cash and cash equivalents	-602	-588
Other interest-bearing assets	-8	-12
Long-term borrowings	1,206	1,281
Short-term borrowings	1,040	967
Net interest-bearing debt excluding pension liabilities	**1,636**	**1,648**
Pension liabilities	277	369
Net interest-bearing debt including pension liabilities	**1,913**	**2,017**

Table 4.2.b Borrowings
(EURm)

	2017	2016
Long-term borrowings:		
Issued bonds	254	419
Mortgage credit institutions	790	798
Bank borrowings	160	52
Finance lease liabilities	2	12
Total long-term borrowings	**1,206**	**1,281**
Short-term borrowings:		
Issued bonds	152	-
Commercial papers	213	115
Mortgage credit institutions	9	1
Bank borrowings	728	815
Finance lease liabilities	11	16
Other current liabilities	27	20
Total short-term borrowings	**1,040**	**967**
Total interest-bearing borrowings	**2,246**	**2,248**

Table 4.2.c Cash flow, net interest-bearing debt
(EURm)

		Cash flow	Non-cash changes				
	1 January 2017	Included in financing activities	Acquisitions	Reclasses	Foreign exchange movements	Fair value changes	31 December 2017
Pension liabilities	369	-39	2	-1	-9	-45	277
Long-term borrowings	1,281	-19	-	-26	-18	-12	1,206
Short-term borrowings	947	51	-	26	-11	-	1,013
Other interest-bearing liabilities	20	7	-	-	-	-	27
Total interest-bearing debt	**2,617**	**-**	**2**	**-1**	**-38**	**-57**	**2,523**
Securities and other interest-bearing receivables	-516	11	-	-	3	-17	-519
Cash	-84	-12	2	-2	5	-	-91
Net interest-bearing debt	**2,017**	**-1**	**4**	**-3**	**-30**	**-74**	**1,913**

Table 4.2.d Net interest-bearing debt excluding pension liabilities, maturity
(EURm)

December 31, 2017	**Total**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025-2027**	**After 2027**
DKK	815	35	22	21	27	30	30	29	186	435
SEK	639	361	152	24	102	-	-	-	-	-
EUR	136	-3	103	7	6	3	1	-	3	16
GBP	16	5	3	3	3	3	-1	-	-	-
Other	30	30	-	-	-	-	-	-	-	-
Total	**1,636**	**428**	**280**	**55**	**138**	**36**	**30**	**29**	**189**	**451**

December 31, 2016	**Total**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024-2026**	**After 2026**
DKK	872	86	12	20	20	32	22	29	153	498
SEK	558	115	181	157	-	105	-	-	-	-
EUR	175	1	134	7	7	6	4	-	1	15
GBP	37	14	12	3	3	3	2	-	-	-
Other	6	-9	15	-	-	-	-	-	-	-
Total	**1,648**	**207**	**354**	**187**	**30**	**146**	**28**	**29**	**154**	**513**

Maturity of net interest-bearing debt excluding pension liabilities at 31 December 2017
(EURm)

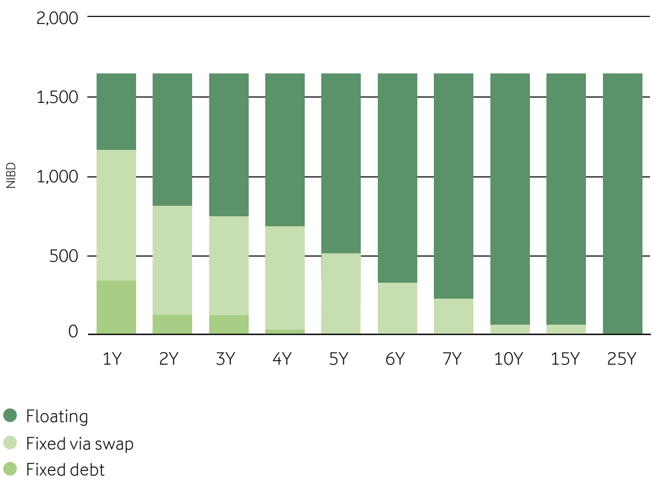
Maturity of net interest-bearing debt excluding pension liabilities at 31 December 2016
(EURm)

Table 4.2.e Interest rate risk at 31 December
(EURm)

	Interest rate	Average interest rate	Fixed for	Carrying amount	Interest rate risk
2017					
Issued bonds:					
SEK 500m maturing 04.06.2018	Fixed	3.25%	0-1 years	51	Fair value
SEK 800m maturing 28.05.2019	Fixed	2.63%	1-2 years	82	Fair value
SEK 500m maturing 31.05.2021	Fixed	1.88%	3-4 years	51	Fair value
SEK 1.000m maturing 04.06.2018	Floating	1.05%	0-1 years	101	Cash flow
SEK 700m maturing 28.05.2019	Floating	0.52%	0-1 years	71	Cash flow
SEK 500mmaturing 31.05.2021	Floating	1.07%	0-1 years	50	Cash flow
Commercial papers	Fixed	0.03%	0-1 years	213	Fair value
Total issued bonds		**1.10%**		**619**	
Mortgages credit institutions:					
Fixed-rate	Fixed	1.15%	2-3 years	44	Fair value
Floating-rate	Floating	0.71%	0-1 years	755	Cash flow
Total mortgage credit institutions		**0.73%**		**799**	
Bank borrowings:					
Fixed-rate	Fixed	-0.04%	0-1 years	506	Fair value
Floating-rate	Floating	1.25%	0-1 years	282	Cash flow
Total bank borrowings		**0.42%**		**788**	
Other borrowings:					
Finance leases	Floating	2.15%	0-1 years	13	Cash flow
Other borrowings	Floating	2.27%	0-1 years	27	Cash flow
Total other borrowings		**2.23%**		**40**	

Table 4.2.e Interest rate risk at 31 December (EURm)	**Interest rate**	**Average interest rate**	**Fixed for**	**Carrying amount**	**Interest rate risk**
2016					
Issued bonds:					
SEK 500m maturing 04.06.2018	Fixed	3.25%	1-2 years	52	Fair value
SEK 800m maturing 28.05.2019	Fixed	2.63%	2-3 years	84	Fair value
SEK 500m maturing 31.05.2021	Fixed	1.88%	4-5 years	53	Fair value
SEK 1.000m maturing 04.06.2018	Floating	1.08%	0-1 years	105	Cash flow
SEK 700m maturing 28.05.2019	Floating	0.56%	0-1 years	73	Cash flow
SEK 500m maturing 31.05.2021	Floating	1.09%	0-1 years	52	Cash flow
Commercial papers	Fixed	0.07%	0-1 years	115	Fair value
Total issued bonds		**1.32%**		**534**	
Mortgages credit institutions:					
Floating-rate	Floating	0.75%	0-1 years	799	Cash flow
Total mortgages credit institutions		**0.75%**		**799**	
Bank borrowings:					
Fixed-rate	Fixed	-0.30%	0-1 years	497	Fair value
Floating-rate	Floating	1.75%	0-1 years	370	Cash flow
Total bank borrowings		**0.57%**		**867**	
Other borrowings:					
Finance leases	Floating	2.15%	0-1 years	28	Cash flow
Other borrowings	Floating	2.87%	0-1 years	20	Cash flow
Total other borrowings		**2.45%**		**48**	

Interest profile for net interest-bearing debt excluding pension liabilities at 31 December 2017
(EURm)



Interest profile for net interest-bearing debt excluding pension liabilities at 31 December 2016
(EURm)

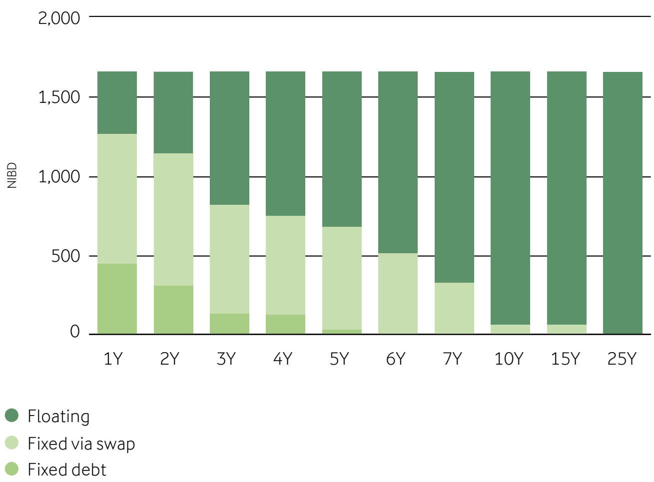


Table 4.2.f Currency profile of net interest-bearing debt excluding pension liabilities
(EURm)

Currency profile of net interest-bearing debt excluding pension liabilities before and after derivative financial instruments	Original principal	Effect of swap	After swap
2017			
DKK	815	-	815
SEK	639	-457	182
EUR	136	254	390
GBP	16	203	219
Other	30	-	30
Total	**1.636**	**-**	**1.636**
2016			
DKK	872	-	872
SEK	558	-470	88
EUR	175	261	436
GBP	37	209	246
Other	6	-	6
Total	**1,648**	**-**	**1,648**

Accounting policies

Financial instruments
Financial instruments are recognised at the date of trade. The Group ceases to recognise financial assets when the contractual rights to the underlying cash flows either cease to exist or are transferred to the purchaser of the financial asset, and substantially all risk and reward related to ownership are also transferred to the purchaser.

Financial assets and liabilities are offset and the net amount is presented in the balance sheet when, and only when, the Group obtains a legal right of offsetting and either intends to offset or settle the financial asset and the liability simultaneously.

Available for sale financial assets
Financial assets classified as available for sale consist of mortgage credit bonds, which correspond in part to raised mortgage debt.

Available for sale financial assets are measured on first-time recognition at fair value plus transaction costs.
The financial assets are subsequently measured at fair value with adjustments made in other comprehensive income and accumulated in the available-for-sale reserve in equity. Interest income, impairment and foreign currency translation adjustments of debt instruments are recognised in the statement of income on a continuous basis under financial income and financial costs.

In connection with sale of financial assets classified as available for sale, accumulated gains or losses, previously recognised in the available-for-sale reserve, are recycled to financial income and financial costs.

Financial assets measured at fair value
Securities classified at fair value consist primarily of listed securities, which are monitored, measured and reported continuously, in accordance with the Group's treasury and funding policy. Changes in the fair value are recognised in the income statement under financial income and financial costs.

Cash and cash equivalents
Cash and cash equivalents consist of readily available cash at bank and deposits together with exchange listed debt securities with an original maturity of three months or less, which have only an insignificant risk of changes in value and can be readily converted to cash or cash equivalents.

Liabilities
Debts to mortgage and credit institutions, as well as issued bonds, are measured at the trade date upon first recognition at fair value plus transaction costs. Subsequently, liabilities are measured at amortised cost with the difference between the loan proceeds and the nominal value recognised in the income statement over the expected life of the loan.

Capitalised residual lease obligations related to financial lease agreements are recognised under liabilities, measured at amortised cost.

Other financial liabilities are measured at amortised cost. For details on pension liabilities, see Note 4.7.

Note 4.3 Financial risks

Financial risk management
Financial risks are an inherent part of the Group's operating activities and as a result the Group's profit is impacted by the development in currencies, interest rates and certain types of commodities. The global financial markets are volatile and thus it is critical for the Group to have a properly implemented financial risk management approach in place in order to mitigate short-term market volatility, whilst simultaneously achieving the highest possible milk price.

The Group's comprehensive financial risk management strategy and system builds on a thorough understanding of the interaction between the Group's operating activities and the underlying financial risks. The overall framework for managing financial risks, being the treasury and funding policy, is approved by the Board of Directors and managed centrally by the treasury department. The policy outlines risk limits for each type of financial risk, permitted financial instruments and counterparties.

Each month, the Board of Directors receives a report on the Group's financial risk exposure from the treasury department, who manage the financial risks on a continuous basis.

Hedging the volatility of milk prices is not within the scope of financial risk management, but an inherent component of the Group's business model.

Note 4.3.1 Liquidity risk

Strong liquidity reserves

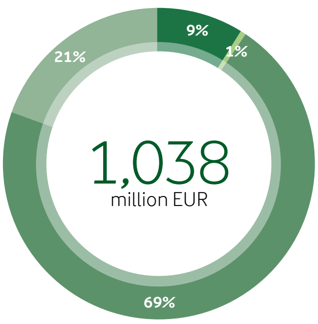
The stable cash generation in 2017 positively influenced the liquidity reserves by reducing the utilisation of loan and credit facilities. Liquidity reserves increased by EUR 101 million to EUR 1,038 million.

Ensuring availability of sufficient operating liquidity and credit facilities for operations is the primary goal of managing liquidity risk. According to the liquidity model inspired by the rating agencies, the Group's current liquidity reserves covering the next 12 months of expected cash flow is more favourable than required.

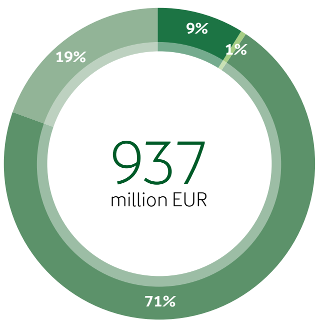
The management of day-to-day liquidity flow, representing more than 95 per cent of the net revenue of the Group, is conducted by Arla Foods Finance A/S via cash pooling arrangements with the Group's banks and credit institutions. This secures a scalable and efficient operating model.

Within the Group, companies with excess liquidity finance companies with liquidity deficits. As a result, the Group achieves a cost-efficient utilisation of credit facilities.

