CONSOLIDATED ANNUAL REPORT

# 2019

# LEADING THROUGH SUSTAINABLE BUSINESS PERFORMANCE

## OUR VISION

# CREATE THE FUTURE OF DAIRY TO BRING HEALTH AND INSPIRATION TO THE WORLD, NATURALLY.

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# 2019 PERFORMANCE AT A GLANCE

## FINANCIAL PERFORMANCE

| | Revenue | Performance price | Milk volume | Profit share* |
|---|---|---|---|---|
| 2019 | **10.5** (BILLION EUR) | **36.6** (EUR-CENT/KG) | **13.7** (BILLION KG) | **3.0%** (OF REVENUE) |
| 2019 | 10.5 | 36.6 | 13.7 | 3.0% |
| 2018 | 10.4 | 36.4 | 13.9 | 2.8% |
| 2017 | 10.3 | 38.1 | 13.9 | 2.8% |
| | Target 2019: 10.2 - 10.6 billion | | | Target 2019: 2.8-3.2% |

## COST AND CASH

| | alcium | Leverage |
|---|---|---|
| 2019 | **110** (MILLION EUR) | **2.8** |
| 2019 | 110 | 2.8 |
| 2018 | 114 | 2.4 |
| 2017 | | 2.6 |
| | Target 2019: 75-100 million | Target 2019: 2.8-3.4 |

## QUALITY OF BUSINESS

| | Strategic branded volume revenue growth | Brand share | International share** |
|---|---|---|---|
| 2019 | **5.1%** | **46.7%** | **21.9%** |
| 2019 | 5.1% | 46.7% | 21.9% |
| 2018 | 3.1% | 45.2% | 19.6% |
| 2017 | 3.0% | 44.6% | 20.2% |
| | Target 2019: 1.5-3.5% | Target 2019: ≥ 46% | Target 2019: ≥ 20% |

## CLIMATE IMPACT

| | Total $CO_2e$ emission | $CO_2e$ emissions reduction, scope 1 and 2*** | $CO_2e$ emission reduction, scope 3 per kg of milk*** |
|---|---|---|---|
| 2019 | **18,503** (MILLION KG) | **15%** | **7%** |
| 2019 | 18,503 | | |
| 2018 | 18,834 | | |
| 2017 | 19,028 | | |
| | | SCIENCE BASED TARGETS DRIVING AMBITIOUS CORPORATE CLIMATE ACTION | SCIENCE BASED TARGETS DRIVING AMBITIOUS CORPORATE CLIMATE ACTION |
| | | Science-based target 2030: 30% | Science-based target 2030: 30% |

■ 2019 ■ 2018 ■ 2017

*Based on profit allocated to owners of Arla Foods amba*
*** International share is based on retail and foodservice revenue, excluding revenue from third party manufacturing, Arla Foods Ingredients and trading activities.*
****Baseline: 2015*

# LEADING THROUGH SUSTAINABLE PERFORMANCE

## MESSAGES FROM THE CHAIRMAN AND THE CEO

# MESSAGE FROM THE CHAIRMAN

2019 was a significant year on many levels. The climate and sustainability agenda changed the world around us, and with it our working conditions as dairy farmers. This year we also saw strong performance and substantial progress in our business, and an unprecedented stability in the milk price.

As dairy farmers, we all have experienced increasing challenges from the climate and sustainability agenda in our everyday lives. We have worked with sustainability for a long time and have come a long way already, but we are continuously met with more requirements and higher expectations from all external stakeholders, who are scrutinising our production methods and urge us to adapt further and faster.

## Taking lead in sustainability

In March, we announced our 2050 climate targets, a clear demonstration that we, as dairy farmers and owners of a global dairy cooperative are determined to take a lead on sustainability, and ensure that consumers maintain confidence in dairy as part of a healthy and sustainable diet.

Our decision to reduce greenhouse gas emissions with 30 per cent by 2030 is ambitious, and was well received by customers, consumers, politicians and organisations. By 2050 we will go even further and will produce carbon net zero dairy.

We have a clearly defined plan for how we, as a business together with all farmer owners, will reach our targets. We worked intensively within our democratic setup to align all owners concerning two essential areas of action. Our farm management programme Arlagården® is being updated to live up to the requirements of customers and consumers, and a new, globally aligned Climate Check programme was launched in 2019. This will help the farmers identify emissions on farms and provide a clear picture of possible actions to reduce them further.

With these programmes we will accumulate one of the world's largest sets of externally verified climate data from dairy farming. This will be a solid foundation for benchmarking, knowledge sharing and research across the dairy industry.

## A strengthened business

For two years in a row, our transformation and efficiency programme, Calcium, has been our key driver for developing our business for the future. It guarantees our ability to invest in our Good Growth 2020 strategy and helps delivering a competitive milk price. With a strong focus on costs, profitability and digital transformation, Calcium exceeded expectations in 2019. As a result we entered 2020 aligned and prepared to meet the challenges ahead.

## Steady milk price all year

The stable performance price at the competitive level of 36.6 EURcent/kg throughout 2019 is a significant result of Calcium and the business that provided stability for us as dairy farmers after years of volatility. It is an especially positive achievement considering what lies ahead of us with the outcomes of Brexit still being unpredictable.

## Looking ahead

With clear targets set for 2030 and 2050 on climate and sustainability we will continue the constructive collaboration in our democratic system around these and other important agendas in 2020, as we roll out the new Arlagården® and encourage all members to complete a Climate Check.

**Jan Toft Nørgaard**
Chairman of the Board of Directors

> **"LET'S EMBRACE THE FUTURE AND TAKE BOLD DECISIONS TO STRENGTHEN OUR BUSINESS."**

Performance price

**36.6**

(EUR-CENT/KG)


# MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

### Leading through sustainable business performance

A solid sustainable performance in 2019 was mainly driven by increased branded growth across Europe, double-digit revenue growth in our international markets, and significant contributions from Calcium.

Arla is a stronger business today than we were a year ago. We achieved the top range of our targets for all key performance indicators and improved milk price with a stable performance price at 36.6 EUR-cent/kg throughout the year. Even with the extraordinary payout of the full 2018 profit to our owners, we maintained a healthy leverage and cash flow, as well as record-high investments that lays strong foundations for future growth.

Despite the slowdown in global growth and declining milk consumption in some European markets, we continued to increase our branded share of volume led by Arla®, Lurpak® and Puck®. Our branded volume growth increased 5.1 per cent compared to last year due to successful innovation and excellent market execution, supported by a strengthened front-line focus in the whole organisation. Not least in Europe, where we continued to deliver branded volume growth, 2.9 per cent, resulting in market share gains in the branded space across the region.

For the second year in a row, our international commercial segment delivered double-digit revenue growth with branded volume growth of 10.3 per cent. An important highlight in this segment was our investment in the Kraft® cheese business in the Middle East and North Africa, which is off to a very good start. We expect the 12-year license agreement to contribute significantly to the value of our investments in the new production site in Bahrain.

### Calcium performed above target

During 2019, our transformation and efficiency programme, Calcium was implemented firmly and at the planned pace. The transformation played a significant role in our overall performance and will continue to influence positively as we change our ways of working and deliver sustainable cost savings. There is still some tough work ahead, particularly in supply chain, before we will reach our overall goal of EUR 400 million.

Sustainability was an overarching theme and we took three big steps to reduce our impact on climate. We launched our ambition to reduce emissions by 30 per cent per kilo of milk by 2030 and become carbon net zero by 2050. We made over one billion pieces of packaging across Europe more environmentally friendly. Moreover, we introduced a new Climate Check tool that enables Arla farmers to take further action to reduce emissions on their farm.

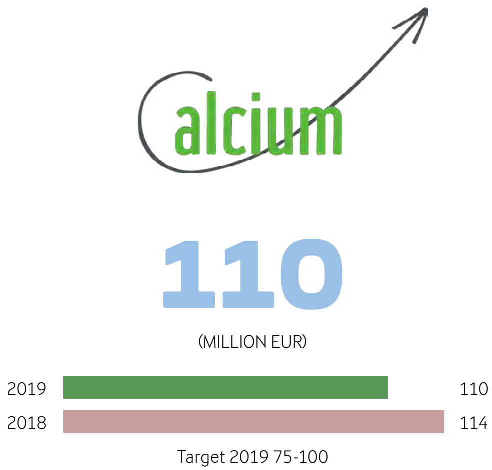
### Building trust for dairy

Overall, Arla stands strong at the start of the new decade. We expect 2020 to be another good year where our branded growth will continue, though at a slightly lower level than in 2019. Succeeding with Calcium in supply chain is a main internal challenge, while externally the macroeconomic and political outlook is gloomy, and the industry remains volatile.

We will continue to monitor the development of plant-based products as well as introduce our own plant-based products as a supplement to the core portfolio. As sustainability continues to be a trend influencing public debate and consumer choice, we will launch new initiatives to build trust and relevance for dairy.

**Peder Tuborgh**
CEO

> "WE FINISHED THE YEAR BEATING OUR EXPECTATIONS, PERFORMING ABOVE TARGETS IN ALL KEY AREAS."




# HIGHLIGHTS

2019 was all about sustainable business performance at Arla, embracing the concept from multiple angles on our way to fulfil our Good Growth 2020 strategy. We launched our ambitious environmental strategy and had our emission targets approved by the Science Based Targets initiative, while our transformation programme, Calcium ensured that we are changing for the better – sustainably.

**Our ambition: Carbon net zero dairy 2050**

Together with our 9,759 farmer owners Arla launched our most ambitious climate targets to date in March: to reduce greenhouse gas emissions by 30 per cent per kilo of milk over the next decade and to work on becoming carbon net zero by 2050. Our 2030 target was officially approved by the Science Based Target initiative as aligned with climate science. With this move, Arla joined the 27 most progressive companies in the food and beverage industry, who also took a forward-thinking stance on climate change. A science-based greenhouse gas reduction target is in line with keeping the global temperature increase below 1.5°C compared to pre-industrial levels, thereby avoiding severe climate change consequences. To read more about our carbon footprint go to page 123.



**Arla takes over cheese business in MENA**

Arla purchased a state-of-the art production facility in Bahrain from Mondeléz International and secured a long-term Kraft® brand licence for their cheese business in MENA. This strategically expands Arla's position within key cheese categories, while also expanding our commercial and supply capabilities to deliver substantial value for the company going forward.

**First in the world: Arla launched the first ever carbon net zero dairy products**

Arla broke global ground in Sweden where we launched under the Arla Ko EKO brand the first ever dairy product that fulfills the ISO standard for climate neutrality. This achievement was confirmed by an external auditor. The move is a result of sustainability initiatives both on and outside the organic farms. On farm, new climate criteria aimed at reducing emissions are being introduced, while for the remaining emissions linked to the products, Arla is compensating by investing in three international projects that reduce carbon emissions. These include a tree planting initiative in Uganda, forest conservation in Indonesia and generating biogas from manure in Kenya, Tanzania and Uganda.


Calcium

**Calcium saving: Above expectations**

Our transformation and efficiency programme, Calcium, delivered EUR 110 million in 2019, ahead of our expectation of EUR 75-100 million. The savings were delivered approximately equally between product optimisation, reduced marketing and indirect spend. Our ambition is to achieve EUR 400+ million bottom line impact by 2021. With EUR 300+ million we will increase the competitiveness of our milk price, and we plan to reinvest EUR 100+ million into growth areas. To read more about Calcium go to page 17.

# HIGHLIGHTS (CONTINUED)

**Committed to developing a sustainable dairy industry in Nigeria**
Already active in existing development projects within the Nigerian dairy industry, in September Arla further engaged with Kaduna State and the Nigerian government in a new public-private partnership. While the state and the government will offer 1,000 nomadic dairy farmers permanent farm lands with access to water, Arla will be the commercial partner that will purchase, collect, process and bring the local milk to market. This new partnership is first of its size in Nigeria, and is part of Arla's business strategy to meet the ever growing consumer demand in Nigeria.

**Our Board got enhanced with first class digital and marketing expertise**
Two external advisors were appointed to our Board of Directors in October, who bring global digital, marketing and technology expertise to compliment the strong commercial and farming knowledge of our elected, active farmer board members. The appointees are Florence Rollet, a venture partner with LuxuryTechFund in Paris and former board member at French spirits company giant Remy Cointreau and Nana Bule, CEO of Microsoft in Denmark and board member at Energinet. To read more about our board go to page 40.


Florence Rollet


Nana Bule


**Arla® Pro scored an innovation success with McDonalds**
In collaboration with the world's largest restaurant chain, McDonalds, Arla® Pro has created Crispy Cheese, meeting the needs of an ever-increasing number of consumers who follow a flexitarian diet. The Crispy Cheese is a new alternative on the burger menu, a unique cheese patty with the taste experience in focus. It was launched in November 2019 in more than 200 McDonald's restaurants across Sweden. The name comes from the crispy deep-fried surface. The new Crispy Cheese burger was such a success it sold out after a few days and expectations are high for 2020. This marks a great start for Arla® Pro's flexitarian platform, which is going to expand in the coming years.

## DAIRY WITH A DIFFERENCE

**Our Arla® brand significantly increased its value**
The Arla® brand is one of the fastest growing FMCG brands in our European markets and our ambition keeps expanding. To leap forward we have a strong focus on pulling our broad portfolio together in a unified consumer facing brand that is trustworthy and emotionally gripping. 2019 marked an important year for the Arla® brand, as branding and communication teams in our European markets moved closer than ever before. They strengthened the brand by delivering key initiatives to drive equity, thus scaling more assets across markets too. Key accomplishments include creating a distinctive visual Arla® brand identity to unify our expression. Our identity has been consistently implemented to drive speed of recognition and saliency. Our teams have meticulously crafted communication so we now can celebrate high performance on brand memorability and persuasion for all European Arla® brand advertisements. Equally important, all Arla® brand campaigns now build on, and convey, our brand essence thereby providing an emotional platform with which we can connect with consumers. Our initiatives have strengthened us as a first choice brand.

# FIVE-YEAR OVERVIEW

| Financial key figures | 2019 | 2018* | 2017* | 2016* | 2015* |
|---|---|---|---|---|---|
| **Performance price** (EUR-cent) | | | | | |
| EUR-cent/kg owner milk | 36.6 | 36.4 | 38.1 | 30.9 | 33.7 |
| **Income statement** (EURm) | | | | | |
| Revenue | 10,527 | 10,425 | 10,338 | 9,567 | 10,262 |
| EBITDA | 837 | 767 | 738 | 839 | 754 |
| EBIT | 406 | 404 | 385 | 505 | 400 |
| Net financials | -59 | -62 | -64 | -107 | -63 |
| Profit for the year | 323 | 301 | 299 | 356 | 295 |
| **Profit appropriation for the year** (EURm) | | | | | |
| Individual capital | 61 | 0 | 38 | 30 | 31 |
| Common capital | 123 | 0 | 120 | 193 | 141 |
| Supplementary payment | 127 | 290 | 127 | 124 | 113 |
| **Balance sheet** (EURm) | | | | | |
| Total assets | 7,106 | 6,635 | 6.442 | 6,382 | 6,736 |
| Non-current assets | 4,243 | 3,697 | 3,550 | 3,714 | 3,903 |
| Current assets | 2,863 | 2,938 | 2,871 | 2,668 | 2,833 |
| Equity | 2,494 | 2,519 | 2,369 | 2,192 | 2,148 |
| Non-current liabilities | 2,304 | 1,694 | 1,554 | 1,742 | 2,084 |
| Current liabilities | 2,308 | 2,422 | 2,499 | 2,448 | 2,504 |
| Net interest-bearing debt including pension liabilities | 2,362 | 1,867 | 1,913 | 2,017 | 2,497 |
| Net working capital | 823 | 894 | 970 | 831 | 999 |
| **Cash flows** (EURm) | | | | | |
| Cash flow from operating activities | 773 | 649 | 386 | 806 | 669 |
| Cash flow from investing activities | -456 | -425 | -286 | -167 | -402 |
| Free cash flow | 202 | 217 | 167 | 639 | 267 |
| Cash flow from financing activities | -136 | -191 | -155 | -624 | -274 |
| Investments in property, plant and equipment | -425 | -383 | -248 | -263 | -348 |
| Purchase of enterprises | -168 | -51 | -7 | - | -29 |

** Not restated following the implementation of IFRS 16 leasing standard.*

| Financial key figures | 2019 | 2018* | 2017* | 2016* | 2015* |
|---|---|---|---|---|---|
| **Financial ratios** | | | | | |
| Profit share | 3.0% | 2.8% | 2.8% | 3.6% | 2.8% |
| EBIT margin | 3.9% | 3.9% | 3.7% | 5.3% | 3.9% |
| Leverage | 2.8 | 2.4 | 2.6 | 2.4 | 3.3 |
| Interest cover | 12.0 | 14.9 | 12.9 | 13.3 | 13.2 |
| Equity ratio | 34% | 37% | 36% | 34% | 31% |
| **Inflow of raw milk** (mkg) | | | | | |
| Total inflow of raw milk | 13,705 | 13,903 | 13,937 | 13,874 | 14,192 |
| Inflow from owners in Denmark | 4,940 | 4,937 | 4,827 | 4,728 | 4,705 |
| Inflow from owners in the UK | 3,230 | 3,196 | 3,203 | 3,210 | 3,320 |
| Inflow from owners in Sweden | 1,788 | 1,826 | 1,855 | 1,909 | 1,995 |
| Inflow from owners in Germany | 1,700 | 1,762 | 1,759 | 1,758 | 1,741 |
| Inflow from owners in Netherlands, Belgium and Luxembourg | 724 | 725 | 729 | 715 | 702 |
| Inflow from others | 1,323 | 1,457 | 1,564 | 1,554 | 1,729 |
| **Number of owners** | | | | | |
| Total number of owners | 9,759 | 10,319 | 11,262 | 11,922 | 12,650 |
| Owners in Sweden | 2,497 | 2,630 | 2,780 | 2,972 | 3,174 |
| Owners in Denmark | 2,436 | 2,593 | 2,675 | 2,877 | 3,027 |
| Owners in Germany | 1,731 | 1,841 | 2,327 | 2,461 | 2,636 |
| Owners in the UK | 2,190 | 2,289 | 2,395 | 2,485 | 2,654 |
| Owners in Netherlands, Belgium and Luxembourg | 905 | 966 | 1,085 | 1,127 | 1,159 |
| **Environmental, social and governance data** | | | | | |
| $CO_2e$ scope 1 and 2 (million kg) | 745 | 760 | 811 | 817 | 877 |
| $CO_2e$ scope 3 (million kg) | 17,758 | 18,073 | 18,217 | 18,292 | 19,802 |
| Average number of full-time employees | 19,174 | 19,190 | 18,973 | 18,765 | 19,025 |
| Gender diversity board | 20%** | 13% | 12% | 7% | 7% |

*** The ratio pertains to all members of the BoD (including employee representatives and external advisors). Gender ratio within the elected members is 13 per cent female, 87 per cent male.*

For in-depth info please refer to the Consolidated Financial Statements (from page 64, and the Consolidated Environmental, Social and Governance Statements from page 121.). For calculations click on the highlighted texts.

# ESSENTIAL BUSINESS PRIORITIES FOR 2019


Arla's essential business priorities are the annual focal points on the Good Growth 2020 journey. They are set by our Executive Management Team and approved by the Board of Directors. We follow-up on our progress on these points monthly.

### 1. Continuous price & margin management while driving volume growth

- ✓ Strong price management
- ✓ Take advantage of our diverse milk pool

### 2. Deliver on Calcium to transform Arla

- ✓ Deliver on Calcium savings
- ✓ Anchor the transformation

### 3. Increase innovation output

- ✓ Review and enhance innovation model
- ● Increase innovation speed and rate

### 4. Drive strong branded volume growth agenda

- ✓ Secure a portfolio of higher-margin and consumer oriented products
- ✓ Execute global brand bets with new launches and scaling of successful products
- ✓ Maintain strong, profitable presence in key markets

### 5. Win in focus markets

- ✓ Stay strong in European core markets
- ✓ Deliver brand growth and/or higher profit in key market segments such as MENA, Bangladesh, China and Nigeria
- ● Assessing the outcome and managing the impact of Brexit

### 6. Take lead on sustainability

- ✓ Launch our new climate ambition
- ✓ Support our branded volume growth with sustainable moves, eg. switching to sustainable packaging

### 7. Power-up Arla Foods Ingredients

- ✓ Increase proportion of value-added products
- ● Secure the growth of our early life nutrition business in China

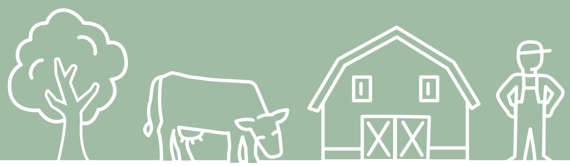

✓ *Target achieved*
● *Trend on track*

# OUR STRATEGY

**We predict milk intake with artificial intelligence**
Knowing how much raw milk we can transform into our nutritious products is crucial for our strategic planning. In 2019 Arla developed a new tool based on artificial intelligence, which can predict in just a few hours how much milk our 1.5 million cows will produce with 1.4 per cent more accuracy. The improved milk intake forecast means that 200 million kilos of milk can be utilised better each year.

Arla is the world's fourth largest dairy company based on milk intake, and the world's largest organic dairy producer. We are also the world's oldest cross-border dairy cooperative, and as such, our farmer owners are at the core of our business model. Our vision is to create the future of dairy to bring health and inspiration to the world, naturally. Our mission is to secure the highest value for our famers' milk while creating opportunities for their growth.

# OUR BUSINESS MODEL



## OWNERS & COWS

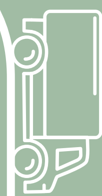
- We have 9,759 farmer owners, who are responsible for over 1.5 million cows
- Our farmers are among the best in the world in innovating to make dairy farms more efficient and sustainable
- Animal welfare is key to our success: we provide digital tools to our owners to constantly track the well-being of their herd

## MILK COLLECTION

- We collect around 13.7 billion kg of raw milk mainly from our owners in seven countries each year
- We are switching to fossil-free fuel in our trucks. This is already the reality in our Swedish business

## MILK PRODUCTION, PACKAGING & INNOVATION

- We process milk at our 60 sites, where 33 per cent of the energy use already comes from renewable sources
- At our sites, we provide work employment opportunities



## CUSTOMERS

- We produce 6.7 billion kilos of nutritious dairy products each year
- We sell our products in 151 countries
- We add value to our owners milk through innovation, branding and marketing, and when the products are sold, the money goes back to our owners as part of the milk price

## CONSUMERS & WASTE MANAGEMENT

- We provide accessible nutrition to millions of people
- Our products' lifecycle of innovation doesn't end at consumption, it is important to us that our products have the least possible negative impact on our environment. We reduced our landfilled waste by 78 per cent since 2005

To read more about our environmental and social performance, go to page 121.