Liquidity reserves 2017



Liquidity reserves 2016



- Cash and cash equivalents
- Securities (free cash flow)
- Unutilised committed loans facilities
- Unutilised other loan facilities

Table 4.3.1.a Liquidity reserves
(EURm)

	2017	2016
Cash and cash equivalents	91	84
Securities (free cash flow)	6	7
Unutilised committed loans facilities	721	666
Unutilised other loan facilities	220	180
Total	**1,038**	**937**

Table 4.3.1.b Gross financial liabilities
(EURm)

		Non-discounted contractual cash flows									
2017	**Carrying amount**	**Total**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025-2027**	**After 2027**
Issued bonds	406	406	152	152	-	102		-	-	-	-
Mortgage credit institutions	799	815	9	18	19	27	29	29	30	193	461
Credit institutions	1,001	1,002	821	107	56	10	7	1	-	-	-
Finance lease liabilities	13	13	11	2	-	-	-	-	-	-	-
Other non-current liabilities	27	27	26	1	-	-	-	-	-	-	-
Interest expense - interest bearing debt	-	112	12	10	8	7	7	6	6	17	39
Trade payable	1,098	1,098	1,098	-	-	-	-	-	-	-	-
Derivative instruments	87	87	23	17	9	8	7	5	2	3	13
Total	**3,431**	**3,560**	**2,152**	**307**	**92**	**154**	**50**	**41**	**38**	**213**	**513**

Table 4.3.1.b Gross financial liabilities
(EURm)

		Non-discounted contractual cash flows									
2016	**Carrying amount**	**Total**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024-2026**	**After 2026**
Issued bonds	419	418	-	157	157	-	104	-	-	-	-
Mortgage credit institutions	799	817	1	9	19	19	27	29	29	154	530
Credit institutions	982	990	760	161	40	12	10	7	-	-	-
Finance lease liabilities	28	28	16	11	1	-	-	-	-	-	-
Other non-current liabilities	20	20	18	2	-	-	-	-	-	-	-
Interest expense - interest bearing debt	-	128	14	13	10	9	8	6	6	18	44
Trade payable	995	995	995	-	-	-	-	-	-	-	-
Derivative instruments	168	168	81	20	17	9	8	7	6	5	15
Total	**3,411**	**3,564**	**1,885**	**373**	**244**	**49**	**157**	**49**	**41**	**177**	**589**

Assumptions
Contractual cash flows are based on the following assumptions:
- The cash flows are based on the earliest possible date at which the Group can be required to settle the financial liability; and
- The interest rate cash flow is based on the contractual interest rate. Floating interest payments were determined using the current floating rate for each item at the reporting date.

Risk mitigation

Risk
Liquidity and funding is vital for the Group to be able to pay its financial liabilities as they become due. It also impacts the ability to attract new funding in the long-run, and is crucial to fulfil the Group's strategic ambitions.

Policy
The treasury and funding policy states the minimum average maturity threshold for net interest-bearing debt, and sets limitations on debt maturing within the next 12 and 24 month periods. Unused committed facilities are taken into account when calculating average maturity.

			Policy	
Average maturity	**2017**	**2016**	**Minimum**	**Maximum**
Average maturity, gross debt	5.7 years	5.9 years	2 years	-
Maturity < 1 year, net debt	0%	0%	-	25%
Maturity > 2 year, net debt	97%	94%	50%	-

How we act and operate
In addition to the treasury and funding policy, the Board of Directors has approved a long-term financing strategy which defines the direction for financing of the Group. This includes, for example, counterparties, instruments and risk appetite and describes future funding opportunities to be explored and implemented. The funding strategy is supported by members' long-term commitment to invest in the business. It is the Group's objective to maintain its credit quality at a robust investment grade level.

The Group has, to a very high degree, centralised its funding and cash management to control and optimise its funding position. The Group aims for a diversified funding platform comprising bilateral bank financing, mortgage loans, supranationals, capital market bond issues, commercial papers and finance leases. The Group aims to have adequate liquidity and credit facility reserves, meeting the requirements for an investment grade company.

Note 4.3.2 Currency risk

Significant currency fluctuations

Compared to last year, the average rate of the GBP and USD weakened by more than 7 per cent and 2 per cent respectively. Our hedging strategies helped to mitigate a large part of the transactions impact from movement in USD and GBP in 2017. The hedging activities delivered a gain of EUR 29 million in 2017, compared to a gain of EUR 35 million last year. The result of hedging activities classified as hedge accounting is recognised in other income and other cost.

The Group is increasingly involved in emerging markets where efficient hedging is not feasible, either due to currency regulations or illiquid financial markets. These markets are mainly Nigeria, Ivory Coast, Senegal, Egypt and Bangladesh. Access to foreign currencies in Nigeria and Egypt improved in 2017 but related currency values were lower compared to 2016.

Our business in Saudi Arabia is a large part of the Group's export to MENA. The Saudi Arabia currency (SAR) has been pegged to USD since 1986, however, given the budget deficit and uncertainty regarding the Saudi Arabia economy, we monitor the currency situation closely.

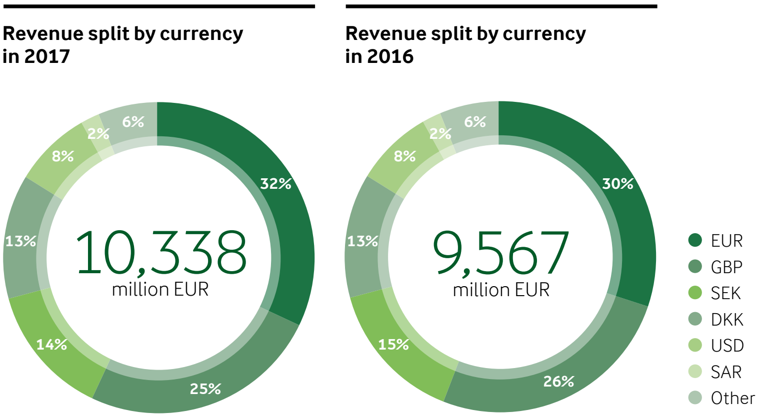


Table 4.3.2.a Exchange rates

	Closing rate			Average rate		
	2017	2016	Change	2017	2016	Change
EUR/GBP	0.8885	0.8554	*-3,86%*	0.8765	0.8176	*-7.19%*
EUR/SEK	9.8476	9.5684	*-2.92%*	9.6317	9.4687	*-1.72%*
EUR/DKK	7.4453	7.4333	*-0.16%*	7.4386	7.4452	*0.09%*
EUR/USD	1.1943	1.0490	*-13.85%*	1.1277	1.1058	*-1.98%*
EUR/SAR	4.4792	3.9367	*-13.78%*	4.2294	4.1473	*-1.98%*

Table 4.3.2.b Currency exposure

(EURm)	EUR/DKK	USD*/DKK	GBP/DKK	SEK/DKK	SAR/DKK
2017					
External exposure:					
Financial liabilities	-155	-15	-212	-844	-2
Financial assets	164	218	123	34	76
Derivatives	-367	-398	-803	592	-153
Net external exposure	**-358**	**-195**	**-892**	**-218**	**-79**
Internal exposure:					
Financial assets	268	3	522	8	13
Derivatives	47	-	192	210	-
Net internal exposure	**315**	**3**	**714**	**218**	**13**
Net exposure	**-43**	**-192**	**-178**	**-**	**-66**
The net exposure relates to:					
Hedging of expected commercial cash flow that qualify for hedge accounting	-	-235	-192	-	-58
Hedging of expected commercial cash flow where hedge accounting is not used	-43	-	-	-	-8
Exposure not hedged	-	43	14	-	-
Applied sensitivity	1%	5%	5%	5%	5%
Impact on profit or loss	-	2	1	-	-
Impact on other comprehensive income	-	-12	-10	-	-3
2016					
External exposure:					
Financial liabilities	-191	-26	-35	-710	-15
Financial assets	148	190	204	39	80
Derivatives	-362	-593	-538	499	-198
Net external exposure	**-405**	**-429**	**-369**	**-172**	**-133**
Internal exposure:					
Financial liabilities	-24	-	-	-4	-
Financial assets	303	-	257	-	15
Derivatives	-	-	-	216	-
Net internal exposure	**279**	**-**	**257**	**212**	**15**
Net exposure	**-126**	**-429**	**-112**	**40**	**-118**
The net exposure relates to:					
Hedging of expected commercial cash flow that qualify for hedge accounting	-	-357	-152	-	-95
Hedging of expected commercial cash flow where hedge accounting is not used	-126	-72	-	-	-23
Exposure not hedged	-	-	40	40	-
Applied sensitivity	1%	5%	5%	5%	5%
Impact on profit or loss	-1	-4	2	2	-1
Impact on other comprehensive income	-	-18	-8	-	-5

* Incl. AED

Risk mitigation

The Group's net external exposure is calculated as external financial assets and liabilities denominated in currencies different from the functional currency of each legal entity, plus any external derivatives converted on Group level into currency risk against DKK, i.e. EUR/DKK, USD/DKK etc. The same applies to net internal exposure. These sum up to the Group's aggregate currency exposure, net exposure.

This analysis excludes net foreign currency investments in subsidiaries, as well as instruments hedging those investments. The hedging relationships are fully effective.

Assumptions for sensitivity analysis
The sensitivity analysis only includes currency exposure arising from financial instruments and thus the analysis does not include hedged future commercial transactions. The applied change in exchange rates is based on historical currency fluctuations.

Risk
Currency risk arises from the Group's export activities, investments and financing activities. The Group operates in many different countries and has significant investments in operations outside of Denmark, of which the UK, Germany and Sweden represent the largest part of the business by net revenue, profit and assets. A major part of the currency risk from net revenue denominated in foreign currencies is offset by sourcing in the same currency.

Currency risks primarily exist due to transactional risks in the form of future commercial and financial payments and translation risks relating to investments in foreign operations in the form of subsidiaries, joint ventures and associated companies.

Transaction risks arise from sales or sourcing in currencies different from the functional currency in each subsidiary. Measured in nominal EUR, the Group's consolidated risk is largest in EUR, followed by USD, GBP, SEK and SAR.

Income statement
Volatility in currency rates impact the Group's revenue, cost of sales and financial items with potential adverse or positive effects on milk prices and cash flow.

Balance sheet
Changes in currency rates could cause volatility in balance, equity and cash flow. The majority of the local funding is obtained in local currencies. Investments in subsidiaries are normally not hedged.

Policy
According to the treasury and funding policy, the treasury department can hedge:
- Up to 15 months of the net forecasted cash receipts and payables. The level of hedging activity is affected by factors such as the underlying business development, currency rates and the time until forecasted cash flow occur.
- Up to 100 per cent of net recognised trade receivables and trade payables.

How we act and operate
Throughout the year, the Group continued to hedge the forecasted sales and purchases in foreign currency, always taking the current market situation into consideration.

The currency exposure is continuously managed by the treasury department. Individual currency exposures are hedged in accordance with the treasury and funding policy.

Financial instruments used to hedge the currency exposure does not necessarily need to qualify for hedge accounting, and hence some of the applied financial instruments, i.e. some option strategies, are accounted for as fair value through the income statement.

Arla Foods amba's functional currency is DKK. However, the risk in relation to the EUR currency is assessed in the same manner as for DKK, hence as an example, in companies using DKK as functional currency, a borrowing in EUR is treated the same as a borrowing in DKK.

The Executive Management Team has the discretion to decide if and when investments in foreign operations should be hedged (translation risks) with an obligation to inform the Board of Directors at the next meeting.

Note 4.3.3 Interest rate risk

Limited hedging activities due to decreased debt levels

The average duration of the Group's interest on interest-bearing debt, including derivatives but excluding pension liabilities, has decreased by 0.7 to 3.8. The duration is reduced due to matured interest rate hedges and a reduction in time to maturity on the remaining hedges.

Even though interest rates were low in 2017, our hedging activity was limited due to the decrease in net interest-bearing debt.

Table 4.3.3 Sensitivity based on a 1 percentage point increase in interest rate
(EURm)

			Potential accounting impact	
	Carrying value	Sensitivity	Income statement	Other comprehensive income
2017				
Financial assets	-610	1%	4	-2
Derivatives	-	1%	7	49
Financial liabilities	2,246	1%	-18	-
Net interest-bearing debt excluding pension liabilities	**1,636**		**-7**	**47**
2016				
Financial assets	-600	1%	4	-2
Derivatives	-	1%	12	63
Financial liabilities	2,248	1%	-22	-
Net interest-bearing debt excluding pension liabilities	**1,648**		**-6**	**61**

Risk mitigation

Risk
The Group is exposed to interest rate risk on interest-bearing borrowings, pension liabilities, interest-bearing assets and the impairment test of non-current assets. The risk is divided between profit exposure and exposure to other comprehensive income. Profit exposure relates to net interest paid, valuation of marketable securities and potential impairment of fixed assets. Exposure to other comprehensive income relates to revaluation of net pension liabilities and interest hedging of future cash flow.

Fair value sensitivity
A change in interest rates will impact the fair value of the Group's interest-bearing assets, interest rate derivative instruments and debt instruments measured at either fair value through the income statement, or through other comprehensive income. Table 4.3.3 shows the fair value sensitivity. The sensitivity is based on a 1 per cent increase in interest rates. A decrease in the interest rate would have the adverse effect.

Cash flow sensitivity
A change in interest rates will impact interest rate payments on the Group's unhedged floating rate debt. Table 4.3.3 shows the one-year cash flow sensitivity, depicting a 1 per cent increase in interest rates on the unhedged floating rate for instruments recognised as at 31 December 2017. A decrease in the interest rate would have the adverse effect.

Policy
Interest rate risk must be managed according to the treasury and funding policy. Interest rate risk is measured as the duration of the debt portfolio including hedging instruments, but excluding pension liabilities.

			Policy	
	2017	**2016**	**Minimum**	**Maximum**
Duration of net-interest bearing debt	3.8	4.5	1	7

How we act and operate
The purpose of interest rate hedging is to mitigate risk and secure a relatively stable and predictable financing cost. The interest rate risk from net borrowing is managed by having an appropriate split between fixed and floating interest rates.

The Group actively uses derivative financial instruments to reduce risks related to fluctuations in the interest rate and to manage the interest profile of the interest-bearing debt. By having a portfolio approach and using derivatives, the Group can indpendently manage and optimise interest rate risk, as the interest rate profile can be changed without having to change the funding itself. Thereby the Group can operate in a fast, flexible and cost efficient manner without changing underlying loan agreements.

The mandate from the Board of Directors provides the Group with the opportunity to use derivatives like interest rate swaps and options, in addition to interest conditions embedded in the loan agreements. At present, no options have been utilised to the portfolio.

Note 4.3.4 Commodity price risk

Limited hedging activities in accordance with strategy

The supply contracts are predominately related to a floating official price index. The treasury department uses financial derivatives to centrally hedge commodity price risk. This secures full flexibility to change suppliers without having to take future hedging into consideration.

The hedging activities concentrate on the most significant risks, including electricity, natural gas and diesel in Denmark, Germany, Sweden and the UK. The total energy commodity spend, excluding taxes and distribution costs, amounts to approximately EUR 95 million a year.

The purpose of hedging is to reduce a short-term volatility in costs related to energy due to changing commodity prices.

In 2017 approximate 30% of the energy spend was hedged. End of 2017, 28 per cent of the energy spend for 2018 was hedged. A 5 per cent increase in commodity prices would negatively impact profit by approximately EUR 3 million. Conversely, other comprehensive income would be positively impacted by EUR 1 million.

Table 4.3.4 Hedged commodities
(EURm)

			Potential accounting impact	
	Sensitivity	**Contract value**	**Income statement**	**Other comprehensive income**
2017				
Diesel / natural gas	5%	1	-2	1
Electricity	5%	-	-1	-
2016				
Diesel / natural gas	5%	2	-3	1
Electricity	5%	1	-1	-

Risk mitigation

Risk
The Group is exposed to commodity risks related to the production and distribution of dairy products. Increased commodity prices negatively impact the costs of production and distribution. The most significant risk relates to energy consumption. However, the Group is, to a minor extent, also exposed to commodities used in packaging, vegetable oils and other ingredients used within production. The risk is divided between profit exposure and exposure to other comprehensive income. The profit exposure relates to future purchases, whereas the exposure to other comprehensive income relates to the revaluation of commodities hedges.

Fair value sensitivity
A change in commodity prices will impact the fair value of the Group's hedged commodity derivative instruments, measured through other comprehensive income and the unhedged energy consumption through the income statement. The table shows the sensitivity of a 5 per cent increase in commodity prices for both hedged and unhedged commodity purchases. A decrease in commodity prices would have the reverse effect.

Policy
According to the treasury policy the forecasted consumption on electricity, natural gas and diesel can be hedged for up to 36 months for a limited proportion increasing to 100 per cent for consumption in the coming 18 months.

How we act and operate
Energy commodity price risks are managed by the treasury department. Commodity price risks are mainly hedged by entering into financial derivative contracts, independent of the physical supplier contracts. Arla is also exploring other commodities relevant for financial risk management.

The Group can use derivative financial instruments such as swaps, futures and options to reduce the risk of fluctuations in the price of energy commodities. Currently no options are used.

The energy exposure and hedging is managed as a portfolio across energy type and country. Not all energy commodities can effectively be hedged by matching the underlying costs, but Arla aims to minimise the base risk. Energy risk is not entirely separated from the commercial markets but is a part of a holistic risk approach.

The Group is gaining experience in hedging price risk on selected milk commodity products with an insignificant value. The scope of hedging is still limited by the evolving but immature dairy derivative markets in the EU and New Zealand. The dairy derivative market is developing and will over years play a role in relation to managing fixed price commodity contracts with customers.

Note 4.3.5 Credit risk

Limited losses

The Group has experienced very limited losses from defaulting counterparties such as customers, suppliers and financial counterparties.

For financial counterparties, the credit risk is minimised by only entering into new derivative transactions with those that have a credit rating of at least A-/A-/A3 from either S&P, Fitch or Moody's. All financial counterparties had satisfactory credit ratings at year-end. In some geographies which are not serviced by our relationship banks and where financial counterparties with a satisfying credit rating do not operate, the Group deviated from the rating requirement.

Other counterparties, customers and suppliers, are subject to continuous monitoring of fulfilment of their contractual obligations and credit quality. Outside the Group's core markets, credit insurance and trade finance instruments are widely used to reduce the risks.

Further information on trade receivables is provided in Note 2.1.c.

The maximum exposure to credit risk is approximately equal to the carrying amount.

The Group has, like in previous years, continuously worked with credit exposure and experienced a very low level of losses arising from customers.

Netting of credit risk
To manage the financial counterparty risk, the Group uses master netting agreements when entering into derivative contracts.

Table 4.3.5 shows the counterparty exposure for those agreements covered by entering into netting agreements that qualifies for netting in case of default.

Table 4.3.5 External rating of financial counterparties (EURm)	**Assets, carrying amount**	**Qualifying for netting**	**Net assets exposure**	**Liabilities, carrying amount**	**Qualifying for netting**	**Net liabilities exposure**
2017						
AA-	3	3	-	39	3	36
A+	4	4	-	11	4	7
A	7	7	-	36	7	29
A-	5	1	4	1	1	-
Total	**19**	**15**	**4**	**87**	**15**	**72**
2016						
AA-	12	11	1	64	11	53
A+	11	11	-	20	11	9
A	7	7	-	71	7	64
A-	1	1	-	13	1	12
Total	**31**	**30**	**1**	**168**	**30**	**138**

In addition, the Group has entered into sales and repurchase agreements on mortgage bonds, described in further details in Note 4.6.

Risk mitigation

Risk
Credit risks arise from operating activities and engagement with financial counterparties. Losses occur when customers, suppliers or financial counterparties default on their obligations towards the Group. Furthermore, a weak counterparty credit quality can reduce their ability to support the Group going forward, thereby jeopardising the fulfilment of our Group's strategy. As an example, there is a risk when money is borrowed, and a counterparty is unable to refinance the credit facility due to its own financial difficulties. When investing in new entities, a thorough due diligence is performed, including a review of the financial condition of the partner.

Policy
Financial counterparties must be approved by a member of the Executive Board and the CFO of Arla Foods amba, and have a credit rating of a least A-/A-/A3 by S&P, Fitch or Moody's in order for the financial counterparty to have a liability towards Arla. In geographies, which are not properly covered by our relationship banks, Corporate Treasury may deviate from counterparty requirements. Corporate Treasury deviated in countries like Nigeria, Ghana and Saudi Arabia.

A credit assessment is performed of all new customers, and existing customers are subject to ongoing monitoring of their credit worthiness. The same process is applied to important suppliers, both for ongoing supply and capital expenditures.

How we act and operate
The Group has an extensive credit risk policy and uses credit insurance and other trade financing products extensively in connection with exports. In certain emerging markets it is not always possible to obtain credit coverage with the required rating, however, the Group then applies for the best coverage available. The Group has determined that this is an acceptable risk as the Group has decided to grow and invest in emerging markets.

If a customer payment is late, internal procedures are followed to mitigate losses. The Group uses a limited number of financial counterparties where credit ratings are monitored on an ongoing basis.

Note 4.4 Derivative financial instruments

Hedging of future cash flows

Hedging of future cash flows
The Group uses forward currency contracts to hedge currency risks against expected future net revenue and costs. Interest rate swaps are used to hedge risks against movements in expected future interest payments and commodity swaps are used for energy hedging.

Hedging of net investments
The Group hedged an insignificant part of currency exposure relating to investments in subsidiaries, joint ventures and associated companies, using loans and derivatives.

Fair value of hedge instruments not qualifying for hedge accounting (financial hedge)
The Group uses currency options which hedge forecasted sales and purchases. Some of these options do not qualify for hedge accounting and hence, the fair value adjustment is recognised directly in the income statement.

Currency swaps are used as part of the daily liquidity management. The objective of the currency swaps is to match the timing of in- and outflow of foreign currency cash flows.

Table 4.4 Hedging of future cash flow from highly probable forecast transactions
(EURm)

			Expected recognition				
	Carrying value	Fair value recognised in other comprehen-sive income	2018	2019	2020	2021	Later than 2021
2017							
Currency contracts	4	4	4	-	-	-	-
Interest rate contracts	-77	-77	-17	-14	-9	-7	-30
Commodity contracts	1	1	1	-	-	-	-
Hedging of future cash flow	**-72**	**-72**	**-12**	**-14**	**-9**	**-7**	**-30**

	Carrying value	Fair value recognised in other comprehen-sive income	2017	2018	2019	2020	Later than 2020
2016							
Currency contracts	-23	-23	-23	-	-	-	-
Interest rate contracts	-100	-100	-20	-17	-15	-9	-39
Commodity contracts	3	3	-	-	-	-	-
Hedging of future cash flow	**-120**	**-120**	**-43**	**-17**	**-15**	**-9**	**-39**

Table 4.4.b Value adjustment of hedging instruments

(EURm)

	2017	2016
Deferred gains and losses on cash flow hedges arising during the period	11	-23
Value adjustments of hedging instruments reclassified to other operating income and costs	29	-34
Value adjustments of hedging instruments reclassified to financial items	11	17
Value adjustments of hedging instruments reclassified to production costs	-3	18
Total	**48**	**-22**

Accounting policies

Derivative financial instruments are recognised from the trade date and measured in the financial statement at fair value. Positive and negative fair values of derivative financial instruments are recognised as separate line items in the balance sheet. Offsetting of positive and negative amounts only take place once the Group has obtained the legal right and intends to settle several financial instruments on a net basis.

Fair value hedging

Changes in the fair value of derivative financial instruments, which meet the criteria for hedging the fair value of recognised assets and liabilities, are recognised alongside changes in the value of the hedged asset or the hedged liability for the portion that is hedged.

Cash flow hedging

Changes in the fair value of derivative financial instruments, that are classified as hedges of future cash flows and effectively hedge changes in future cash flows, are recognised under other comprehensive income in a special reserve for hedging transactions under equity, until the hedged cash flows impact the income statement. The reserve for hedging instruments under equity is presented net of tax.

The cumulative gains or losses from hedging transactions that are retained in equity are reclassified and recognised under the same line item as the hedged item (basic adjustment).

If a hedging instrument no longer meets the criteria for hedge accounting, the hedge will cease from that point onward.

The accumulated change in value recognised in other comprehensive income is recycled to the income statement once the hedged cash flows affect the income statement or are no longer likely to be realised.

If the hedged cash flows are no longer expected to be realised, the cumulative value change is immediately recycled from equity to the income statement.

For derivative financial instruments that do not meet the conditions for treatment as hedging instruments, changes in fair value are recognised on a continuous basis in the income statement under financial income and financial costs.

Note 4.5 Financial instruments disclosed

Table 4.5.a Categories of financial instruments
(EURm)

	2017	2016
Available for sale financial assets	511	504
Loans and receivables	968	911
Financial assets measured at fair value through profit or loss	56	50
Derivatives	87	168
Financial liabilities measured at amortised cost	3,344	3,243

The fair value of financial assets and financial liabilities measured at amortised cost is approximately equal to the carrying amount.

Table 4.5.b Fair vzalue hierarchy - carrying amount
(EURm)

	Level 1	Level 2	Level 3	Total
2017				
Financial assets:				
Bonds	511			511
Shares	12			12
Derivatives		19		19
Total financial assets	**523**	**19**	**-**	**542**
Financial liabilities:				
Issued bonds		406		406
Mortgage credit institutions	799			799
Derivatives		87		87
Total financial liabilities	**799**	**493**	**-**	**1.292**
2016				
Financial assets:				
Bonds	504	-	-	504
Shares	13	-	-	13
Derivatives	-	31	-	31
Total financial assets	**517**	**31**	**-**	**548**
Financial liabilities:				
Issued bonds	-	419	-	419
Mortgage credit institutions	798	-	-	798
Derivatives	-	168	-	168
Total financial liabilities	**798**	**587**	**-**	**1,385**

Risk mitigation

Methods and assumptions applied when measuring fair values of financial instruments:

Bonds and shares
The fair value is determined using the quoted prices in an active market.

Non-option derivatives
The fair value is calculated using discounted cash flow models and observable market data. The fair value is determined as a termination price and consequently, the value is not adjusted for credit risks.

Option instruments
The fair value is calculated using option models and observable market data, such as option volatilities. The fair value is determined as a termination price and consequently, the value is not adjusted for credit risks.

Fair value hierarchy
Level 1: Fair values measured using unadjusted quoted prices in an active market
Level 2: Fair values measured using valuation techniques and observable market data
Level 3: Fair values measured using valuation techniques and observable as well as significant non-observable market data

Note 4.6 Transfer of financial assets

Sale and repurchase agreements

The Group has invested in mortgage bonds underlying its mortgage debt. The reason for investing in mortgage bonds is that the Group is able to achieve a lower interest rate than current market interest rates on mortgage debt by entering into a sale and repurchase agreement on the listed Danish mortgage bonds. The net interest rate payable, by raising financing through this kind of sale and repurchase agreement, is the interest rate inherent in the sale and repurchase agreement and the contribution to the mortgage institute. Due to the repurchase agreement, the risks and rewards arising from the ownership of transferred mortgage bonds have been retained by the Group. These mortgage bonds have been classified as available for sale with value adjustments recognised through other comprehensive income. The received proceeds create a repurchase obligation which has been recognised within short-term loans.

Table 4.6 Transfer of financial assets (EURm)	**Carrying value**	**Notional amount**	**Fair value**
2017			
Mortgage bonds	504	499	504
Repurchase liability	-498	-497	-498
Net position	**6**	**2**	**6**
2016			
Mortgage bonds	496	508	496
Repurchase liability	-496	-507	-496
Net position	**-**	**1**	**-**

Note 4.7 Pension liabilities

Reduced pension liabilities

Pension liability consists primarily of defined benefit plans in the UK and Sweden. The defined benefit plans provide pension disbursements to participating employees based on seniority and final salary. Net pension liabilities were EUR 277 million, a decrease of EUR 92 million compared to last year. The carrying value of defined benefit plans decreased primarily in the UK due to actuarial gains related to lower salary increase expectation as well as higher inflation expectation.

Pension plans in Sweden
The defined benefit plan in Sweden does not currently require the Group to make cash contributions. The recognised net liability was EUR 200 million, an increase of EUR 15 million compared to last year. An actuarial loss of EUR 19 million, resulting from a decrease in the discount rate, was partly offset by currency translation.

These pension plans were contribution based plans, guaranteeing defined benefit pension at retirement. Contributions are paid by the Group. The schemes do not provide any insured disability benefits. The plan assets are legally structured as a trust and the Group has control over the operation of the plans and their investments. The investment of the assets is based on the investment strategy defined by the board of the trust.

These pension plans do not include a risk-sharing element between the Group and the plan participants.

Pension plans in the UK
The recognised net liability was EUR 47 million, representing a decrease of EUR 103 million compared to last year. The reduction is primarily related to actuarial gains of EUR 77 million due to lower salary increase expectations. Additionally, payments to the plans reduced the liability with EUR 30 million.

The defined benefit plans in the UK are administered by independent pension funds that invest deposited amounts to cover future pension payments.

These pension plans are defined benefit final salary schemes. The schemes are closed to both new entrants and future accrual. Employer's contributions are determined with the advice of independent qualified actuaries on the basis of tri-annual valuations. The schemes do not provide any insured disability benefits.

The schemes are legally structured as trust-based statutory sectionalized pension schemes. The Group has limited control over the operation of the plans and their investments. The trustees of the schemes set the investment strategy and have established a policy on asset allocation to best match the assets to the liabilities of the schemes. The trustees appoint an independent external advisor to the schemes who is responsible for advising on the investment strategy and investing the assets.