# OUR STRATEGY FOR 2020 AND BEYOND

In December 2015, we launched our Good Growth 2020 strategy. Four years into Good Growth, we are still confident that this is the right strategy for us. However, the world is rapidly changing around us , with fierce competition, new demographic realities and fast-changing consumer trends. That's why in 2018 we accelerated Good Growth with our transformation and efficiency programme, Calcium, and also why we launched our ambitious sustainability strategy in 2019.

## OUR STRATEGY

### GOOD GROWTH 2020

**Our vision:** Create the future of dairy to bring health and inspiration to the world, naturally.

**Our mission:** To secure the highest value for our famer's milk while creating opportunities for their growth.

**Our points of focus:**

**Excel in eight categories**
Matching global trends to our own strengths, we identified eight product categories that are the core focus for our efforts to win the dairy market. Our key categories are milk and powder; milk-based beverages, spreadable cheese, yoghurt, butter and spreads, specialty cheeses, mozzarella and ingredients.

**Focus on six regions**
Six regions represent the markets in which we believe Arla has the biggest potential to grow a long-term profitable business: Northern Europe, Middle East and North Africa, China, South East Asia and West Africa, North America and Russia.

**Win as ONE Arla**
Arla's ambition is that all our 19,174 employees work from ONE strong common platform. This means more aligned performance management and planning, but also a commons vision for Arla's future.

Read more

### Calcium

Calcium is accelerating our strategy by transforming the way we work, spend and invest.

Read more

### OUR SUSTAINABILITY APPROACH

Arla can't win without addressing the most pressing issues of our times, therefore we launched our sustainability approach, which aims to significantly reduce our negative impact on the world around us, while increasing our positive impact.

**Our sustainability strategy is built on two elements:**

**Stronger people**
The ever growing population of the world needs to be nourished, and our healthy and nutritious products play an important role in creating sustainable diets.

**Stronger planet**
We at Arla believe that dairy can be the part of the solution when it comes to fight climate change. We aim to produce carbon net zero dairy by 2050.

Read more

### BEYOND 2020

In 2021 we are entering into a new strategic period, which will be defined by our enhanced strategy. As a logical next step following Good Growth 2020, it will guide us through the next period of value generation.

# EMBRACING CHANGE

We believe that our strategy must constantly evolve to incorporate changing market conditions and consumer trends. Here we highlight the major trends and our corresponding responses to ensure the delivery of our strategy.

TREND

## ECONOMIC SLOWDOWN AND DECLINING DAIRY CONSUMPTION

- Global economic growth is slowing down, a trend driven by declining growth in developed markets, with less than 2 per cent GDP growth in both North America and Europe
- In our core European markets, dairy consumption is flat or in decline in certain categories, while it is growing in developing countries, however at a slower pace than previously seen

## POLITICAL VOLATILITY IN EUROPE AND BEYOND

- The outcomes of Brexit are still uncertain
- New EU leadership and political shifts in core EU countries cause uncertainty around future policies
- US-China and other trade wars continue, increasing cost of doing business internationally
- Conflicts in the MENA regions are escalating

## GROWING DEMAND IN DEVELOPING COUNTRIES

- Emerging markets generate approximately 85 per cent of dairy consumption growth
- There's a push for building-up local value chains and self-sufficient local production in certain markets

RESPONSE

In our core European markets, we are combating consumption decline by building strong brands and constantly innovating our products. In 2019 we launched products targeting the growing number of flexitarian consumers, we expanded our lactose free products, and launched the world's first climate - neutral dairy products in Sweden. Our strong commercial execution in the markets ensures that we build scale behind these successes. In our key MENA market we increased our capacity to serve the growing demand by acquiring a production site and the Kraft® brand cheese license from Mondeléz International.


As trade and other negotiations following Brexit progress, we are continuously and thoroughly preparing for various possible outcomes, while also keep delivering arguments for the free movement of people and goods to politicians. To read more on our Brexit strategy refer to page 50. Concerning trade wars, we will utilise our global presence and agility to assure that we take advantage of the possibilities new agreements give us, just as we will absorb the challenges that the current system presents to us.

We have a wide presence in emerging markets. Our international segment delivered strong growth rates since 2015. We expect this trend to continue in 2020 and beyond. In 2019 we further strengthened our position and secured local production capacity in the Middle East, our biggest strategic growth market by launching production in our newly acquired production site in Bahrain. In China, we work in partnership with a local dairy giant, Mengniu to satisfy the growing demand, and the sales of our organic early life nutrition products doubled in 2019.

# EMBRACING CHANGE (CONTINUED)

## DEMAND FOR A SUSTAINABLE DIET

TREND

- The majority of consumers are concerned about what they can personally do to help protect the environment, including eating more conciously (62 per cent in Europe, 59 per cent in the US)
- A growing number of consumers are willing to pay more for products that do less harm to the environment
- Plant-based alternatives to dairy are on the rise, projected to grow by 13% in the next two years

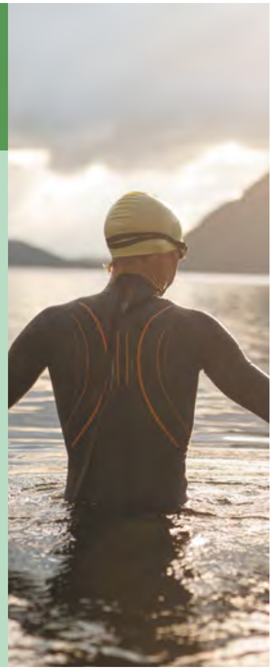
RESPONSE

At Arla we are aware of our footprint as a dairy company, and work very hard to reduce our negative environmental impact. In 2019 we introduced an industry-leading move in recyclable packaging, and we also launched out climate ambition of becoming carbon neutral by 2050. We already produce carbon net zero dairy products in Sweden under the Arla® EKO brand. To read more about our sustainability agenda turn to page 30.


## FAST CHANGING CONSUMER PREFERENCES

TREND

- Rushed lifestyles create a strong need for convenience and on-the-go meals
- The population in the developed world is aging and obesity is growing
- Healthy choices are the fastest growing in the food and beverages industry



RESPONSE

True to our vision to bring health to the word and inspire healthy food choices, our ambition is to bring the goodness of dairy to the global market. With our ambitious sustainability agenda, we are reclaiming dairy's place in a healthy and sustainable diet, while our innovation pipeline is full of affordable, convenient, nutritious and healthy products, such as our Arla&More line or our Arla® Explorers, offering sugar-free, nutritious products to the youngest. To read more about how we inspire healthy food choices, go to page 33.


## DIGITALIZATION IS CHANGING THE GAME

TREND

- E-commerce is the fastest growing area of sales, projected to grow by 47% in the next four years (but still likely to be small within grocery)
- Automatic reordering is expected to be the new norm in the FMCG industry in the next 5 years
- 58 per cent of average global consumers say they are on the internet constantly

RESPONSE

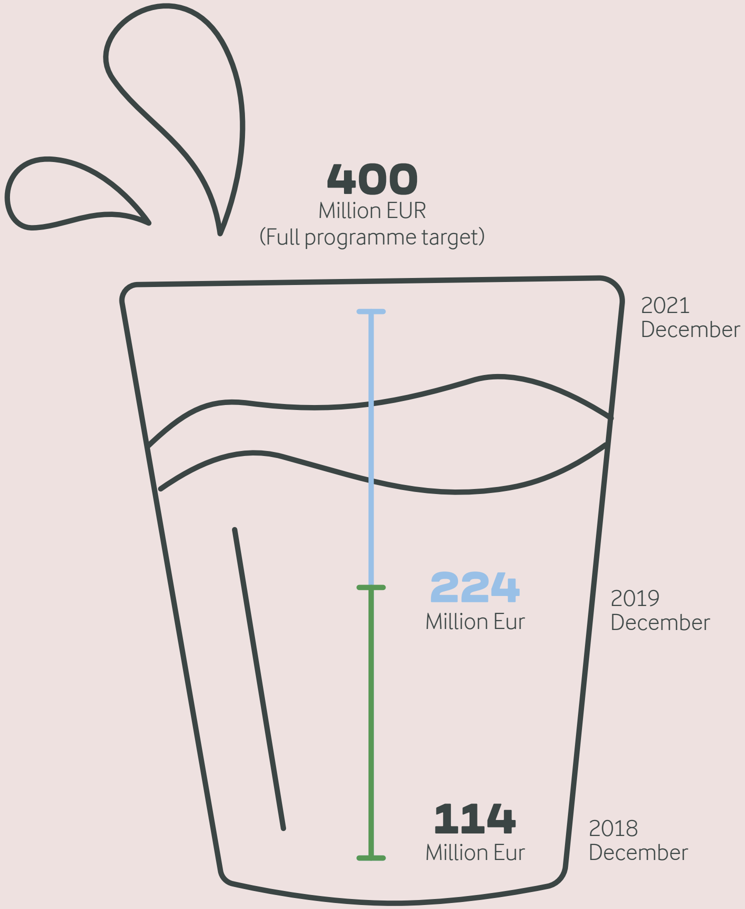
Our social media engagement reached 500 million in 2019, and we launched an array of digital marketing initiatives lead by our in-house creative agency, the Barn. We also launched an e-commerce platform for our customers in Denmark, where they can purchase products near to their expiry date, and plan to expand it to new markets in the near future..

# EMBRACING CHANGE FROM WITHIN Calcium

Changing fat and protein prices and major shifts in currencies in countries where we operate have impacted Arla's competitive position in 2016 and 2017. Therefore in 2018 we launched our transformation and efficiency programme, Calcium to accelerate our strategy by transforming the way we work, spend and invest. Calcium strengthens our bones, creates efficiencies and releases money to reinvest in our growth.

**110**

Million EUR saved in 2019
**Target 2019:** 75-100 Million EUR



# EMBRACING CHANGE FROM WITHIN Calcium

A new level of transparency by deep diving to the smallest details of our spend enables us to spend where it matters. We are significantly reducing costs that do not directly contribute to our products.