The pension plans do not include a risk-sharing element between the Group and the plan participants.

Table 4.7.a Pension liabilities recognised on the balance sheet
(EURm)

	Sweden	UK	Other	Total
2017				
Present value of funded liabilities	210	1,336	38	1,584
Fair value of plan assets	-11	-1,289	-20	-1,320
Deficit of funded plans	**199**	**47**	**18**	**264**
Present value of unfunded liabilities	1	-	12	13
Net pension liabilities recognised on the balance sheet	**200**	**47**	**30**	**277**
Specification of total liabilities:				
Present value of funded liabilities	210	1,336	38	1,584
Present value of unfunded liabilities	1	-	12	13
Total liabilities	**211**	**1,336**	**50**	**1,597**
2016				
Present value of funded liabilities	196	1,425	45	1,666
Fair value of plan assets	-11	-1,275	-24	-1,310
Deficit of funded plans	**185**	**150**	**21**	**356**
Present value of unfunded liabilities	-	-	13	13
Net pension liabilities recognised on the balance sheet	**185**	**150**	**34**	**369**
Specification of total liabilities:				
Present value of funded liabilities	196	1,425	45	1,666
Present value of unfunded liabilities	-	-	13	13
Total liabilities	**196**	**1,425**	**58**	**1,679**

Table 4.7.b Development in pension liabilities
(EURm)

	2017	2016
Present value of liability at 1 January	1,679	1,610
Reclassification	-3	-
New pension liability from acquired companies	2	-
Paid in by employees	1	1
Current service cost	3	3
Interest cost	42	52
Actuarial gains and losses from changes in financial assumptions (OCI)	-4	282
Benefits paid	-60	-59
Curtailments and settlements	-	-3
Exchange rate adjustment	-63	-207
Present value of pension liability at 31 December	**1,597**	**1,679**

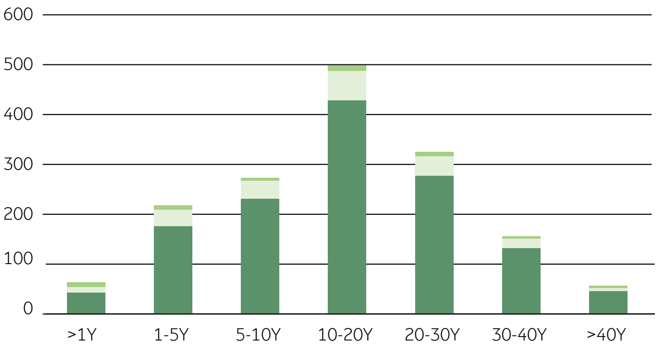
Table 4.7.c Development in fair value of plan assets
(EURm)

	2017	2016
Fair value of plan assets at 1 January	1,310	1,316
Reclassification	-2	-
Interest income	33	44
Return on plan assets excluding interest income (OCI)	54	150
Contributions to plans	30	34
Benefits paid	-50	-48
Administration expenses	-1	-2
Exchange rate adjustments	-54	-184
Fair value of plan assets at 31 December	**1,320**	**1,310**

The Group expects to contribute EUR 35 million to the plan assets in 2018 and EUR 132 million in 2019-2022.

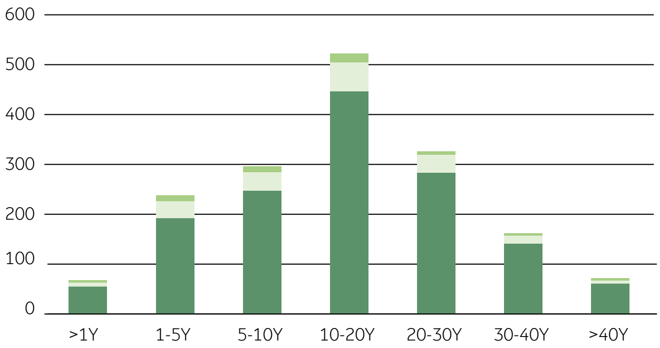
	2017	2016
Actual return on plan assets:		
Calculated interest income	33	44
Return excluding calculated interest	54	150
Actual return	**87**	**194**

Maturity of pension liability at 31 December 2017
(EURm)



	Total	>1Y	1-5Y	5-10Y	10-20Y	20-30Y	30-40Y	>40Y
UK	1,337	43	177	231	430	278	132	46
Sweden	210	10	35	38	61	40	19	7
Other	50	9	7	5	10	9	6	4
Total	**1,597**	**62**	**219**	**274**	**501**	**327**	**157**	**57**

Maturity of pension liability at 31 December 2016
(EURm)



	Total	>1Y	1-5Y	5-10Y	10-20Y	20-30Y	30-40Y	>40Y
UK	1,425	55	192	247	446	283	141	61
Sweden	196	9	34	37	58	36	16	6
Other	58	3	11	13	19	8	3	1
Total	**1,679**	**67**	**237**	**297**	**523**	**327**	**160**	**68**

Table 4.7.d Sensitivity of pension liabilities to key assumptions
(EURm)

	2017	**2017**	**2016**	**2016**
Impact on pension liabilities at 31 December	+	-	+	-
Discount rate +/- 10bps	-19	20	-25	25
Expected salary increases +/- 10bps	2	-2	2	-2
Life expectancy +/- 1 year	64	-64	66	-66
Inflation +/- 10 bps	17	-17	18	-18

Table 4.7.e Pension assets recognised
(EURm)

	2017	**%**	**2016**	**%**
Diversified Growth Funds & Debt vehicles	579	44%	486	37%
Liability-Driven Investments	163	12%	246	19%
Absolute return Bonds	143	11%	198	15%
Equity instruments	165	12%	154	12%
Properties	100	8%	88	7%
Infrastructure	70	5%	42	3%
Bonds	11	1%	11	1%
Other assets	89	7%	85	6%
Total assets	**1,320**	**100%**	**1,310**	**100%**

Table 4.7.f Recognised in the income statement for the year
(EURm)

	2017	2016
Current service cost	3	4
Administration cost	1	2
Curtailments and settlements	-	-3
Recognised as staff costs	**4**	**3**
Interest cost on pension liability	42	52
Interest income on plan assets	-33	-44
Recognised as financial cost	**9**	**8**
Total amount recognised in the income statement	**13**	**11**

Table 4.7.g Recognised in other comprehensive income
(EURm)

	2017	2016
Accumulated actuarial losses at 1 January	-287	-155
Actuarial gains/(losses) for the year	58	-132
Accumulated actuarial gains and losses at 31 December	**-229**	**-287**

Table 4.7.h Assumptions for the actuarial calculations	2017	2016
Discount rate, Sweden	2.5%	2.8%
Discount rate, UK	2.5%	2.7%
Expected payroll increase, Sweden	2.3%	2.2%
Expected payroll increase, UK	2.5%	4.5%
Inflation (CPI), Sweden	1.9%	2.2%
Inflation (CPI), UK	3.1%	1.7%

Accounting policies

Pension liabilities and similar non-current liabilities
The Group has entered post-employment pension plan agreements with a significant number of employees. The post-employment pension plan agreements take the form of defined benefit plan and defined contribution plan agreements.

Defined contribution plans
For defined contribution plans, the Group pays fixed contributions to independent pension companies. The Group has no obligation to make supplementary payments beyond those fixed payments, and the risk and reward of the value of the pension plan therefore rests with the plan members, and not the Group. Amounts payable for contributions to defined contribution plans are expensed in the income statement as incurred.

Defined benefit plans
Defined benefit plans are characterised by the Group's obligation to make specific payments from the date the plan member is pensioned, depending on, for example, the member's seniority and final salary. The Group is subject to the risks and rewards associated with the uncertainty that the return generated by the assets are able to meet the pension liability, which are affected by assumptions concerning mortality and inflation.

The Group provides both funded and unfunded defined benefit plans to certain employees. Funded plans are where the Group pays cash contributions into a separately administered fund, which invests the contributions into various assets, with the aim of generating returns to meet present and future pension liabilities. Unfunded plans are where no cash or other assets are set aside from the Group's assets used in operations to cover the future pension liability.

The Group's net liability is the amount presented on the balance sheet as pension liability.

The net liability is calculated separately for each defined benefit plan. The net liability is the amount of future pension benefits that employees have earned in current and prior periods (i.e. the liability for pension payments for the portion of the employee's estimated final salary earned at the balance sheet date) discounted to a present value (the defined benefit liability), less the fair value of assets held separately from the Group in a plan fund.

The Group uses qualified actuaries to annually calculate the defined benefit liability using the projected unit credit method.

The balance sheet amount of the net obligation is impacted by remeasurement, which includes the effect of changes in assumptions used to calculate the future liability (actuarial gain and losses) and the return generated on plan assets (excluding interest). Remeasurements are recognised through other comprehensive income.

Interest cost for the period is calculated using the discounted rate used to measure the defined benefit liability at the start of the reporting period applied to the carrying amount of the net liability, taking into account changes arising from contributions and benefit payments. The net interest cost and other costs relating to defined benefit plans are recognised in the income statement.

The provision primarily covers defined benefit plans in the UK and Sweden.

Uncertainties and estimates

The costs relating to defined benefit pension plans and their carrying amounts are assessed based on a number of assumptions, including discount rates, inflation rates, salary growth and mortality. A small difference in actual variables compared to assumptions and any changes in assumptions can have a significant impact on the carrying amount of the net liability.

NOTE 5
OTHER AREAS

Note 5.1 Tax

Current and deferred tax

Tax in the income statement
The tax cost was EUR 22 million, compared to a tax cost of EUR 42 million last year. The reduction is mainly due to deferred tax and adjustments relating to previous years. The current tax cost primarily consists of EUR 7 million tax cost relating to cooperative tax, and a EUR 19 million tax cost relating to corporate income tax. The equivalent tax costs last year were EUR 10 million and EUR 16 million respectively.

Deferred tax
Net deferred tax liabilities amounted to EUR 16 million, which represents an increase of EUR 10 million compared to last year.

Deferred tax assets of EUR 43 million are primarily based on temporary differences of property, plant and equipment, tax losses carried forward, and pension liabilities. Deferred tax liabilities of EUR 59 million mainly relate to temporary differences on property, plant and equipment and other temporary differences.

The increase in the net liability position can be explained by a reduction in deferred tax assets arising from actuarial movements on pension liabilities.

A deferred tax asset of EUR 32 million was not recognised, as the Group does not expect to be able to use the benefits arising from the associated temporary differences in the foreseeable future. Last year the unrecognised deferred tax asset amounted to EUR 154 million. The change reflects an updated approach in assessing historical unrecognised temporary differences.

Table 5.1.a Tax in the income statement
(EURm)

	2017	2016
Cooperative tax	7	10
Corporate income tax	19	16
Deferred tax	2	8
Adjustments regarding previous years, actual tax	-3	3
Adjustments regarding previous years, deferred tax	-3	5
Total tax in the income statement	**22**	**42**

Table 5.1.b Calculation of effective tax rate
(EURm)

	2017	2016
Statutory corporate income tax rate in Denmark	22.0%	22.0%
Net deviation in foreign subsidiaries' tax rates compared with the Danish tax rate	-4.7%	-3.7%
Adjustments for cooperative tax	-18.8%	-13.1%
Net non-taxable income less non-tax-deductible costs	-2.6%	-5.0%
Change in tax percentage	0.0%	0.1%
Adjustments regarding previous years	-1.9%	2.0%
Other adjustments	12.9%	8.2%
Effective tax rate	**6.9%**	**10.5%**

Table 5.1.c Deferred tax (EURm)	Intangible assets	Property, plant and equipment	Financial assets	Current assets	Provisions	Other liabilities	Tax loss carry-forwards	Other category	Total
2017									
Net deferred tax asset/liability at 1 January	-2	8	-3	-3	27	1	6	-40	-6
Income/charge to the income statement	-1	4	-1	-	-12	-	3	8	1
Income/charge to other comprehensive income	-	-	-	-	-10	-	-	-1	-11
Exchange rate adjustment	-	-	-	-	-1	-	-	-	-1
Other adjustments	-	-3	-	-	11	-1	-1	-5	1
Net deferred tax asset/liability at 31 December	**-3**	**9**	**-4**	**-3**	**15**	**-**	**8**	**-38**	**-16**
Specification:									
Deferred tax asset at 31 December	-	35	-	-	4	-	8	4	43
Deferred tax liability at 31 December	-3	-26	-4	-3	-11	-	-	-34	-59
2016									
Net deferred tax asset/liability at 1 January	-1	1	2	-3	26	5	10	-41	-1
Income/charge to the income statement	-	-2	-5	-	-8	3	-3	2	-13
Income/charge to other comprehensive income	-	-	-	-	21	-4	-	-1	16
Change in tax rate	-	-2	-	-	2	-	-	-	-
Exchange rate adjustment	-1	-3	-	-	-3	-	-1	-	-8
Other adjustments	-	14	-	-	-11	-3	-	-	-
Net deferred tax asset/liability at 31 December	**-2**	**8**	**-3**	**-3**	**27**	**1**	**6**	**-40**	**-6**
Specification:									
Deferred tax asset at 31 December	-	39	-	-	28	1	6	-	74
Deferred tax liability at 31 December	-2	-31	-3	-3	-1	-	-	-40	-80

Accounting policies

Tax in the income statement
Taxable income is assessed according to national rules and regulations that apply to the entities in the Group. Tax is assessed on the basis of cooperation or income tax.

Tax in the income statement comprises current tax and adjustments to deferred tax. Tax is recognised in the income statement, except to the extent that it relates to a business combination or items (earnings and costs) recognised directly in equity or in other comprehensive income.

Current tax
Current tax is assessed based on cooperation or income tax. Cooperative taxation is based on capital, while income tax is based on the company's income for the year. Current tax payable and receivable are recognised in the balance sheet as tax calculated on the taxable income for the year, adjusted for any tax from previous years' taxable income as well as prepaid on-account taxes. The amount is calculated using tax rates enacted or substantively enacted at the balance sheet date.

Deferred tax
Deferred tax and related adjustments for the year are calculated applying the balance sheet liability method, this is the temporary differences between carrying amounts and the tax base of assets and liabilities.

Deferred tax is not recognised on temporary differences relating to goodwill, which is not deductible for tax purposes, or arising at the acquisition date of an asset or liability without affecting either the profit or loss for the year or taxable income, except for those arising from business combinations.

Deferred tax assets, including the value of tax losses carried forward, are recognised under other non-current assets at the value at which they are expected to be used, either by elimination in the tax of future earnings or by offsetting against deferred tax payable in companies within the same legal tax entity or jurisdiction.

Deferred tax is calculated at the tax rates that are expected to apply to the respective countries and the period in which the asset will be realised or the liability is settled, based on tax rules and tax rates that are enacted or substantively enacted at the reporting date. Changes in deferred tax assets and liabilities due to changes in the tax rate are recognised in the comprehensive income for the year.

Uncertainties and estimates

Deferred tax
Deferred tax reflects assessments of future taxable income across all legal entities. Actual future taxes may deviate from these estimates due to changes to expectations relating to future taxable income, future statutory changes in income taxation or the outcome of tax authorities' final review of the Group's tax returns. Recognition of a deferred tax asset also depends on an assessment of the future use of the asset.

Note 5.2 Fees to auditors appointed by the Board of Representatives

Fees paid to EY

The fees to auditors are attributable to EY.

Table 5.2 Fees to auditors appointed by the Board of Representatives
(EURm)

	2017	2016
Statutory audit	1.4	1.3
Other assurance engagements	-	0.1
Tax assistance	1.3	1.4
Other services	0.7	1.4
Total fees to auditors	**3.4**	**4.2**

Note 5.3 Management remuneration and transactions

Remuneration paid to management

The remuneration of the Executive Board is annually proposed by the Chairmanship and approved by the Board of Directors and salary was maintained on par with last year.

Remuneration for the Board of Directors is annually approved by the Board of Representatives. Principles applied to management remuneration are described on page 60.

Related parties exercising significant influence comprise the Board of Directors and Executive Board. Members of the Board of Directors are paid for milk supplies to Arla Foods amba on equal terms with other owners of the company.

Table 5.3.a Management remuneration
(EURm)

	2017	2016
Board of Directors		
Wages, salaries and remuneration	1.3	1.3
Total	**1.3**	**1.3**
Executive Board		
Fixed compensation	2.2	2.2
Pension	0.2	0.3
Other benefits	0.1	0.1
Short-term variable incentives	0.6	0.6
Long-term variable incentives	0.2	0.2
Total	**3.3**	**3.4**

Table 5.3.b Transactions with the Board of Directors
(EURm)

	2017	2016
Purchase of goods	14.0	10.7
Supplementary payments received regarding previous years	0.4	0.3
Total	**14.4**	**11.0**
Trade payables	1.2	0.6
Owner accounts	1.4	2.1
Total	**2.6**	**2.7**

Note 5.4 Contractual commitments, contingent assets and liabilities

Contractual commitments

The Group is party to a small number of lawsuits, disputes and other claims. Management believes that the outcome of these will not impact the Group's financial position beyond what is already recognised in the financial statements.

As security for mortgage debt based on the Danish Mortgage Act with a nominal value of EUR 815 million, compared with EUR 817 million last year, the Group provided security in property.

Contingent assets
The Finnish Supreme Administrative Court ruled on 29 December 2016, that the Finnish dairy company Valio violated the applicable competition law rules by its predatory pricing on the fresh liquid milk market in Finland. The decision is final. The violations by Valio have led to losses for Arla in previous years, for which Arla raised a claim for damages of approximately EUR 58 million. This civil claim for damages is being pursued by Arla before the Helsinki District Court in Finland. We expect the court proceedings to continue throughout the course of 2018.

Table 5.4 Contractual commitments and contingent liabilities
(EURm)

	2017	2016
Guarantee commitments	**2**	**5**
0-1 years	53	65
1-5 years	108	139
Over 5 years	43	39
Operating rent and lease commitments	**204**	**243**
Commitments in relation to agreements on the purchase of property, plant and equipment	112	92

Uncertainties and estimates

The Group entered into a number of lease agreements. Management assesses the substance of the agreements in order to classify the lease agreements as either financial or operating leases. The Group mainly entered into lease agreements for standardised assets that are short-term in relation to the asset's useful lives. As such, the lease agreements have been classified as operating leases. First of January 2019 IFRS 16 Leasing standard will be applicable. Arla is currently preparing for implementation of this standard. For more details read note 5.6.

Note 5.5 Subsequent events after the balance sheet date

On 25 January 2018, the Board of Directors decided to close Brabrand Dairy in Denmark and move its production to other sites. The restructure is due to a lack of expansion options at the site, which is necessary to meet an increasing demand for yogurt products in Europe. The closure will take place mid-2019 and will affect 160 employees. The decision has no effect on the financial statements of 2017.

On 8 February 2018, Arla announced the acquisition of Yeo Valley Dairies Limited, a subsidiary of the Yeo Valley Group Limited. The transaction will give Arla the rights to use the Yeo Valley® brand in the UK market for milk, butter, spreads and cheese under an intellectual property license.

On 9 February 2018, Arla Foods Ingredients agreed to acquire the remaining 50 per cent of the Argentinian-based, Arla Foods Ingredients S.A (AFISA), currently owned by SanCor, to support the company's ambition for market growth in South America. The investment was previously classified as a joint venture and will be recognised as a fully owned subsidiary following the acquisition.

No other subsequent events with a material impact on the financial statements occurred after the balance sheet date.

Note 5.6 General accounting policies

Consolidated financial statements
The consolidated financial statements included in this annual report are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU, and additional disclosure requirements in the Danish Financial Statement Act for class C large companies. Arla is not an EU public interest entity as the Group has no debt instruments traded on a regulated EU market place. The consolidated financial statements were authorised for issue by the company's Board of Directors on 20 February 2018 and presented for approval by the Board of Representatives on 28 February 2018.

The consolidated financial statements are prepared as a compilation of the parent company's and the individual subsidiaries' financial statements, prepared under the Group's accounting policies. Revenue, costs, assets and liabilities, along with items included in equity of subsidiaries are aggregated and presented on a line-by-line basis. Intra-group shareholdings, balances and transactions, as well as any unrealised income and expenses arising from intra-group transactions are eliminated.

The consolidated financial statements comprise Arla Foods amba (parent company) and the subsidiaries in which the parent company directly or indirectly holds more than 50 per cent of the voting rights, or otherwise maintains control to obtain benefits from its activities. Entities in which the Group exercises joint control through a contractual arrangement are considered to be joint ventures. Entities in which the Group exercises a significant but not a controlling influence, are considered as associates. A significant influence is typically obtained by holding or having at the Group's disposal, directly or indirectly, more than 20 per cent, but less than 50 per cent, of the voting rights in an entity.

Unrealised gains arising from transactions with joint ventures and associates, i.e. profits from sales to joint ventures or associates and whereby the customer pays with funds partly owned by the Group, are eliminated against the carrying amount of the investment in proportion to the Group's interest in the company. Unrealised losses are eliminated in the same manner, but only to the extent that there is no evidence of impairment.

The consolidated financial statements are prepared on a historical cost basis, except for certain items with alternative measurement bases, which are identified in these accounting policies.

Translation of transactions and monetary items in foreign currencies
For each reporting entity in the Group, a functional currency is determined, being the currency used in the primary economic environment where the entity operates. Where a reporting entity transacts in a foreign currency, it will record the transaction in its functional currency using the transaction date rate. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency using the exchange rate applicable at the reporting date. Exchange differences are recognised in the income statement under financial items. Non-monetary items, for example property, plant and equipment which are measured based on historical cost in a foreign currency, are translated into the functional currency upon initial recognition.

Translation of foreign operations
The assets and liabilities of consolidated entities, including the share of net assets and goodwill of joint ventures and associates with a functional currency other than EUR, are translated into EUR using the year-end exchange rate. The revenue, costs and share of the results for the year are translated into EUR using the average monthly exchange rate if this does not differ materially from the transaction date rate. Foreign currency differences are recognised in other comprehensive income and accumulated in the translation reserve.

On partial divestment of associates and joint ventures, the relevant proportional amount of the cumulative foreign currency translation adjustment reserve is transferred to the results for the year, along with any gains or losses related to the divestment. Any repayment of outstanding balance considered part of the net investment is not in itself considered to be a partial divestment of the subsidiary.

Alternative performance measures
The Group presents a range of financial measures in the consolidated annual report that are not defined according to IFRS. The Group believes that these measures provide valuable information to external stakeholders and management and enable better evaluation of overall performance and trends. The financial measures should not be considered as a replacement for performance measures as defined under IFRS, but rather as supplementary information.

Adoption of new or amended IFRS
The Group implemented all new standards and interpretations effective in the EU from 2017. None of these newly adopted standards and interpretations had or are expected to have an impact on the consolidated financial statements of Arla. IASB issued a number of new or amended and revised accounting standards and interpretations that have not yet come into effect. Arla expects to incorporate the new standards when they become mandatory.

IFRS 9 – Financial instruments
In November 2016, the EU endorsed IFRS 9 "Financial Instruments", which is effective for annual periods beginning on or after 1 January 2018. IFRS 9 replaces IAS 39 and changes the classification and measurement of financial assets and liabilities.

IFRS 9 introduces a logical classification of financial assets based on the Group's business model and its underlying cash flow. Furthermore, a new "expected loss"-model is introduced, as opposed to an incurred credit loss model under IAS 39. The expected loss model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk.

Furthermore, new requirements for hedge accounting will be more closely aligned to the Group's business risk management policies. An assessment of the Group's current hedging relationships indicates that they will qualify as continuing hedging relationships upon application of IFRS 9.

An assessment was performed which indicates that the new standard would not have any material impact on the classification of financial assets. Analysis confirms that the expected loss model for trade receivables, nor the change in hedge accounting will have a material impact on the recognition or measurement in the Group's figures.

IFRS 15 – Revenue
IFRS 15 was issued in May 2014 and amended in April 2016, and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration which an entity expects to be entitled to, in exchange for transferring goods or services to a customer.

The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required from 1 January 2018. Arla decided to apply the modified retrospective method.

Arla sells consumer dairy products, ingredients and raw milk to customers. The goods are sold based on the respective contracts with customers.

Arla conducted the assessment on the impact of IFRS 15. For contracts with customers in which the sale of goods is generally expected to be the only performance obligation, adoption of IFRS 15 is not expected to have an impact on Arla's revenue or profit and loss. Arla expects the revenue recognition to occur at a point in time when control of the goods is transferred to the customer, generally on delivery of the goods.

In preparing to adopt IFRS 15, Arla is taking the variable considerations into account. Some contracts with customers provide trade discounts, listing fees or volume rebates. Currently, Arla recognises revenue from the sale of goods measured at the fair value of the consideration received or receivable, net of returns and allowances, trade discounts and volume rebates. Such provisions give rise to variable consideration under IFRS 15, and will be required to be estimated at contract inception and updated thereafter.

IFRS 15 requires the estimated variable consideration to be constrained to prevent over-recognition of revenue. Arla expects that application of the constraint will have no significant change on the revenue being deferred compared to the current standard.

The presentation and disclosure requirements in IFRS 15 are more detailed compared to the current standard, whereby several disclosure requirements in IFRS 15 are new. Arla expects that the notes to the financial statements will be expanded due to the disclosure of significant judgements made.

In addition, as required by IFRS 15, Arla will disaggregate revenue recognised from contracts with customers into different categories.

IFRS 16 Leases
IFRS 16 was issued in January 2016 and replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases on-balance, similar to the accounting treatment for finance leases under IAS 17. The standard, which is effective on 1 January 2019 for Arla, will significantly change the accounting treatment for lease contracts that are currently treated as operational leases to date.

The standard requires that all lease contracts regardless of type, with some exemptions, need to be capitalised on the lessee's balance sheet as an asset, representing the right to use the underlying asset, with a matching lease liability, representing the lease payments. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets, for example personal computers, and short-term leases, i.e., leases with a lease term of 12 months or less.

The income statement will also be impacted by the annual leasing costs. Annual leasing costs will be divided into two elements, depreciation and interest costs, as opposed to the current treatment whereby the annual costs relating to operational lease agreements are expensed solely as operating costs. This will have a positive impact on the Group's EBITDA and to a lesser extent on EBIT. Furthermore, it is expected that the cash flow statement will be impacted due to the current operational lease payments. Operational lease payments are presently disclosed as cash flow from operating activities, and will be disclosed as financing activities as a result of the new standard.

Arla will be required to remeasure the lease liability upon the occurrence of certain events, for example a change in the lease term or a change in future lease payments resulting from a change in an index or rate used to determine those payments. Arla will generally recognise the amount relating to the remeasurement of the lease liability as an adjustment to the right-of-use asset. IFRS 16 requires more extensive disclosures than its predecessor, IAS 17.

Arla assessed the impact of the adoption of the new standard based on a preliminary analysis. The preliminary analysis indicates an increase in total assets of approximately 5 per cent. Arla's 2019 income statement will show a shift from operating expenses to depreciation and interest. This will have an expected increase of around 14 per cent on EBITDA and 20 per cent on EBIT. It is expected that the net result will not be significantly affected.

In accordance with IFRS 16, the annual operational lease payment of approximately EUR 100 million in 2017 needs to be presented as cash flow from financing activities, as opposed to the current treatment as cash flow from operating activities. This change in disclosure will improve the cash flow from operating activities by approximately 25 per cent.

In 2018, Arla will continue to assess the impact of IFRS 16 on its consolidated financial statements.

IFRIC 22 – Foreign Currency Transactions and Advance Consideration
IFRIC 22 addresses how to account for advance consideration in currencies different from the functional currency. IFRIC 22 is not expected to have a material impact on the Group's consolidated financial statements because the Group already accounts for currency transactions and advance consideration in way that is consistent with the amendments.

Other new or revised accounting standards and implementations are not expected to have a material impact on the consolidated financial statements of the Group.