We have reduced air travel mileage by **18*** per cent, saving cost and $CO_2e$ emissions

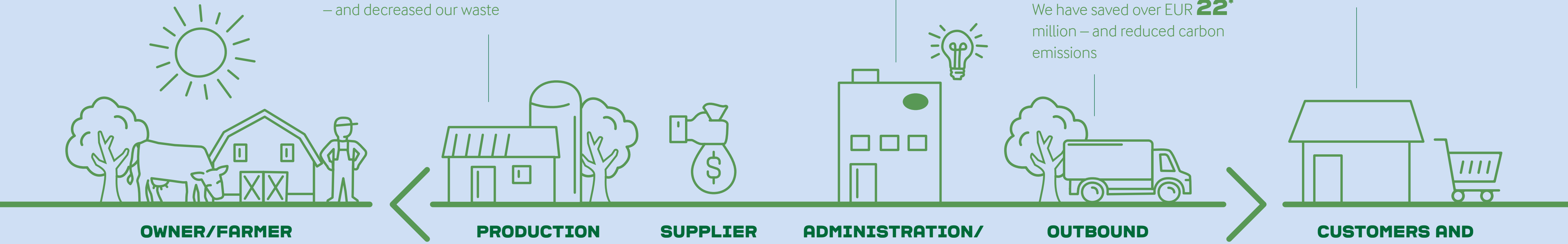
We are creating profound change at every site and in every role. We are shifting our focus to the efficiency of the individual production line and to overall equipment efficiency to ensure that no part of raw milk is lost. We are also reducing complexity and share more products across markets.

By reducing material losses we have saved EUR **65*** million – and decreased our waste

With the help of increased transparency into logistics data, we are optimising the distribution to the customers – route by route – creating value for us and our customers.

We have saved over EUR **22*** million – and reduced carbon emissions

Better service and more sustainable products for our consumers



**OWNER/FARMER** | **PRODUCTION** | **SUPPLIER** | **ADMINISTRATION/ SALES AND MARKETING** | **OUTBOUND LOGISTICS** | **CUSTOMERS AND CONSUMERS**

Savings and efficiencies used to improve milk price

We are signficantly reducing the number of suppliers and increasing compliance with ordering policies.

We have saved EUR **30*** million on better packaging contracts alone

We are spending less on developing campaigns and more on reaching consumers. Our content is now developed cheaper, faster and better in our in-house digital studios, the Barn. With the help of data we are also optimising our focused trade investments to enable our key account managers to make informed decisions.

We have reduced cost per reach by **50*** per cent with our in-house agency

** Figures on this page relate to savings accumulated since the start of Calcium in 2018.*

# ESSENTIAL BUSINESS PRIORITIES FOR 2020

### Deliver Calcium transformation

- Maintain momentum of ongoing projects
- Keep delivering supply chain savings
- Anchor the transformation beyond 2021

### Succeed with commercial priorities

- Maintain growth momentum in markets such as China, Nigeria, SEA and MENA
- Strengthen our European market and brand positions
- Minimise any negative impacts of Brexit

### Excite our people about the future direction of Arla

- Improve employee engagement
- Excite employees about our strategy beyond 2020

### Drive core brands and boost innovation

- Improve innovation impact
- Deliver big bets for our strategic brands
- Launch plant-based concept in Europe

### Build strong customer partnership and grow

- Deliver improved service levels
- Over-proportionately grow branded volumes with our top customers

### Take lead and execute sustainability agenda

- Accelerate climate performance on farm level with Climate Check programme
- Support branded growth with health and packaging innovations

### Grow Arla Foods Ingredients

- Secure the growth of early life nutrition products in China
- Grow value-added segment


# OUR BRANDS AND COMMERCIAL SEGMENTS

**Bringing organic child nutrition to China**
China was our fastest growing market in 2019 and represents a focus market within the international commercial segment. Arla is well-positioned in the country with our early life nutrition products, experiencing double digit growth both in volume and revenue, while bringing the goodness of organic nutrition to millions of Chinese babies.

# OUR BRANDS

Our philosophy of producing natural, healthy and high quality dairy products dates back to the 1880s when the first dairies in Denmark and Sweden were founded. The world turned around many times since, and our dairy products became branded, but one thing didn't change: we provide the world with healthy, nutritious food, naturally. Our brands are at the heart of our business and they drive the majority of Arla's profitability, therefore it is imperative to our success to constantly innovate and use the most effective digital tools to reach our consumers.

**Puck® is breaking into a new category**

Our strongest brand in the Middle East, Puck®, made the bold move of expanding to one of the largest and fastest growing dairy categories in the region, by launching Puck® Cream Cheese Squares in February. With this move Puck® conquered the rest of the breakfast table, where we already have a strong presence with the popular Puck® cream cheese in a jar. Blind consumer testing showed that Squares are well-liked by consumers, which was confirmed by the EUR 2.8 million in revenue in the first 12 months.


**10 years of steep growth for Starbucks™**

Over the last decade, Arla and Starbucks™ have successfully partnered via a license agreement, giving Arla the right to manufacture, distribute and market Starbucks™-branded premium ready-to-drink (RTD) coffee beverages in the EMEA region. The partnership continues to blossom with yet another year of double digits. Our Starbucks™'s RTD products are currently sold in 43 countries, Italy being the latest addition to the club, already exceeding our expectations with the sales levels. We also readily follow the ever-changing consumer habits: a new plant-based range was introduced early 2019 to address the growing group of vegans and flexitarian diet adopters. Starbucks™ Chilled Classics Almond Iced Coffee with an almond base was the first to be introduced in this line and will be followed with two exciting additions in 2020.


**Lurpak® pulled off the biggest innovation in butter packaging in 60 years**

Butter has been wrapped in foil since 1957, and a huge number of consumers found it impractical to use probably ever since then. Consumer research revealed 45% of shoppers agreed block butter packaging was "messy to use". Our relentless packaging innovation team cracked this problem by inventing a re-closable, mess-free box for our beloved Lurpak® butter, which was launched in the UK in September. The box addresses the consumer barriers and frustrations with block butter in foil, and gives consumers a reason to trade up. The product was well received in the UK and has been selected by 10.000 UK consumers as the 'Product of the year' in the dairy category.

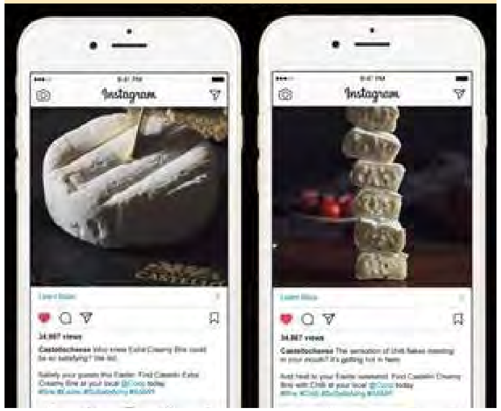

**Arla® Pro tapping into the flexitarian trend**

Being flexitarian means having the freedom to choose between meat-based and vegetarian dishes. Arla® Pro has launched a brand new flexitarian product called Arla® Pro Grilling Cheese across five European markets. This innovative solution has been developed together with customer chefs, targeting restaurants with burgers on the menu. Highly versatile, this cheese can be cut into tasty and perfect sized cheese patties for burgers – but can also be cut into cubes or sticks for wraps, appetizers and hot dishes. Arla® Pro Grilling Cheese comes in two delicious variants.

# OUR BRANDS (CONTINUED)

### New digital campaign helps Castello® race past 10 million engagement

In collaboration with our internal creative agency, The Barn, Castello® launched its first digital creative work in support of our white mould cheese, Creamy White in spring 2019. After going live in the UK, Sweden and Denmark, engagement levels grew six times higher than last years' benchmark, with over 3 million consumers viewing the content through digital channels such as Facebook and YouTube. As well as smashing historical engagement levels, the Creamy White content which was first off the production line for the new global campaign 'Feed Your Senses', and has helped trigger sales above forecast and create a positive momentum in our white mould business.




### What three YouTube influencers do on a dairy farm?

The influencer generation is often associated with glamourous urban lifestyle and superficial values. However, at Arla, our Swedish marketing department, together with an external creative agency decided to go against these preconceptions, and sent three of Sweden's most popular YouTubers to an Arla farm, to participate in a YouTube reality show, with a competition very much out of their comfort zone: they did tractor racing, farmhouse treasure hunting, and of course shared a lot of content with their followers about Arla® and the goodnesss of dairy. The five episodes of the show reached 889,000 viewers on YouTube, significantly above expectations, and all episodes had above-average audience retention rates (compared to the creative agency's benchmark).

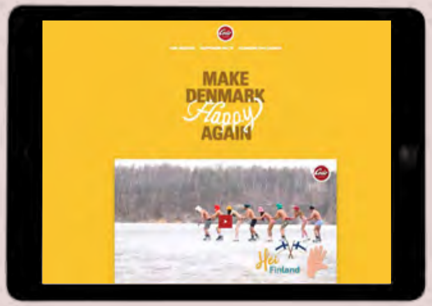
### Our brands hit 500 million digital engagements in 2019

In an effort to build trust and passion among consumers in a world with rapidly changing media consumption habits, our marketing organization managed to increase digital engagements more than five times in only three years. From a baseline of 82 million engagements in 2016 we reached 500 million engagements in 2019. This amazing result was driven by a mindset change within the brand teams, and also by our recently established internal creative agency, The Barn. Insourcing media buying and know-how significantly lowered the cost per reach, and increased media strategy sharing across markets.


MAKE DENMARK Happy AGAIN

### Cocio® helped make Denmark happy again!

Denmark was known as the happiest country in the world for years, and when other Scandinavian nations took over the leading spot Cocio® decided to do something about it. Our beloved chocolate milk's mission was twofold: besides making Danes happy, they also wanted to increase Cocio®'s saliency and consumption frequency. In the Make Denmark Happy Again campaign we launched a mission video and the single biggest sample activity in the brand's history, with over 44,000 samples given away in 4 weeks. Our video was loved by the audience: we achieved triple the impressions expected, it generated a lot of viral content, and the average viewer watched it almost 3 times. On top of that, our cost per view was 5 times cheaper than our internal benchmark.



# EUROPE

Our European commercial segment delivered strong performance with branded volumes growing of 2.9 per cent and record profitability for the region. This was driven by growth in the Arla brand, particularly in the ArlaPro™ Foodservice and Lactofree sub-brands. Our milk-based branded beverages, including Starbucks™ also grew at double-digit rates. We also took big steps towards reducing our carbon footprint, by improving packaging materials and launching carbon net zero dairy products in Sweden. The Calcium transformation journey is strengthening our competitiveness in Europe and is enabling us to retain a number of highly competitive retail contracts.

**Revenue, million EUR**

6,353

2018: 6,507

**Strategic branded volume driven revenue growth**

2.9%

2018: 2.5%

**Brand share**

53%

2018: 50.5%

**Strategic branded volume driven revenue growth by country**

UK

8.8%

2018: 4.1%

Germany

2.6%

2018: 6.5%

Denmark

0.4%

2018: 4.7%

Sweden

0.7%

2018: 0.6%

Netherlands, Belgium and France

5.2%

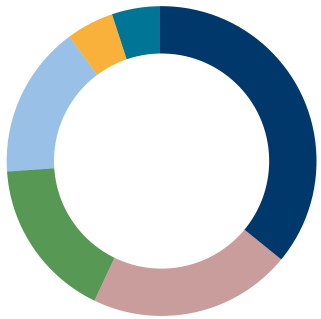
2018: 12.9%

Finland

3.2%

2018: 0.0%

**Revenue split by country, 2019**



| | 2019 | 2018 |
|---|---|---|
| UK | 36% | 35% |
| Sweden | 21% | 21% |
| Germany | 17% | 18% |
| Denmark | 16% | 16% |
| Netherlands, Belgium and France | 5% | 5% |
| Finland | 5% | 5% |

"OUR EUROPEAN COMMERCIAL SEGMENT HAD ANOTHER GREAT YEAR WITH STRONG BRANDED GROWTH AND MARKET SHARE GAINS IN THE COMPETITIVE EUROPEAN MARKETPLACE. WE SHOWED MOMENTUM IN ALL MARKETS – PARTICULARLY IN THE UK AND SCANDINAVIA. AND OUR STRATEGY TO BUILD SCALE BEHIND OUR BIG BRANDS AND INNOVATIONS IS CONTINUING TO PAY OFF."