Note 5.7 Group companies

	Country	Currency	Group Equity interest (%)
Arla Foods amba	**Denmark**	**DKK**	
Arla Foods Ingredients Group P/S	Denmark	DKK	100
Arla Foods Ingredients Energy A/S	Denmark	DKK	100
Arla Foods Ingredients KK	Japan	JPY	100
Arla Foods Ingredients Inc.	USA	USD	100
Arla Foods Ingredients Korea, Co. Ltd.	Korea	KRW	100
Arla Foods Ingredients Trading (Beijing) Co. Ltd.	China	CNY	100
Arla Foods Ingredients S.A. *	Argentina	USD	50
Arla Foods Ingredients Singapore Pte. Ltd.	Singapore	SGD	100
Arla Foods Ingredients S.A. de C.V.	Mexico	MZN	100
Arla Foods Holding A/S	Denmark	DKK	100
Arla Foods Distribution A/S	Denmark	DKK	100
Cocio Chokolademælk A/S	Denmark	DKK	50
Arla Foods International A/S	Denmark	DKK	100
Arla Foods UK Holding Ltd.	UK	GBP	100
Arla Foods UK plc	UK	GBP	100
Arla Foods GP Ltd.	UK	GBP	100
Arla Foods Finance Ltd.	UK	GBP	100
Arla Foods Holding Co. Ltd.	UK	GBP	100
Arla Foods UK Services Ltd.	UK	GBP	100
Arla Foods Nairn Ltd.	UK	GBP	100
Arla Foods Ltd.	UK	GBP	100
Arla Foods limited Partnership	UK	GBP	100
Milk Link Holdings Ltd.	UK	GBP	100
Milk Link Processing Ltd.	UK	GBP	100
Milk Link (Crediton No 2) Ltd.	UK	GBP	100
Milk Link Investments Ltd.	UK	GBP	100
The Cheese Company Holdings Ltd.	UK	GBP	100
The Cheese Company Ltd.	UK	GBP	100
Cornish Country Larder Ltd.	UK	GBP	100
The Cheese Company Investments Ltd.	UK	GBP	100
Westbury Dairies Ltd.	UK	GBP	100
Arla Foods (Westbury) Ltd.	UK	GBP	100
Arla Foods Cheese Company Ltd.	UK	GBP	100
Arla Foods Ingredients UK Ltd.	UK	GBP	100
MV Ingredients Ltd. *	UK	GBP	50
Arla Foods UK Property Co. Ltd.	UK	GBP	100
Arla Foods B.V.	Netherlands	EUR	100
Arla Foods Ltda	Brazil	BRL	100
Danya Foods Ltd.	Saudi Arabia	SAR	75
AF A/S	Denmark	DKK	100
Arla Foods Finance A/S	Denmark	DKK	100
Kingdom Food Products ApS	Denmark	DKK	100
Ejendomsanpartsselskabet St. Ravnsbjerg	Denmark	DKK	100
Arla Insurance Company (Guernsey) Ltd.	Guernsey	DKK	100
Arla Foods Energy A/S	Denmark	DKK	100
Arla Foods Trading A/S	Denmark	DKK	100
Arla DP Holding A/S	Denmark	DKK	100
Arla Foods Investment A/S	Denmark	DKK	100
Arla Senegal SA.	Senegal	XOF	100
Tholstrup Cheese A/S	Denmark	DKK	100
Tholstrup Cheese USA Inc.	USA	USD	100
Arla Foods Belgium A.G.	Belgium	EUR	100
Walhorn Verwaltungs GmbH (Under liquidation)	Germany	EUR	100
Arla Foods Ingredients (Deutschland) GmbH	Germany	EUR	100
Arla CoAr Holding GmbH	Germany	EUR	100
ArNoCo GmbH & Co. KG *	Germany	EUR	50
Arla Biolac Holding GmbH	Germany	EUR	100
Biolac GmbH & Co. KG *	Germany	EUR	50
Biolac Verwaltungs GmbH *	Germany	EUR	50
Arla Foods Kuwait Company LLC	Kuwait	KWD	49
Arla Kallassi Foods Lebanon S.A.L.	Lebanon	USD	50
Arla Foods Qatar WLL	Qatar	QAR	40
AFIQ WLL **	Bahrain	BHD	25
Arla Foods Trading and Procurement Ltd.	Hong Kong	HKD	100
Arla Foods Sdn. Bhd.	Malaysia	MYR	100
Arla Foods Panama S.A.	Panama	USD	100
Arla Foods Inc.	Philippines	PHP	100
Arla Foods Ltd.	Ghana	GHS	100
Arla Global Dairy Products Ltd.	Nigeria	NGN	100
TG Arla Dairy Products LFTZ Enterprise	Nigeria	NGN	50
TG Arla Dairy Products Ltd.	Nigeria	NGN	100

	Country	Currency	Group Equity interest (%)
Arla Foods AB	Sweden	SEK	100
Arla Gefleortens AB	Sweden	SEK	100
Arla Oy	Finland	EUR	100
Massby Facility & Services Oy	Finland	EUR	60
Osuuskunta MS tuottajapalvelu **	Finland	EUR	37
Restaurang akademien Aktiebolag **	Sweden	SEK	50
Vardagspuls AB	Sweden	SEK	100
Arla Foods Russia Holding AB	Sweden	SEK	100
Arla Foods LLC	Russia	RUB	80
Arla Foods Inc.	USA	USD	100
WNY Cheese Enterprise LLC **	USA	USD	20
Arla Foods Production LLC	USA	USD	100
Arla Foods Transport LLC	USA	USD	100
Arla Foods Deutschland GmbH	Germany	EUR	100
Arla Foods Verwaltungs GmbH	Germany	EUR	100
Arla Foods Agrar Service GmbH	Germany	EUR	100
Arla Foods Agrar Service Luxemburg GmbH	Luxembourg	EUR	100
Arla Foods Agrar Service Belgien AG	Belgium	EUR	100
Arla Foods LLC	Russia	RUB	20
Martin Sengele Produits Laitiers SAS	France	EUR	100
Team-Pack GmbH	Germany	EUR	100
Arla Foods France, S.a.r.l	France	EUR	100
Dofo Cheese Eksport K/S	Denmark	DKK	100
Dofo Inc.	USA	USD	100
Aktieselskabet J. Hansen	Denmark	DKK	100
J.P. Hansen USA Incorporated	USA	USD	100
AFI Partner ApS	Denmark	DKK	100
Arju For Food Industries S.A.E.	Egypt	EGP	49
Andelssmør A.m.b.a.	Denmark	DKK	98
Arla Côte d'Ivoire	Ivory Coast	XOF	51
Arla Foods AS	Norway	NOK	100
Arla Foods Bangladesh Ltd.	Bangladesh	BDT	51
Arla Foods Dairy Products Technical Service (Beijing) Co. Ltd.	China	CNY	100
Arla Foods FZE	UAE	AED	100
Arla Foods Hellas S.A.	Greece	EUR	100
Arla Foods Inc.	Canada	CAD	100
Arla Foods Logistics GmbH	Germany	EUR	100
Arla Foods Mayer Australia Pty, Ltd.	Australia	AUD	51
Arla Foods Mexico S.A. de C.V.	Mexico	MXN	100
Arla Foods S.A.	Spain	EUR	100
Arla Foods S.a.r.l.	France	EUR	100
Arla Foods S.R.L.	Dominican Republic	DOP	100
Arla Foods SA	Poland	PLN	100
Arla Foods Srl	Italy	EUR	100
Arla Foods UK Farmers Joint Venture Co. Ltd.	UK	GBP	100
Arla Global Financial Services Centre Sp. Z.o.o.	Poland	PLN	100
Arla Milk Link Limited	UK	GBP	100
Arla National Foods Products LLC	UAE	AED	40
Cocio Chokolademælk A/S	Denmark	DKK	50
Hansa Verwaltungs und Vertriebs GmbH (Under liquidation)	Germany	EUR	100
Marygold Trading K/S	Denmark	DKK	100
Mejeriforeningen	Denmark	DKK	91
COFCO Dairy Holdings Limited **	British Virgin Irlands	HKD	30
Svensk Mjölk Ekonomisk förening **	Sweden	SEK	75
Lantbrukarnas Riksförbund upa **	Sweden	SEK	24

* Joint ventures ** Associates
The Group also owns a number of entities without material commercial activities.

Parent company Management Review

Under section 149 of the Danish Financial Statements Act, the consolidated financial statements of Arla Foods (also referred to as the 'Group') represent an extract of Arla's complete annual report. This annual report of the parent company is an integrated part of the full annual report, which contains the statement from the Board of Directors and the Executive Board as well as the independent auditor's report.

These parent company financial statements show the financial position, the result and the cash flow of Arla Foods amba on a non-consolidated basis for the financial year 1 January to 31 December 2017.

Principal activities
Arla Foods amba conducts dairy activities in Denmark and purchases milk from the company's farmer owners in seven member countries. Milk collected outside of Denmark is resold to foreign subsidiaries in the Group.

This structure ensures that all owners receive milk payments according to common guidelines and exercise influence according to the owner democracy, including elections of the Board of Representatives and the Board of Directors, in accordance with the Articles of Association and merger agreements.

Arla Foods amba operates as the head office for the Group, in addition to conducting its primary dairy activities.

Performance
Market milk prices improved throughout 2017 and the Group succeeded in closing the year with the highest milk price to farmer owners in three years. As a consequence, revenue and production costs in Arla Foods amba increased. Revenue increased by 16.5 per cent to EUR 7,709 million, compared to EUR 6,620 million last year. The development was driven primarily by increased prices to external- as well as group-internal customers. Gross profit amounted to EUR 899 million, which is at the same level as last year.

Profit for the year increased to EUR 188 million, compared to EUR 70 million last year. The improved profit was due to increased dividends distributed from subsidiaries in 2017, which amounted to EUR 97 million, versus EUR 44 million last year, as well as a gain of EUR 44 million from the disposal of Arla Foods amba's investment in Vigor Alimentos S.A. The investment was previously classified as an associated company. Investments in subsidiaries were impaired by EUR 185 million, compared to EUR 162 million last year.

Content

Income statement

(EURm)	Note	2017	2016
Revenue	1.1	7,709	6,620
Production costs	1.2	-6,810	-5,723
Gross profit		**899**	**897**
Sales and distribution costs	1.2	-482	-496
Administration costs	1.2	-203	-205
Other operating income	1.3	38	38
Other operating costs	1.3	-23	-14
Earnings before interest and tax (EBIT)		**229**	**220**
Impairment of investments in subsidiaries	3.3	-185	-162
Financial income	4.1	171	79
Financial costs	4.1	-25	-57
Profit before tax		**190**	**80**
Tax	5.1	-2	-10
Profit for the year		**188**	**70**

Profit appropriation

(EURm)	2017	2016
Profit for the year	**188**	**70**
Proposed profit appropriation:		
Supplementary payment for milk	124	121
Interest on contributed capital	3	3
Total supplementary payment	**127**	**124**
Transferred to equity:		
Capital account	-134	-332
Reserve for special purposes	120	193
Contributed capital	38	30
Reserve for development costs	37	55
Total transferred to equity	**61**	**-54**
Appropriated profit	**188**	**70**

Comprehensive income

(EURm)	2017	2016
Profit for the year	**188**	**70**
Other comprehensive income		
Items that may be reclassified subsequently to the income statement		
Value adjustment of hedging instruments	46	-24
Foreign exchange adjustments	-2	15
Other comprehensive income, net of tax	**44**	**-9**
Total comprehensive income	**232**	**61**

Balance sheet

(EURm)	Note	2017	2016
Assets			
Non-current assets			
Intangible assets	3.1	190	182
Property, plant and equipment	3.2	603	610
Investments in subsidiaries	3.3	1,187	1,172
Investments in associates	3.3	266	295
Subordinated loans to subsidiaries	3.3	633	579
Total non-current assets		**2,879**	**2,838**
Current assets			
Inventory	2	298	253
Trade receivables	2	209	170
Amounts owed by subsidiaries		873	685
Amounts owed by associates		8	6
Derivatives	4	13	8
Other receivables		41	39
Securities	4	199	193
Cash and cash equivalents		-	-
Total current assets		**1,641**	**1,354**
Total assets		**4,520**	**4,192**
Equity and liabilities			
Equity			
Common capital		1,563	1,559
Individual capital		502	503
Other equity accounts		85	4
Proposed supplementary payments to owners		127	124
Total equity		**2,277**	**2,190**
Liabilities			
Non-current liabilities			
Loans	4	274	281
Total non-current liabilities		**274**	**281**
Current liabilities			
Loans	4	202	214
Trade payables	4	531	438
Amounts owed to subsidiaries	4	1,098	882
Derivatives	4	34	79
Other current liabilities		84	87
Deferred income		20	21
Total current liabilities		**1,969**	**1,721**
Total liabilities		**2,243**	**2,002**
Total equity and liabilities		**4,520**	**4,192**

Changes in equity

(EURm)	Common capital		Individual capital			Other equity accounts			
	Capital account	Reserve for special purposes	Delivery-based owner certificates	Contributed capital	Proposed supplementary payments to owners	Reserve for value adjustment of hedging instruments	Reserve for foreign exchange adjustments	Reserve for development costs	Total
Equity at 1 January 2017	**793**	**766**	**87**	**416**	**124**	**-62**	**11**	**55**	**2,190**
Profit for the year	-134	120	-	38	127	-	-	37	188
Other comprehensive income	-	-	-	-	-	46	-2	-	44
Total comprehensive income	**-134**	**120**	**-**	**38**	**127**	**46**	**-2**	**37**	**232**
Capital issued to new owners	3	-	-	-	-	-	-	-	3
Payments to owners	-	-	-7	-21	-	-	-	-	-28
Supplementary payments to owners	-	-	-	-	-120	-	-	-	-120
Foreign exchange adjustments	15	-	-1	-10	-4	-	-	-	-
Total transactions with owners	**18**	**-**	**-8**	**-31**	**-124**	**-**	**-**	**-**	**-145**
Equity at 31 December 2017	**677**	**886**	**79**	**423**	**127**	**-16**	**9**	**92**	**2,277**
Equity at 1 January 2016	**1,094**	**573**	**94**	**422**	**113**	**-38**	**-4**	**-**	**2,254**
Profit for the year	-332	193	-	30	124	-	-	55	70
Other comprehensive income	-	-	-	-	-	-24	15	-	-9
Total comprehensive income	**-332**	**193**	**-**	**30**	**124**	**-24**	**15**	**55**	**61**
Capital issued to new owners	-	-	-	5	-	-	-	-	5
Payments to owners	-	-	-6	-16	-	-	-	-	-22
Supplementary payments to owners	-	-	-	-	-108	-	-	-	-108
Foreign exchange adjustments	31	-	-1	-25	-5	-	-	-	-
Total transactions with owners	**31**	**-**	**-7**	**-36**	**-113**	**-**	**-**	**-**	**-125**
Equity at 31 December 2016	**793**	**766**	**87**	**416**	**124**	**-62**	**11**	**55**	**2,190**

Refer to the Group consolidated financial statements for an explanation of the characteristics of each equity account, except "Reserve for development costs" which is explained in Note 5.6.

Cash flow

(EURm)	Note	2017	2016
EBIT		229	220
Depreciation, amortisation and impairment losses		135	119
Gain/loss on disposal of non-current assets		2	-
Change in working capital		14	45
Dividends received		97	44
Interest paid		-13	-16
Interest received		24	35
Tax paid		-2	-11
Cash flow from operating activities		**486**	**436**
Investment in intangible fixed assets	3.1	-51	-55
Investment in property, plant and equipment	3.2	-87	-75
Sale of property, plant and equipment		-	1
Operating investing activities		-138	-129
Free operating cash flow		*348*	*307*
Investment in subsidiaries	3.3	-200	-574
Investment in associates	3.3	-1	-
Sale of associates		74	-
Issuance/repayment of subordinated loans		-62	-32
Financial investing activities		-189	-606
Cash flow from investing activities		**-327**	**-735**
Free cash flow		159	-299
Supplementary payment regarding the previous financial year		-120	-108
Paid out from equity regarding terminated membership contracts		-28	-22
Change in non-current liabilities		-2	-3
Change in current liabilities		-12	431
Net change in marketable securities		3	1
Cash flow from financing activities		**-159**	**299**
Net cash flow		**-**	**-**
Cash and cash equivalents at 1 January		-	-
Cash and cash equivalents at 31 December		**-**	**-**

Note 1 Revenue and operational cost

Note 1.1 Revenue

(EURm)

	Internal sales of goods	External sales of goods	Total revenue
2017			
Raw milk	2,822	26	2,848
Milk, yoghurt, powder and cooking	355	1,065	1,420
Cheese	962	674	1,636
Butter, spreads and margarine	1,017	217	1,234
Other	48	523	571
Total revenue	**5,204**	**2,505**	**7,709**
2016			
Raw milk	2,216	151	2,367
Milk, yoghurt, powder and cooking	268	945	1,213
Cheese	812	584	1,396
Butter, spreads and margarine	974	170	1,144
Other	74	426	500
Total revenue	**4,344**	**2,276**	**6,620**

Note 1.2 Costs

(EURm)

Research and development costs are included in sales and distribution costs and amounts to EUR 22 million, compared to EUR 25 million last year.

	2017	2016
Operational costs split by function		
Production costs	6,810	5,723
Sales and distribution costs	482	496
Administration costs	203	205
Total costs	**7,495**	**6,424**
Specification:		
Weighed-in raw milk	4,484	3,502
Staff costs	442	427
Depreciation, amortisation and impairment losses	135	119
Other costs	2,434	2,376
Total costs	**7,495**	**6,424**
Staff costs		
Wages, salaries and remuneration	407	392
Pensions	33	33
Other social security costs	2	2
Total staff costs	**442**	**427**
Staff costs relate to:		
Production costs	283	280
Sales and distribution costs	59	44
Administration costs	100	103
Total staff costs	**442**	**427**
Average number of full-time employees	5,428	5,299

Depreciation, amortisation and impairment losses

(EURm)	2017	2016
Intangible assets, amortisation	43	32
Property, plant and equipment, depreciation	92	87
Total depreciation, amortisation and impairment losses	**135**	**119**
Depreciation, amortisation and impairment losses relate to:		
Production costs	94	93
Sales and distribution costs	17	2
Administration costs	24	24
Total depreciation, amortisation and impairment losses	**135**	**119**

Note 1.3 Other operating income and costs

(EURm)	2017	2016
Financial instruments	35	35
Other items	3	3
Total other operating income	**38**	**38**
Financial instruments	6	-
Other items	17	14
Total other operating costs	**23**	**14**

Note 2 Net working capital

Net working capital
(EURm)

	2017	2016
Inventory	298	253
Trade receivables	209	170
Amounts owed by subsidiaries	863	685
Amounts owed by associated	8	6
Trade payables	-531	-438
Amounts owed to subsidiaries	-160	-180
Net working capital	**687**	**496**

Inventory
(EURm)

	2017	2016
Inventory before write-downs	305	257
Write-downs	-7	-4
Total inventory	**298**	**253**
Raw materials and consumables	102	102
Work in progress	91	67
Finished goods and goods for resale	105	84
Total inventory	**298**	**253**

Trade receivables
(EURm)

	2017	2016
Trade receivables before provisions for bad debts	211	171
Write-downs for bad debts	-2	-1
Total trade receivables	**209**	**170**

Note 3 Capital employed

Note 3.1 Intangible assets

(EURm)

	Licenses and trademarks	IT and other development projects	Total
2017			
Cost at 1 January	28	264	292
Additions	-	51	51
Disposals	-	-2	-2
Cost at 31 December	**28**	**313**	**341**
Amortisation and impairment at 1 January	-4	-106	-110
Amortisation for the year	-2	-41	-43
Amortisation on disposals	-	2	2
Amortisation and impairment at 31 December	**-6**	**-145**	**-151**
Carrying amount at 31 December	**22**	**168**	**190**
2016			
Cost at 1 January	28	219	247
Additions	-	55	55
Disposals	-	-10	-10
Cost at 31 December	**28**	**264**	**292**
Amortisation and impairment at 1 January	-2	-86	-88
Amortisation for the year	-2	-30	-32
Amortisation on disposals	-	10	10
Amortisation and impairment at 31 December	**-4**	**-106**	**-110**
Carrying amount at 31 December	**24**	**158**	**182**

Note 3.2 Property, plant and equipment

(EURm)

	Land and buildings	Plant and machinery	Fixture and fitting, tools and equipment	Assets in course of construction	Total
2017					
Cost at 1 January	406	1,076	76	63	1,621
Additions	1	8	2	76	87
Transferred from assets under construction	32	40	15	-87	-
Disposals	-	-3	-2	-	-5
Cost at 31 December	**439**	**1,121**	**91**	**52**	**1,703**
Depreciation and impairment at 1 January	-242	-717	-52	-	-1,011
Depreciation for the year	-11	-71	-10	-	-92
Depreciation on disposals	-	2	1	-	3
Depreciation and impairment at 31 December	**-253**	**-786**	**-61**	**-**	**-1,100**
Carrying amount at 31 December	**186**	**335**	**30**	**52**	**603**
Of which assets held under a finance lease	3	13	1	1	18
2016					
Cost at 1 January	404	1,034	65	46	1,549
Additions	-	19	3	53	75
Transferred from assets under construction	2	25	9	-36	-
Disposals	-	-2	-1	-	-3
Cost at 31 December	**406**	**1,076**	**76**	**63**	**1,621**
Depreciation and impairment at 1 January	-233	-649	-44	-	-926
Depreciation for the year	-9	-70	-9	-	-88
Depreciation on disposals	-	2	1	-	3
Depreciation and impairment at 31 December	**-242**	**-717**	**-52**	**-**	**1,011**
Carrying amount at 31 December	**164**	**359**	**24**	**63**	**610**
Of which assets held under a finance lease	4	13	2	1	20

Note 3.3 Investments and subordinated loans

(EURm)

	Investments in subsidiaries	Investments in associates	Subordinated loans to subsidiaries
2017			
Cost at 1 January	1,694	295	648
Additions	200	1	87
Disposals	-	-30	-25
Cost at 31 December	**1,894**	**266**	**710**
Adjustments at 1 January	-522	-	-69
Exchange rate adjustments	-	-	-8
Impairment	-185	-	-
Adjustments at 31 December	**-707**	**-**	**-77**
Carrying amount at 31 December	**1,187**	**266**	**633**

In 2017, the investment in Arla Foods Deutschland GmbH was written down by EUR 185 million to the recoverable amount, as a result of an operating loss in this entity.

	Investments in subsidiaries	Investments in associates	Subordinated loans to subsidiaries
2016			
Cost at 1 January	1,120	293	616
Additions	574	-	62
Disposals	-	-	-30
Other adjustments	-	2	-
Cost at 31 December	**1,694**	**295**	**648**
Adjustments at 1 January	-360	2	-34
Exchange rate adjustments	-	-	-35
Impairment	-162	-	-
Other adjustments	-	-2	-
Adjustments at 31 December	**-522**	**-**	**-69**
Carrying amount at 31 December	**1,172**	**295**	**579**

In 2016, the investment in Arla Foods Deutschland GmbH was written down by EUR 160 million to the recoverable amount, as a result of an operating loss in this entity.

Transactions with subsidiaries (EURm)	**2017**	**2016**
Sale of goods	5,204	4,344
Purchase of distribution services	-74	-71
Sale of administration services	69	69
Royalty from subsidiaries	1	1
Interest from subsidiaries	23	31
Dividends from subsidiaries	97	44

Transactions with associates

Refer to the Group consolidated financial statements.

Note 4 Funding

Financial risks are managed by Group Treasury. Refer to Note 4 in the Group consolidated financial statements for a description of the objectives, policies and processes for measuring and managing the exposure to financial risks. Specifications relevant to the parent company can be found below.

Note 4.1 Financial income and financial costs

(EURm)	2017	2016
Interest, securities	1	1
Dividends from subsidiaries	97	44
Gain from divestment of associates	44	-
Interest from subsidiaries	23	31
Fair value adjustment	6	3
Total financial income	**171**	**79**
Interest costs on financial instruments measured at amortised cost	-15	-18
Foreign exchange losses (net)	-12	-41
Interest transferred to property, plant and equipment	2	2
Total financial costs	**-25**	**-57**
Net financial income	**146**	**22**

Note 4.2 Interest-bearing debt

Net interest-bearing debt

(EURm)	2017	2016
Securities	-199	-193
Subordinated loans to subsidiaries	-633	-579
Current liabilities	1,152	916
Non-current liabilities	274	281
Net interest-bearing debt	**594**	**425**

Borrowings (EURm)	2017	2016
Mortgage credit institutions	266	271
Bank borrowings	6	8
Finance lease liabilities	1	-
Other non-current borrowings	1	2
Total non-current borrowings	**274**	**281**
Current borrowing from subsidiary	938	702
Bank borrowings	201	195
Commercial papers	-	4
Finance lease liabilities	1	1
Other current borrowings	12	14
Total current borrowings	**1,152**	**916**
Total interest-bearing borrowings	**1,426**	**1,197**

Amounts owed to subsidiaries were EUR 1,098 million, compared to EUR 882 last year, of which EUR 938 million, versus EUR 702 million last year, was interest-bearing and therefore included in net interest-bearing debt as current borrowings. There were no significant non-cash movements in net interest-bearing debt, except for fair value adjustments on securities of EUR 10 million, and foreign exchange rate adjustments on subordinated loans of EUR 7 million.

Net interest-bearing debt, maturity
(EURm)

2017	Total	2018	2019	2020	2021	2022	2023	2024	2025-2027	After 2027
DKK	671	483	9	8	14	-70	16	16	50	145
EUR	31	31	-	-	-	-	-	-	-	-
GBP	-218	-218	-	-	-	-	-	-	-	-
SEK	56	56	-	-	-	-	-	-	-	-
Other	54	54	-	-	-	-	-	-	-	-
Total	**594**	**406**	**9**	**8**	**14**	**-70**	**16**	**16**	**50**	**145**

2016	Total	2017	2018	2019	2020	2021	2022	2023	2024-2026	After 2026
DKK	623	707	-356	8	7	14	17	16	51	159
EUR	-25	-	-14	-	-	-	-11	-	-	-
GBP	-188	-	-188	-	-	-	-	-	-	-
SEK	4	4	-	-	-	-	-	-	-	-
Other	11	11	-	-	-	-	-	-	-	-
Total	**425**	**722**	**-558**	**8**	**7**	**14**	**6**	**16**	**51**	**159**

Note 4.3 Financial risks

Liquidity reserves (EURm)	2017	2016
Unutilised committed loan facilities	721	666
Other unutilised loan facilities	220	180
Total	**941**	**846**

Gross financial liabilities
(EURm)

		Non-discounted contractual cash flows									
31 December 2017	**Carrying value**	**Total**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025-2027**	**After 2027**
Borrowings from subsidiaries	938	938	938	-	-	-	-	-	-	-	-
Mortgage credit institutions	266	272	5	5	6	13	16	16	16	50	145
Credit institutions	222	222	216	2	2	1	1	-	-	-	-
Interest expense - interest-bearing debt	-	39	3	3	3	3	3	2	2	5	15
Trade payables	531	531	531	-	-	-	-	-	-	-	-
Derivative instruments	34	34	11	9	5	4	3	2	-	-	-
Total	**1,991**	**2,036**	**1,704**	**19**	**16**	**21**	**23**	**20**	**18**	**55**	**160**

31 December 2016	**Carrying value**	**Total**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024-2026**	**After 2026**
Borrowings from subsidiaries	702	702	702	-	-	-	-	-	-	-	-
Mortgage credit institutions	271	277	-	5	5	6	14	16	16	52	163
Credit institutions	224	224	214	4	2	2	1	1	-	-	-
Interest expense - interest-bearing debt	-	35	3	2	2	2	2	2	2	5	15
Trade payables	438	438	438	-	-	-	-	-	-	-	-
Derivative instruments	79	79	45	11	9	5	4	3	2	-	-
Total	**1,714**	**1,755**	**1,402**	**22**	**18**	**15**	**21**	**22**	**20**	**57**	**178**

Currency risk
(EURm)

Currency risk 31 December 2017	**EUR/DKK**	**USD/DKK***	**GBP/DKK**	**SEK/DKK**	**SAR/DKK**
Applied sensitivity	1%	5%	5%	5%	5%
Impact on profit or loss	-	2	1	-	-
Impact on OCI	-	-12	-10	-	-3

Currency risk 31 December 2016	**EUR/DKK**	**USD/DKK***	**GBP/DKK**	**SEK/DKK**	**SAR/DKK**
Applied sensitivity	1%	5%	5%	5%	5%
Impact on profit or loss	-1	4	-2	-2	-1
Impact on OCI	-	-18	-8	-	-5

** incl. AED*

Note 4.4 Derivative financial instruments

Arla uses forward currency contracts to hedge currency risks regarding expected future revenue and costs.