Peter Giørtz-Carlsen,
Member of the Executive Board, and
Chief Commercial Officer, Europe

# EUROPE (CONTINUED)

## UK

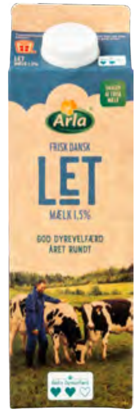
Our UK market had a stellar year of near double-digit branded growth amidst a backdrop of challenging industry dynamics, particularly within the liquid milk category. Revenue in the UK was EUR 2,283 million. The Arla®, Lurpak®, Castello® & Starbucks™ brands grew and consolidated their number one positions. Anchor® grew to become the UK's second preferred spreadable brand, following category leader Lurpak®. Our customers chose Arla as the best dairy supplier, and the fourth best supplier in Food and Drink. We continue to develop robust plans to deal with the potential outcome of the Brexit negotiations. Refer to page 50 for more detail.


## Germany

Germany successfully continued to improve the portfolio mix, strengthened the collaboration with retailers, and increased branded share. Revenue in the market was EUR 1,063 million. Germany fully embarked on our sustainability journey by growing organic sales with sustainable packaging solutions, lowering obsolescence cost, and joining the too-good-to-go initiative to combat food waste. The construction of a new powder tower in Pronsfeld marks the largest investment in German production sites in several years.


## Denmark

Arla's branded business continued to grow. in a market where dairy consumption is declining. Revenue in Denmark was EUR 1,000 million. Organic consumption continued to increase, with Arla building value into the category. We launched a new white milk concept 'Cows on Grass', and kicked-off Arla's sustainability strategy. As part of our Calcium transformation programme we invested in new yoghurt and skyr production capacity to serve the increasing demand in Denmark for organic products..




## Sweden

In 2019, against a backdrop of category decline, Arla Sweden delivered strong branded volume growth. Revenue in Sweden was EUR 1,348 million. Arla's focus on the sustainability agenda, spearheaded with the launch of the world first climate neutral milk, was acknowledged in the Sustainable Brand index with a ranking of 9 out of more than 300 companies in Sweden. Milk category decline has decelerated further due to the ongoing success of our "only milk tastes milk" campaign.


## Netherlands, Belgium and France

On our Dutch market Arla had the largest value growth within fresh dairy, with some key brands including Starbucks™, Arla® Lactofree and Melkunie® Protein driving double digit growth. The strong branded growth also continues in Belgium, following the successful launch of Arla® Skyr in 2018. Revenue in the region was EUR 319 million.


## Finland

Focus on innovation delivered strong branded growth in Finland, and a revenue of EUR 322 million. Growth was delivered across most of our main brands, but in particular with Arla® Lempi and Luonto+, with new sustainable packaging. Using artificial intelligence and blockchain in our digital solution "Arla Iris", we gave consumers opportunity to view varied and up-to-date information on the welfare of cows and the origin of milk Our foodservice business in Finland delivered strong branded volume growth with the Arla® Pro brand.

# INTERNATIONAL

Our international commercial segment delivered very strong results in 2019, with a branded volume growth of 10.3 per cent and increased profitability in nearly all markets. We significantly strengthened our position in the Middle East and North Africa with the integration of a Kraft®-licence business and a production site in Bahrain to our value chain, enabling further expansion in the region. Our various early life nutrition products, such as Arla® Baby&Me and Arla® PureGrow performed remarkably across markets from China to Indonesia, as did our family nutrition milk powders in Bangladesh and Nigeria, which outperformed the markets.

**Revenue, million EUR**

1,802

2018: 1,576

**Strategic branded volume driven revenue growth**

10.3%

2018: 4.6%

**Brand share**

82.7%

2018: 85.0%

**Strategic branded volume driven revenue growth by region**

Middle East and North Africa

7.0%

2018: 7.1%

West Africa

22.6%

2018: 6.5%

China

61.9%

2018: -8.0%

Southeast Asia

24.2%

2018: 26.0%

North America

-4.1%

2018: 6.7%

Rest of the world

6.1%

2018: 0.7%

**Revenue split by country, 2019**

| | 2019 | 2018 |
|---|---|---|
| Middle East and North Africa | 35% | 36% |
| Rest of the world | 26% | 23% |
| North America | 14% | 20% |
| South East Asia | 9% | 9% |
| China | 9% | 6% |
| West Africa | 7% | 6% |

**"2019 WAS ANOTHER STRONG YEAR IN INTERNATIONAL MARKETS, WITH DOUBLE-DIGIT BRANDED VOLUME GROWTH. BUILDING ON THE MOMENTUM CREATED IN 2019 WE ARE CONTINUING TO GROW IN 2020."**

Tim Ørting Jørgensen,
Executive Vice President, International

# INTERNATIONAL (CONTINUED)

### Middle East and North Africa

Our strategic agenda in the Middle East and North Africa progressed ahead of targets in 2019, despite political and economic instability, and strong price pressure in the region. Our branded volumes grew 7.0 per cent and profitability increased significantly. Revenue was EUR 637 million. The growth was mainly driven by our core brands in the region, Puck® and Lurpak®, and the Saudi Arabian market performing far above our expectations. We acquired and successfully integrated the Kraft®-licence business from Mondeléz International in 2019, already delivering results above the original business case. Going forward, our new production site in Bahrain will be a strong foundation for expanding our opportunities in MENA.


### West Africa

In 2019 we delivered strong growth for our strategic brands in the region at 22.6 per cent, mainly driven by our biggest market, Nigeria. Here we also started a cooperation with local farmers to help them increase their production. We also rapidly expanded our business in Ghana and Senegal with launches in the flavoured milk, cheese and spreadable segments. Revenue in the region was EUR 123 million.


### China

China delivered remarkable branded volume growth and profitability in 2019. Branded volume growth was an extraordinary 61.9 per cent. Revenue was EUR 152 million. Our milk segment grew above market, and our organic early life nutrition brand, Arla® Baby&Me delivered double digit growth both in volume and revenue. We received the authorization to sell two other types of early life nutrition, Arla® Blue Dawn and Arla® Milex, which were also well received by consumers. Furthermore, we finalised a sales joint venture set up that enables us to capture the potential of the Chinese cheese market.


### South East Asia

South East Asia has delivered another year of strong growth in 2019. Revenue amounted to EUR 171 million. We saw market share increases in the key branded positions, most notably in Bangladesh where the Dano brand delivered 9.9 per cent branded volume growth. In the food service channel Arla® Pro delivered solid growth by offering new solutions for selected channels and key customers. Organic is a key focus in SEA; in 2019 we launched the first organic early life nutrition brand – Arla® PureGrow – in Indonesia. The consumer and customer response has been very positive so far.


### North America

For our US market 2019 was about shifting our strategic direction to ensure a more stable growth course. As a result, branded volumes in the region declined by 4.1 per cent, despite a 3.1 volume growth in Canada. Revenue was EUR 254 million in the region. In line with our transformation and efficiency programme, Calcium, our supply chain is also showing increased efficiency,


### Rest of World

We also delivered strong results in the rest of the countries where our products are sold. Branded volume grew 6.1 per cent, and revenue was EUR 465 million.. The growth was driven mainly by the success of Starbucks™, which also gained traction in new Central European markets, and by Lurpak® in Australia and our distributor markets. Our Russian sales performed ahead of expectations.

# ARLA FOODS INGREDIENTS

Arla Foods Ingredients' (AFI) mission is to discover and deliver all the wonders whey can bring to people's life. AFI is a global leader in whey-based ingredients used in a wide range of categories from infant, clinical and sport nutrition to bakery, beverages and dairy. In addition, we manufacture child nutrition products for third parties.

AFI has a history of delivering solid growth, and 2019 was no different with double digit sales growth and improved profitability. Our performance was strong, although the ongoing trade war between China and the US negatively impacted our results, especially within the child nutrition manufacturing business.

## Product differentiation is key

AFI's core customers request even more product differentiation than before. We bring unique protein and lactose solutions with considerable added value to our customers. Our products provide proteins for clear beverages in sport nutrition, protein fractions and lactose for infant formula getting even closer to mimicking human milk, and solutions for food applications with unique functional properties.

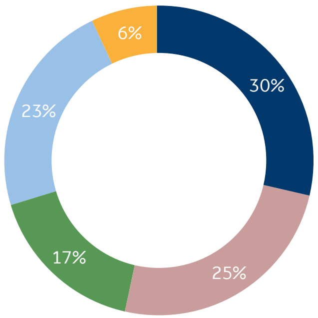
In 2019 all of our business units within the ingredients segment – pediatric, health & performance and food – continued to increase sales. Our child nutrition business however experienced lower revenue due to repercussions from the major changes in Chinese infant formula regulations, which kept our products off the market for over a year. Nevertheless, we continued with our strategy aiming to continously grow our child nutrition products, which included investing in significant capacity increases to supply the strong global demand for organic child nutrition.

## AFI highlights in 2019

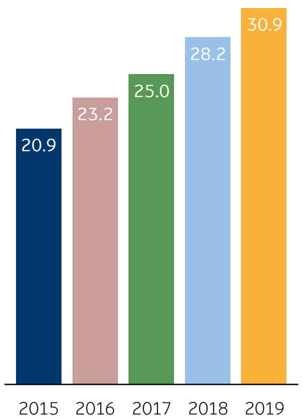
- In 2019, we started operations in our new infant milk formula (IMF) plant at Arinco, and this will ensure supply for our rapidly growing organic infant milk formula business.
- We launched a unique new product, Lacprodan® ISO.Water, a 100 per cent whey protein ingredient that helps clear protein waters taste good, and does not leave a dry mouthfeel.
- Our alpha-lactalbumin product used in infant formula, Lacprodan® ALPHA-10 was approved by the US Food & Drug Administration. This enables AFI to supply the US market with alpha-lactalbumin enriched infant formula, which emulates human milk more closely and has a wide range of health benefits.
- Construction of our new Innovation Centre in Nr. Vium has been started, and once completed it will become a world-leading centre of whey research. It will operate in close cooperation with our key production site, Danmark Protein. Construction will be completed by 2021.
- We have also made progress on several important projects to increase our raw material supply, most of which are expected to continue into 2020. However, we were forced to pause our projects in the US with Foremost Farms.
- In 2019, we initiated a strategy to further improve our quality and food safety. The objective is to position AFI as the leading force in quality and food safety and to support a close and committed relationship with our customers based on these qualities.

2019 was an eventful year in AFI, and looking into 2020, growth remains at the top of our agenda with large investments set to be completed, and a considerable increase in whey supply is also expected.

**Revenue split by segments**




**Development of value added sales volumes** (MT)




**Revenue, million EUR**

710

2018: 652

**Growth of value add products**

9.4%

2018: 12.8%

**Value add share**

68.5%

2018: 65.7%

# 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. We refer to these activities as trading, 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 variability in milk intake, ensuring that we are able to process and sell all the milk our members deliver, whilst maintaining the availability of the milk that our branded, retail and foodservice businesses require.