(EURm)

			Expected recognition				
2017	**Carrying value**	**Fair value recognised in OCI**	**2018**	**2019**	**2020**	**2021**	**Later than 2021**
Currency contracts	4	4	4	-	-	-	-
Interest rate contracts	-30	-30	-9	-7	-5	-4	-5
Hedging of future cash flows	**-26**	**-26**	**-5**	**-7**	**-5**	**-4**	**-5**

2016	**Carrying value**	**Fair value recognised in OCI**	**2017**	**2018**	**2019**	**2020**	**Later than 2020**
Currency contracts	-23	-23	-23	-	-	-	-
Interest rate contracts	-40	-40	-9	-9	-7	-5	-10
Hedging of future cash flows	**-63**	**-63**	**-32**	**-9**	**-7**	**-5**	**-10**

Note 4.5 Financial instruments

Categories of financial instruments (EURm)	**2017**	**2016**
Available for sale financial assets	199	193
Loans and receivables	1,723	1,440
Financial assets measured at fair value through profit or loss	21	13
Derivatives	34	79
Financial liabilities measured at amortised cost	2,105	1,815

The fair value of financial assets and financial liabilities measured at amortised cost is approximately equal to the carrying amount.

Fair value hierarchy – carrying amount
(EURm)

31 December 2017	Level 1	Level 2	Level 3	Total
Financial assets				
Bonds	199	-	-	199
Shares	6	-	-	6
Derivatives	-	13	-	13
Total financial assets	**205**	**13**	**-**	**218**
Financial liabilities				
Mortgage credit institutions	266	-	-	266
Derivatives	-	34	-	34
Total financial liabilities	**266**	**34**	**-**	**300**

31 December 2016	Level 1	Level 2	Level 3	Total
Financial assets				
Bonds	193	-	-	193
Shares	6	-	-	6
Derivatives	-	8	-	8
Total financial assets	**199**	**8**	**-**	**207**
Financial liabilities				
Mortgage credit institutions	271	-	-	271
Derivatives	-	79	-	79
Total financial liabilities	**271**	**79**	**-**	**350**

Note 4.6 Transfer of financial assets
(EURm)

31 December 2017	Carrying value	Notional value	Fair value
Mortgage bonds	199	194	199
Repurchase liability	194	193	194
Net position	**5**	**1**	**5**

31 December 2016	Carrying value	Notional value	Fair value
Mortgage bonds	193	196	193
Repurchase liability	193	196	193
Net position	**-**	**-**	**-**

Note 5 Other areas

Note 5.1 Tax

Tax in the income statement (EURm)	**2017**	**2016**
Tax on taxable equity (cooperative tax)	6	10
Adjustments regarding previous years, actual tax	-4	-
Total tax in the income statement	**2**	**10**

Calculation of effective tax rate	**2017**	**2016**
Statutory corporate income tax rate in Denmark	22.0%	22.0%
Adjustment for cooperative tax	-18.1%	-9.5%
Adjustment regarding previous years	-2.5%	0.0%
Effective tax rate	**1.4%**	**12.5%**

Note 5.2 Fees to auditors appointed by the Board of Representatives

(EURm)	**2017**	**2016**
Statutory audit	0.3	0.3
Tax assistance	0.4	0.5
Other services	0.4	0.7
Total fees to auditors	**1.1**	**1.5**

Note 5.3 Management remuneration and transactions

Refer to the Group consolidated financial statements.

Note 5.4 Contractual commitments and contingent liabilities

(EURm)	**2017**	**2016**
Guarantee commitments	**1,100**	**1,115**
0-1 year	13	16
1-5 years	26	25
Over 5 years	9	9
Operating rent and lease commitments	**48**	**50**
Commitments in relation to agreements on the purchase of property, plant and equipment	**55**	**32**

Arla Foods amba is party to a small number of lawsuits, disputes, etc. Management believe that the outcome of these lawsuits will not significantly impact the company's financial position beyond what is recognised in the financial statements.

Note 5.5 Events after the balance sheet date

Refer to the Group consolidated financial statements.

Note 5.6 General accounting policies and significant accounting estimates and judgements

The financial statements of Arla Foods amba have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU and additional requirements in the Danish Financial Statements Act (large class C).

With the exception of the accounting policies described below, the accounting policies for Arla Foods amba are identical to the Group's consolidated financial statements.

Dividends from subsidiaries and associates
Dividends from subsidiaries and associates are recognised in the income statement as a financial item when declared.

Investments in subsidiaries and associates
Investments in subsidiaries and associates are measured at cost. An impairment test is performed, if indications of impairment arise, for example loss-making, declines in market values, among others. If the carrying amount exceeds the recoverable amount, it will be written down to the recoverable amount. Impairment losses, as well as gains and losses on disposal, are classified as financial items.

Reserve for development costs
The equity reserve for developments projects capitalised in 2016 and onwards is non-distributable. The reserve will be reversed as the capitalised development projects are expensed.

Adoption of new and amended IFRS
Refer to the Group consolidated financial statements for a description of new and amended IFRS. None of these have had or are expected to have a significant impact on the financial statements of Arla Foods amba, except the implementation of IFRS 16. Arla Foods amba assessed the impact of adoption of IFRS 16 based on a preliminary analysis. The preliminary analysis shows an increase in total assets of approximately EUR 50 million. Arla Food amba's income statement for 2019 will reflect a shift from operating expenses to depreciation and interest. This will have an expected increase of EUR 15 million on EBITDA. It is expected that the net result will not be significantly impacted. In accordance with IFRS 16, annual operational lease payment of approximately EUR 15 million in 2017 are required to be presented as cash flow from financing activities, as opposed to the current leasing standard in which the operational lease payments are presented as cash flow from operating activities. This change in disclosure will improve the cash flow from operating activities.

Significant accounting estimates and judgements
Valuation of certain assets and liabilities at the reporting date requires estimates of how future events will develop. The significant estimates relate to:

- Inventory, refer to Note 2.1 in the Group consolidated financial statements
- Receivables, refer to Note 2.1 in the Group consolidated financial statements
- Property, plant and equipment, refer to Note 3.3 in the Group consolidated financial statements
- Joint ventures and associates, refer to Note 3.4 in the Group consolidated financial statements
- Investments in Group companies: Recoverable amounts of investments in Group companies that are directly owned by Arla Foods amba are continuously monitored and tested for impairment if indicators of such exist. The most important parameters in an impairment test for a specific subsidiary are expected future free cashflow in the subsidiary, cashflow in underlying subsidiaries, as well as assumptions on discount rates. Expectations for these are based on the same expectations as outlined in Note 3.2 in the Group consolidated financial statements
- Leases, refer to Note 5.4 in the Group consolidated financial statements.

Note 5.7 Group companies

Refer to the Group consolidated financial statements.

Independent auditor's report

To the owners of Arla Foods amba

Opinion
We have audited the consolidated financial statements and the parent company financial statements of Arla Foods amba for the financial year 1 January – 31 December 2017, which comprise income statement, statement of comprehensive income, balance sheet, statement of changes in equity, cash flow statement and notes, including accounting policies, for the Group and the Parent Company. The consolidated financial statements and the parent company financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the EU and additional requirements of the Danish Financial Statements Act.

In our opinion, the consolidated financial statements and the parent company financial statements give a true and fair view of the financial position of the Group and the Parent Company at 31 December 2017 and of the results of the Group's and the Parent Company's operations and cash flows for the financial year 1 January – 31 December 2017 in accordance with International Financial Reporting Standards as adopted by the EU and additional requirements of the Danish Financial Statements Act.

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (ISAs) and additional requirements applicable in Denmark. Our responsibilities under those standards and requirements are further described in the "Auditor's responsibilities for the audit of the consolidated financial statements and the parent company financial statements" (hereinafter collectively referred to as "the financial statements") section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence
We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and additional requirements applicable in Denmark, and we have fulfilled our other ethical responsibilities in accordance with these rules and requirements.

Statement on the Management's review
Management is responsible for the Management's review.

Our opinion on the financial statements does not cover the Management's review, and we do not express any assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the Management's review and, in doing so, consider whether the Management's review is materially inconsistent with the financial statements or our knowledge obtained during the audit, or otherwise appears to be materially misstated.

Moreover, it is our responsibility to consider whether the Management's review provides the information required under the Danish Financial Statements Act.

Based on our procedures, we conclude that the Management's review is in accordance with the financial statements and has been prepared in accordance with the requirements of the Danish Financial Statements Act. We did not identify any material misstatement of the Management's review.

Management's responsibilities for the financial statements
Management is responsible for the preparation of consolidated financial statements and parent company financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and additional requirements of the Danish Financial Statements Act and for such internal control as Management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, Management is responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting in preparing the financial statements unless Management either intends to liquidate the Group or the Parent Company or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance as to whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs and additional requirements applicable in Denmark will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they

could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit conducted in accordance with ISAs and additional requirements applicable in Denmark, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's and the Parent Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.

- Conclude on the appropriateness of Management's use of the going concern basis of accounting in preparing the financial statements and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's and the Parent Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group and the Parent Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and contents of the financial statements, including the note disclosures, and whether the financial statements represent the underlying transactions and events in a manner that gives a true and fair view.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Aarhus, 20 February 2018

Ernst & Young
Godkendt Revisionspartnerselskab
CVR no. 30 70 02 28

Jesper Koefoed
State Authorised
Public Accountant
MNE no. 11689

Morten Friis
State Authorised
Public Accountant
MNE no. 32732

Glossary

BEPS refers to Base Erosion and Profit Shifting, an initiative issued by the OECD which consists of 15 actions designed to equip governments with domestic and international instruments to address tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is created.

Brand share measures the revenue from strategic brands as a proportion of total revenue, and is defined as the ratio of revenue from strategic branded products and total revenue.

BSM is an abbreviation of the product category containing butter, spreads, and margarine.

CAPEX is an abbreviation of capital expenditure.

Capacity cost is defined as the cost for running the general business, and includes staff cost, maintenance, energy, cleaning, IT, travelling and consultancy etc.

Conscious living means living by actively evaluating one's activities, decisions and options, and making deliberate choices based on one's values.

Conversion cost refers to the total cost of production of finished and semi-finished goods, excluding the cost for milk, divided by the product volume. The conversion cost enables evaluation of efficiency improvements in the conversion of raw milk to production output over time.

CPI is an abbreviation of Consumer Price Index.

Digital engagement is defined as the number of interactions consumers have across digital channels. The interaction is measured in a number of different ways, for example, by viewing a video on all media channels for more than 10 seconds, visiting a webpage, commenting, liking or sharing on our social media channels.

EBIT is an abbreviation of earnings before interest and tax, and a measure of earnings from operations.

EBITDA is an abbreviation of earnings before interest, tax, depreciation and amortisation from ordinary operations.

EBIT margin measures EBIT as a percentage of total revenue.

Equity ratio is the ratio between equity excluding minority interests and total assets, and is a measure of the financial strength of Arla.

Flexitarian refers to a diet which is plant-based with the occasional addition of meat. Flexitarians are also known as flexible vegetarians, casual vegetarians or vegivores.

FMCG is an acronym for fast-moving consumer goods.

Free cash flow is defined as cash flow from operating activities after deducting cash flow from investing activities.

Innovation pipeline is defined as the net incremental revenue generated from innovation projects up to 36 months from their launch.

Interest cover is the ratio between EBITDA and net interest costs.

International share of business is defined as the revenue from the zone International as a percentage of the revenue from the zones International and Europe.

Leverage is the ratio between net interest-bearing debt inclusive of pension liabilities and EBITDA. It enables evaluation of the ability to support future debt and obligations; the long-term target range for leverage is between 2.8 and 3.4.

MENA is an acronym referring to the Middle East and North Africa.

Milk volume is defined as total intake of raw milk in kg from owners and contractors.

M&A is an abbreviation of mergers and acquisitions.

MYPC is an abbreviation for Arla's largest product category which contains' milk, yoghurt, powder, and cooking.

Net interest-bearing debt is defined as current and non-current interest-bearing liabilities less securities, cash and cash equivalents, and other interest-bearing assets.

Net interest-bearing debt inclusive of pension liabilities is defined as current and non-current interest-bearing liabilities less securities, cash and cash equivalents, and other interest-bearing assets plus pension liabilities.

OECD refers to the Organisation for Economic Cooperation and Development.

Performance price for Arla Foods is defined as the prepaid milk price plus net profit divided by total member milk volume intake. It measures value creation per kg of owner milk including retained earnings and supplementary payments.

Prepaid milk price describes the cash payment farmers receive per kg milk delivered during the settlement period.

Private label refers to retail brands, which are owned by retailers but produced by Arla based on contract manufacturing agreements.

Profit share is defined as the ratio between profit for the period allocated to owners of Arla Foods, and total revenue.

Net working capital is the capital tied up in inventories, receivables, and payables including payables for owner milk.

Net working capital excluding owner milk is defined as capital that is tied up in inventories, receivables, and payables excluding payables for owner milk.

Retail and foodservice volume driven revenue growth is defined as revenue growth associated with growth in retail and foodservice volumes while keeping prices constant.

Scalability measures the relative cost efficiency of the business and is defined as the ratio between retail and foodservice volume driven revenue growth and growth in total capacity cost adjusted for special items. The strategic ambition for scalability is > 2.0.

Strategic brands are defined as products sold under branded products such as Arla®, Lurpak®, Castello® and Puck®.

Strategic branded volume driven revenue growth is defined as revenue growth associated with growth in volumes from strategic branded products while keeping prices constant.

Trading share is a measure for the total milk consumption for producing commodity products relative to the total milk consumption, i.e. based on volumes. Commodity products are sold with lower or no value added, typically via business-to-business sales for other companies to use in their production as well as via industry sales of cheese, butter, or milk powder.

UHT is an abbreviation for ultra-high temperature (UHT) processing, which is a food processing technology that sterilises liquid food, for example milk, by heating it above 135 °C.

Value-added protein segment contains products with special functionality
and compounds, compared to standard protein concentrates with a protein content of approximately 80 per cent.

Vegan refers to a diet which refrains from the consumption of animal products, not only meat but also eggs, dairy products and other animal-derived substances.

Volume driven revenue growth is defined as revenue growth associated with growth in volumes while keeping prices constant.

Corporate calendar

Financial reports and major events

28 February – 1 March 2018
Board of Representatives meeting in Sweden

2 March 2018*
Publication of consolidated annual report for 2017

24 August 2018
Publication of consolidated half-year report for 2018

10-11 October 2018
Board of Representatives meeting

**Subject to approval from the Board of Representatives.*

Arla

Arla Foods amba
Sønderhøj 14
DK-8260 Viby J.
Denmark
CVR no.: 25 31 37 63

Phone +45 89 38 10 00
E-mail arla@arlafoods.com

www.arla.com

Arla Foods UK plc
4 Savannah Way
Leeds Valley Park
Leeds, LS10 1AB
England

Phone +44 113 382 7000
E-mail arla@arlafoods.com

www.arlafoods.co.uk