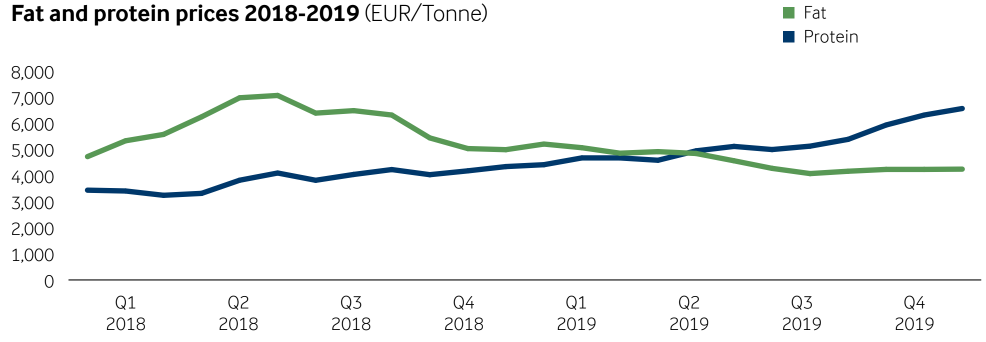
Our strategic decision to increase trading capacities in higher value commodities, such as mozzarella and fat-filled milk powder, which came on line towards the end of the year, strengthens our business. It gives us more options in managing our milk pool and helping to reduce our exposure to low-margin private label contracts.

The share of overall milk volumes sold through the trading business decreased to 25.0 per cent from 26.5 per cent compared to last year.

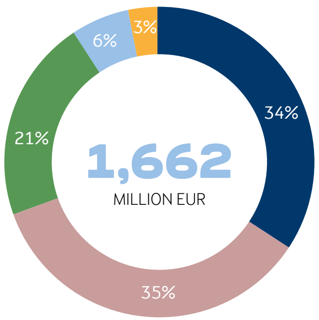
Revenue from trading* slightly decreased to EUR 1,662 million compared to EUR 1,690 million last year, representing 15.2 per cent of total revenue for Arla in 2019.

The major shift in commodity markets in the year has been the increase in protein prices in the second half of the year as global demand increased. This, coupled with continued weakening in fat prices has meant that fat and protein values are returning to their long term historical relationship. For most of the year, the increasing protein prices offset the reducing fat prices, meaning commodity milk prices held relatively stable. Towards the end of the year we also saw prices strengthening, especially in the cheese and powders segments.

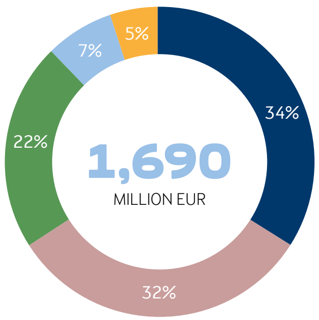
**Fat and protein prices 2018-2019** (EUR/Tonne)




**Revenue split by product categories, 2019**




**Revenue split by product categories, 2018**




Raw milk Powder Cheese Butter Other

*For reporting purposes revenue from trading also includes revenue from other sales activities, such as the sales of school milk through the Danish Dairy Board. The addition is virtually immaterial.*

# OUR RESPONSIBILITY

**Arla farmers are using big data to combat climate change**

Arla was the first dairy company in Europe to introduce a comprehensive Climate Check programme across seven countries that will triple the speed of $CO_2e$ reductions on farms and accumulate one of the world's largest sets of externally verified climate data from dairy farming. Climate assessments will help farmers identify emissions on farms and provide a clear picture of the actions farmers can take to reduce emissions further. The programme includes a digital reporting tool, in which all farmers will submit their climate data. The data is verified by an external advisor who will visit the farm to provide advice on action plans.

# OUR SUSTAINABILITY STRATEGY

The biggest challenge for the food industry is how to feed a growing world population, sustainably. At Arla we believe that dairy is part of the solution. Our healthy products satisfy a range of nutritional needs across generations and continents with constantly reduced environmental impact. We are guided by our comprehensive sustainability strategy inspired by the United Nations Sustainable Development Goals, and we are committed to make both the planet and people stronger.

## STRONGER PLANET

### Sustainable farming
- Increase feed and resource efficiency
- Enhance and track animal welfare
- Conduct carbon assessments on all Arla farms
- Step-up carbon sequestration
- Support research and innovations into sustainable dairy farming

### Carbon net zero operations
- Switching to renewable energy sources at sites and in offices
- Switching to fossil free fuels in transportation of raw material and products
- Increase energy efficiency
- Increase the use of biogas
- Support innovation to achieve our goals

### Minimising food waste
- Strengthen collaboration with value chain to minimise waste in production
- Campaigns for food waste reduction targeting consumers

### Sustainable packaging
- Upgrade product packaging to be renewable, recyclable or reusable
- Constant innovation in packaging
- Stronger collaboration within the value chain to reduce packaging waste

### Protecting nature
- Increase biodiversity and access to nature
- Initiatives to support clean air and water
- Source responsibly

## STRONGER PEOPLE

### Health and nutrition
- Follow our Nutrition Criteria to bring healthy foods to consumers
- Invest in research on how to improve nutritional value without compromising on quality and taste
- Develop new products based on research findings

### Food inspiration
- Organise open farm days to connect consumers and farmers
- Educate consumers about healthy diets
- Organise food festivals and camps to educate consumers on how to eat more sustainably

### Supporting communities
- Develop local dairy value chains
- Inspire innovative partnerships with local customers and consumers
- Reach consumers in regions where access to good nutrition is challenged

### Caring for people
- Live by the Arla values
- Keep our colleagues safe and healthy
- Provide a diverse and inclusive workplace with equal chances for all
- Engage our colleagues to be interested in the future of Arla and dairy



For in-depth information about our sustainability strategy, read our CSR report.

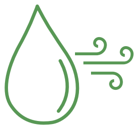
# OUR ENVIRONMENTAL AMBITION

Together with our 9,759 farmer owners we launched our ambitious climate targets in March 2019. These targets are part of our broader environmental ambition to create a stronger planet by accelerating the transition to more sustainable dairy production, with intensified focus on decreasing emissions on farms. Our main target is to reduce greenhouse gas emissions by 30 per cent per kilo of milk over the next decade, and to work towards becoming carbon net zero by 2050.

## OUR AMBITION COVERS THREE THEMES

**Better climate**


**Clean air & water**



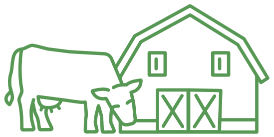
Nitrogen and phosphorus cycles in balance

**More nature**

Increase biodiversity and access to nature

## TO REACH OUR GOALS WE WILL FOCUS ON THREE AREAS

**Farms**



- Optimized feed for the cows to decrease methane emissions
- Improved manure efficiency
- Improved carbon capture in the soil on farms

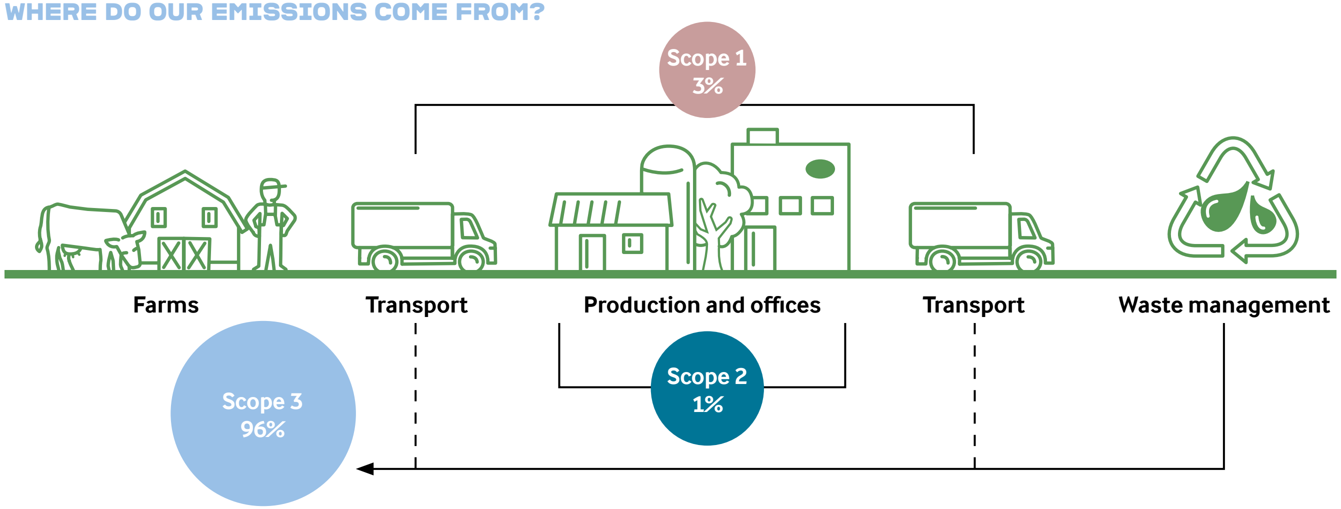
**Production**

- Increased fossil free transportation
- Increased use of energy-efficiency technologies
- Increased use of renewable energy in supply chain

**Packaging and food waste**

- Improved sustainability of packaging
- Decreased food waste through several initiatives
- Increased use of recyclable materials

## WHERE DO OUR EMISSIONS COME FROM?




Scope 1 emissions relate to the activities under our direct control. They include transport with Arla's vehicles, and emissions from Arla's production facilities. **We have reduced our $CO_2$ emission from production, packaging and transport by 25 per cent since 2005.**

Scope 2 emissions are the indirect emissions caused by the energy that Arla purchases, i.e. electricity, steam, heating or cooling. We are working towards reducing our impact by increasing the use of renewable energy. **In 2019 33 per cent of our overall energy consumption came from renewable sources.**

Scope 3 emissions are the indirect emissions from purchased goods and services (e.g raw milk from our owners, packaging and external transport)), but also from waste handling (eg. recycling) at our sites. **Since 1990 we reduced our $CO_2$ footprint per kilo of milk by 23 per cent.**

Read more about our efforts to reduce our carbon footprint on page 123.

# SUSTAINABLE DAIRY FARMING

Our farmer owners produce around 13 billion kilo of milk each year. Arla milk is already some of the most climate efficient in the world, with a $CO_2e$ emissions intensity approximately half of the global average. As we understand more about climate change and how to fight it, we must evolve even further, and with even greater urgency. Our on-farm Climate Action Plan is being implemented to improve on the effective programmes we already have in place.

**Evolving Arlagården®**
Arlagården initially focused on milk quality, food standards and tracking animal welfare, but since 2019 we strengthened it even further. Our revised standards drive improvements and bring greater transparency in critical areas, while incorporating the environmental and animal welfare priorities of today's consumers and governments. Self-assessment of herd management and documentation practices as well as facilities and procedures are being completed every 3 months, and farms receive an external audit at least every 3 years. Risk audits to address suspected problems and 48-hours notice random spot checks were also introduced.

**Climate checks on all farms**
Our previous Climate Check model has already helped many farmers. In support of our sustainability targets, from 2020 our Climate Check programme will be further strengthened, globally aligned and offered to all Arla farmer owners, who will receive an incentive of 1 eurocent per kilo of milk to have their farms checked. With our new, state-of-the-art digital farm management platform farmers will gather data across key emissions areas, including feed type, energy use, fertilizer use, and manure storage and application. When farmers submit their data to the system, they receive a detailed picture of their farm's carbon footprint, and an advisory visit from an external emissions specialist to provide guidance on how to reduce emissions.

**A new digital farm management platform**
To streamline the updated Arlagården® and the Climate Check processes a new digital platform was developed in a close collaboration with famer owners. Secure and easy to use, the platform gathers robust information that evidences our standards and achievements as well as providing insight that can be used by farmer owners, the wider business and advisors supporting the farmers to make informed change. Gathering detailed, high-quality data from 9,759 owners across 7 different countries also means we are creating one of the richest sources of dairy industry data, that can be utilized by researchers to fight climate change.

**"WE'RE EXTREMELY PRIVILEGED TO BE CUSTODIANS OF OUR ENVIRONMENT AND WE SHOULD FIGHT TO PROTECT IT. TOGETHER WE HAVE THE RESPONSIBILITY TO ENSURE THAT WE MINIMISE THE IMPACT OF FARMING TO ENSURE FUTURE GENERATIONS CAN CONTINUE TO FARM THE LAND. AS AN ARLA FARMER I WANT TO LOOK AFTER THE ENVIRONMENT WHILE PRODUCING A FANTASTIC AND NUTRITIOUS PRODUCT IN THE MOST EFFICIENT WAY I CAN."**

Patrick Morris-Eyton, UK farmer owner

# INSPIRING SUSTAINABLE DIETS

We believe that dairy products play a positive role in a sustainable diet, balancing the environmental impact of production with the nutritional value of the food. Our commitment to promote and offer nutritious and affordable dairy products around the world is a core element of our new sustainability strategy. To support better food choices and make people stronger, we constantly improve our product portfolio with healthier variants. Here we present some examples launched in 2019.

### Let's start with the youngest ones ...

Healthy diets start with conscious parents choosing the best, most natural products for their babies. We aim to provide parents with the right choices everywhere. Following a global trend, modern Indonesian millennial parents are seeking more organic options for their children. We were first in the market to help them in their quest by launching our organic baby formula under the Arla® Baby&Me brand, and a growing-up milk for toddlers aged 1 to 3. Both products are fortified with vitamins and minerals, and contain no added sugar.


### ... then continue as they grow

We also have an ambition to get kids to intuitively choose better food, and to do this, we decided to not only make healthier great tasting products but also make the product experience more fun so that kids would want to try them. In 2019 the Arla® brand expanded its youghurt portfolio with the launch of Arla® Explorers in Denmark and the UK. Made using only natural ingredients and real fruit, it features a range of yoghurt variants, all containing at least 30 per cent less sugar than a standard flavoured yoghurt. The new range is in line with our philosophy around empowering the next generation to have a better relationship with food whilst also addressing growing consumer concerns around sugar and use of artificial ingredients.


### ... and feed the busy adults as well!

Modern active lifestyles also mean changing eating patterns, where consumers more often are having several small meals and snacks rather than only three big meals per day. Our new ready-to-eat products support this habit, by turning snacking into something healthy. New skyr products with fruit and seeds were launched in Germany, the Netherlands, Sweden and Finland in 2019. High in protein, reduced sugar, fat free and simply delicious, each small pot is layered with a thick and creamy skyr yogurt mixed with buckwheat, sunflower and poppy seeds over a fruit puree.

# OUR GOVERNANCE

**Skills and expertise of our Board of Directors**
Our Board of Directors  initiated and executed a thorough investigation into their skills and expertise before the election period in May 2019. The process, in which the BoD defined the necessary skills to be qualified leaders for Arla, was supported by external experts in executive evaluation.

# GOVERNANCE FRAMEWORK

Arla is a cooperative owned by 9,759 dairy farmers in seven countries. Ensuring that all of our owners' voices are heard and represented is essential for success and trusting relations. Our owners elect members to the Board of Representatives, which in turn elects the Board of Directors. The company's governance is shared between these elected bodies and the Executive Management Team.

**COOPERATIVE GOVERNANCE**

**OWNERS (FARMERS)**

**OWNER NATIONALITIES**

Denmark, Sweden, Luxembourg, Belgium, Germany, The Netherlands, United Kingdom

**DISTRICTS**

**LOCAL REPRESENTATIVES**

**REGIONS**

**BOARD OF REPRESENTATIVES**
175 (+12 employee repr.)

77 DK members | 50 SE members | 23 CE members | 25 UK members

**OUR BOARDS AND COUNCILS**

Area council (Denmark)

Area council (Sweden)

**BOARD OF DIRECTORS**
15 (+3 employee repr.
+ 2 external advisors)

Area council (Luxembourg, Germany, Belgium, The Netherlands)

Area council (United Kingdom)

**COOPERATIVE GOVERNANCE**

**EXECUTIVE BOARD**
CEO + CCO

**EXECUTIVE MANAGEMENT TEAM**
Executive board + 5 officers

**19,174 EMPLOYEES**

# GOVERNANCE FRAMEWORK (CONTINUED)

## COOPERATIVE GOVERNANCE

Arla's democratic structure gives decision-making authority to the Board of Directors (BoD) and to the Board of Representatives (BoR). Their primary tasks are to develop the ownership base, safeguard the cooperative democracy, embed decisions and develop leadership competencies amongst farmer owners, and set the overall strategic direction for Arla.

### Owners

In 2019, 9,759 milk producers in Sweden, Denmark, Germany, the UK, Belgium, Netherlands and Luxemburg were the joint owners of Arla. Last year, the cooperative had 10,319 joint owners. The decline in the number of farmers is partly due to farmers who stopped producing milk, or had their business acquired by another member, and to a lesser extent due to famers resigning to supply another dairy company. This decline is in line with the trend seen in the whole dairy sector over a number of years. All cooperative owners have the opportunity to influence significant decisions.

### District councils

Each year, cooperative owners convene for a local annual assembly in their respective countries to ensure democratic influence of the cooperative owners in the owner countries. The members in the district council elect members to represent their district on the BoR.

### Board of Representatives

The BoR is the supreme decision making body comprising 187 members, of whom 175 are cooperative owners, and 12 are employee representatives. Owner representatives are elected every other year in odd years. The last election took place in May 2019, when 55 new members were elected to the BoR. The BoR makes decisions including appropriation of profit for the year and elects the BoD. The BoR meets at least twice a year.

### Board of Directors

Appointed by the BoR, the BoD is responsible for strategic direction setting, monitoring the company's activities and asset management, maintaining the accounts satisfactorily and appointing the Executive Board. The BoD is also responsible for ensuring that Arla is managed in the best interest of the farmer owners and making decisions concerning the ownership structure. They also take care of other stakeholders' interests in the company: lenders, investors in bond instruments and employees, among others. The BoD consists of 15 elected farmer owners, three employee representatives and two external advisors. In the 2019 election cycle four new elected members joined the BoD, and two external members were also appointed to ensure that the BoD's skill set covers all important areas for leading an international business. The composition of the elected memembers of the BoD reflects Arla's ownership structure across the countries.

### Area councils

Arla has four area councils that are sub-committees of the BoD and consists of members of the BoD, as well as members of the BoR. 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.

## CORPORATE GOVERNANCE

Corporate governance in Arla is shared between the Executive Board and the Board of Directors (BoD). Together they define and ensure adherence to the company's strategic direction, 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. The Executive Board is usually comprised of the CEO and another member of the Executive Management Team. From 1st February 2019, Chief Commercial Officer for Europe, Peter Giørtz-Carlsen was appointed to enter the Executive Board.

### Executive Management Team

The Executive Management Team (EMT) is appointed by the Executive Board. The EMT is responsible for Arla's day-to-day business operations, preparing strategies and planning the future operating structure. The EMT consists of the Executive Board plus four functional experts and one commercial leader. The functional experts cover the management areas of Finance, IT and Legal (CFO), Marketing and Innovation (CMO), Human Resources (CHRO), and Supply Chain (COO); while the commercial leader is responsible for our international commercial segment. The members of the EMT keep each other informed on all significant developments in their business area and align on all cross-functional measures.

### Employees

Arla has 19,174 full time equivalents (FTE) globally, compared to 19,190 last year. Our employees are represented by three members in the BoD and 12 members in the BoR.

# DIVERSITY AND INCLUSION

At Arla we are committed to creating a place where our people can bring their authentic selves to work every day. Diversity and inclusion are imperative to the success of our business and we know that a diverse and inclusive workforce generates innovation and stronger results. We define diversity broadly as differences between people with a diverse range of backgrounds, while inclusion is about valuing differences among individuals.

### Our principles

- To secure a stronger leadership pipeline and improve opportunities for all to advance, we aim for no more than 70% of the same gender in any given team.
- To better represent our global consumers and the global nature of our company, we aim for no more than 70% of the same nationality in any given team.
- We welcome multiple generations in our workforce with attractive working conditions for both young and old. We aim for no more than 70% of the same age group in any given team.
- We recognise that within some lines of work, especially within our blue-collar workforce, we often face a less-diverse supply of labour, which makes it difficult to reach our aim.

Here are our strategic priorities for achieving a more diverse workforce and creating an inclusive environment, where colleagues are included and treated with openness and mutual respect, recognising and harvesting the benefits of diversity.

### Competency development

We offer training to our people managers and talent acquisition partners regarding unconscious bias awareness, to promote unbiased selection and people assessment.

### Recruitment

Hiring managers and talent acquisition partners must adhere to the systems, structures and processes defined in our Global Recruitment Policy to select the best candidate based on merit. We require all executives to be recruited from a pool of candidates which includes both genders and more than one nationality. To support a fair and unbiased hiring process, the talent acquisition partners are there to ensure compliance with the recruitment process and policy.

### People review and fair pay

We strive to offer a fair and competitive remuneration at market level and in line with local legislation, and have a structured approach to remuneration ensuring that salaries are unbiased towards gender, age, seniority, tenure or nationality.

### Talent programs

Our high potential talents are identified, developed and retained based on merit. We proactively ensure a balanced gender and nationality distribution in our talent programs when selecting candidates to fuel a diverse leadership pipeline.

### Building internal communities

In 2017 employees dedicated to creating a more diverse and inclusive workplace launched a global employee resource group, the Arla Diversity & Inclusion Network.

The Network is endorsed and supported by the management, and had many activities in 2019, including:

- A discussion panel with external speakers live-streamed globally to understand how we can drive more inclusion & diversity globally also in terms of LGBT+ representation
- Establishment of an internal forum for all people to come and ask questions, offer support or help with any activities regarding D&I
- Organised an event to support and inspire working mums, where working mums in more senior roles talked about their experience
- Launched an interview series with internal role models and D&I ambassadors so that others can be inspired and encouraged to be out and proud in the workplace

### Monitoring

We are committed to report on our progress towards our long-term diversity and inclusion goals to our Executive Management Team and externally on a regular basis. The diversity of our workforce is reported annually and published as part of our annual report.

**"ARLA RUNS A GLOBAL BUSINESS, AND WE BELIEVE THAT DIVERSE TEAMS COMBINING INHERENT DIVERSITY – SUCH AS GENDER, AGE, NATIONALITY, ACQUIRED KNOWLEDGE AND SKILLS – ARE KEY FOR US, IN ORDER TO UNDERSTAND AND MEET THE NEEDS OF OUR CONSUMERS AND CUSTOMERS."**

Ola Arvidson, Chief Human Resources Officer

# DIVERSITY AND INCLUSION (CONTINUED)

As part of our commitment to accelerating diversity and inclusion, each year we publish the demographics of our workforce by gender, age and nationality. Transparency is critical to achieving our goal of becoming an inclusive and diverse company. While we have made good progress in this direction, we know there is more work to do.

## Gender distribution*


Female

**42%**

2018: 42%


Male

**58%**

2018: 58%

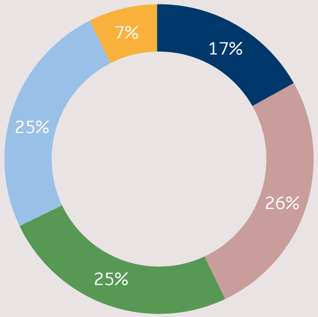
** This is the gender ratio in the white collar workforce. Gender ratio in blue collar workforce: female: 18%; male: 82% ; and in Arla in total: female: 27%; male: 73%.*

## Gender distribution in management

| | Female | | Male | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| EMT | 29% | 29% | 71% | 71% |
| BoD** | 20% | 13% | 80% | 87% |
| BoR | 16% | 13% | 84% | 87% |
| Director+ level | 26% | 23% | 74% | 77% |

*** The presented ratio pertains to all the members of the BoD (20), including employee representatives and external advisors. Gender ratio among members elected by the general assembly is 13 per cent female, 87 per cent male, unchanged from last year.*

## Age distribution

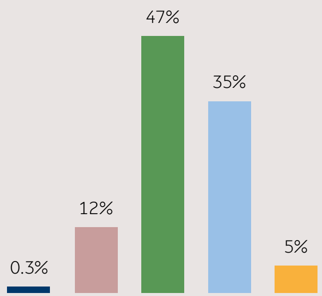



<30 30-39 40-49 50-59 >60

## Diversity in teams, Age*

**85%**

## Age distribution on the director+ level

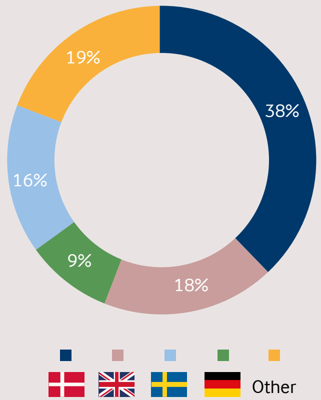



** Percentage of teams that have members from at least two age categories.*

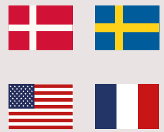
## Total number of nationalities

**108**

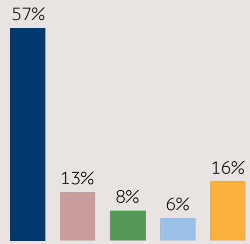
## Split between nationalities




## Nationalities in the EMT



## Nationality distribution on the director+ level




## Diversity in teams, nationality*

**30%**

** Percentage of teams that have member from at least two nationalities.*

# OUR BOARD OF DIRECTORS

Our Board of Directors has a wealth of knowledge, consisting of 15 elected farmer owners, three employee representatives and two external advisors. 2019 was an election year, hence we welcomed 4 newly elected members to the BoD: René Lund Hansen, Marcel Goffinet, Jørn Kjær Madsen, and Walter Lausen. For the first time in the history of our Board, two external advisors also joined the board: Florence Rollet, a venture partner with LuxuryTechFund in Paris, and Nana Bule, CEO of Microsoft in Denmark.

From left to right: Harry Shaw, Manfred Graff, Jørn Kjær Madsen, Marcel Goffinet, Steen Nørgaard Madsen, Håkan Gillström, Simon Simonsen, Heléne Gunnarson, Arthur Richard Fearnall, Jan Toft Nørgaard, Johnnie Russell, Janne Hansson, Florence Rollet, Jonas Carlgren, René Lund Hansen, Inger-Lise Sjöström, Bjørn Jepsen, Walter Lausen, Nana Bule

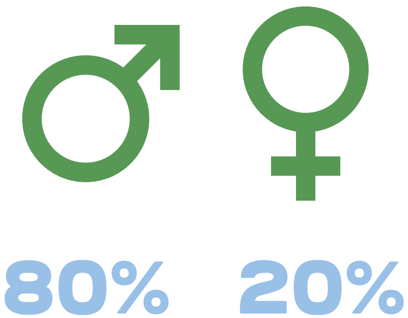
# OUR BOARD OF DIRECTORS (CONTINUED)

Our board's diverse range of skills and experiences supports the effective governance and robust decision-making of Arla. In 2019 a new process for a thorough competency evaluation of the members was introduced, which ensures that the BoD has the right skills to conduct good global governance. As a result of the process, two external advisors joined the board, who bring digital, marketing and technology expertise to compliment the strong commercial and farming knowledge of its elected board members.

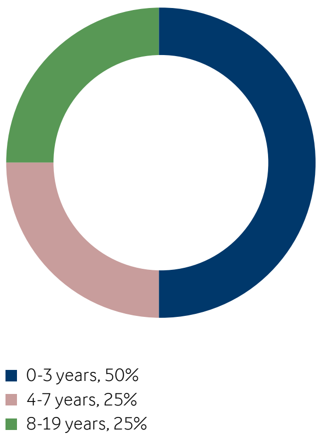
## COMPETENCIES OF THE BOARD

The competency evaluation was facilitated by external executive assessment experts. The members of the board defined the necessary skills for leading Arla, and then Evaluation Committees constituting of farmer owners evaluated all candidates across those dimensions. The process was transparent and approved by the Board of Representatives.

**Diversity in the board***




**Tenure**




*The ratio pertains to all members of the BoD (including employee representatives and external advisors). Gender ratio within the elected members is 13 per cent female, 87 per cent male. In accordance with section 99b of the Danish Financial Statements Act, in 2019 Arla has set a 4-year target to achieve a female representation in the general assembly members of the Board of Directors of at least 13 per cent, reflecting the gender ratio of our Board of representatives.*

### JAN TOFT NØRGAARD (1960)

**Member since:** 1998
**Nationality:** Danish
**Profession:** Dairy farmer
**Internal positions:** Chairman of the Board Learning and Development Committee Remuneration Committee
**External positions:** Comp. Board of the Danish Agriculture and Food Council 2009 -

### HELÉNE GUNNARSON (1969)

**Member since:** 2008
**Nationality**: Swedish
**Profession:** Dairy farmer
**Internal positions:** Vice chairman of the Board Global Training Committee, Learning and Development Committee, Remuneration Committee
**External positions:** Member of the Swedish Dairy Association 2014 -, Member of the Board of Varbergs Sparbank

### NANA BULE (1978)

**Member since:** 2019
**Nationality:** Danish
**Profession:** CEO of Microsoft Denmark & Iceland
**External positions:** Member of the Board of Energinet 2018 -, Member of the Board of Confederation of the Danish Industry 2019 -

### JONAS CARLGREN (1968)

**Member since:** 2011
**Nationality:** Swedish
**Profession:** Dairy farmer
**Internal positions:** Global Appeals Committee, Remuneration Committee
**External positions:** Chairman of the Board of the Swedish Dairy Association 2013 -, Member of the Board of the Swedish Farmers' Foundation for Agricultural Research 2016 -, Dairy Ambassador for UN High Level Political Forum

### ARTHUR FEARNALL (1963)

**Member since:** 2018
**Nationality:** British
**Profession:** Dairy farmer
**Internal positions:** Chairman of the Arla UK Area Council, Global Appeals Committee

# OUR BOARD OF DIRECTORS (CONTINUED)

**HÅKAN GILLSTRÖM** (1953)
**Member since:** 2015
**Nationality:** Swedish
**Profession:** Dairy worker
**External positions:** Member of the Swedish worker's union

**MARCEL GOFFINET** (1988)
**Member since:** 2019
**Nationality:** Belgian
**Profession:** Dairy farmer
**Internal positions:** Global Appeals Committee
**External positions:** Chairman of the Board of Agra Ost Agriculture Research, member of the municipal government of St.Vith

**MANFRED GRAFF** (1959)
**Member since:** 2012
**Nationality:** German
**Profession:** Dairy farmer
**Internal positions:** Chairman of the Arla Germany Area Council, Learning and Development Committee Remuneration Committee
**External positions:** Member of Board of the German Milch NRW 2007 -, Member of Board of the German Federation of Cooperatives 2015 -

**RENÉ LUND HANSEN** (1967)
**Member since:** 2019
**Nationality:** Danish
**Profession:** Dairy farmer
**External positions:** Member of the cattle section and the Comp. Board of the Danish Agriculture and Food Council 2019 -, Member of the Board of Agri Nord 2012 -

**JAN ERIK (JANNE) HANSSON** (1963)
**Member since:** 2018
**Nationality:** Swedish
**Profession:** Dairy farmer
**Internal positions:** Chairman of the Global Organic Committee
**External positions:** Member of the Board of the Swedish Dairy Association

**BJØRN JEPSEN** (1963)
**Member since:** 2011
**Nationality:** Danish
**Profession:** Dairy farmer
**Internal positions:** Global Organic Committee
**External positions:** Member of the cattle section of the Danish Agriculture and Food Council 2009 -, Member of the Board of the Danish Cattle Levy Fund 2009 -, Member of the Board of the Danish Milk Levy Fund 2019 -, Vice Chairman of Skjern Bank 2012 -, Vice Chairman of the Danish Dairy Board 2019 -,

**WALTER LAUSEN** (1959)
**Member since:** 2019
**Nationality:** German
**Profession:** Dairy farmer
**Internal positions:** Global Organic Committee

**JØRN KJÆR MADSEN** (1967)
**Member since:** 2019
**Nationality:** Danish
**Profession:** Dairy farmer
**Internal positions:** Global Appeals Committee

**STEEN NØRGAARD MADSEN** (1956)
**Member since:** 2005
**Nationality:** Danish
**Profession:** Dairy farmer
**Internal positions:** Arla Denmark Area Council Chairman Learning and Development Committee
**External positions:** Deputy Chairman of the Comp. Board of the Danish Agriculture and Food Council 2014 -, Chairman of the Agro Food Park steering committee 2016 -, Chairman of the Danish Milk Levy Fund 2012 -, Chairman of the Danish Dairy Board 2012 -

**IB BJERGLUND NIELSEN** (1960)
**Member since:** 2013
**Nationality:** Danish
**Profession:** Dairy production worker
**External positions of trust:** Member of the Danish worker's union

**FLORENCE ROLLET** (1966)
**Member since:** 2019
**Nationality:** French
**Profession:** Senior advisor to Luxury Tech Funds
**External positions:** Member of the Global Advisory Board of the EMLyon Business School 2018 -

**JOHNNIE RUSSELL** (1950)
**Member since:** 2012
**Nationality:** British
**Profession:** Dairy farmer, chartered accountant
**Internal positions:** Learning and Development Committee, Remuneration Committee
**External positions:** Chairman of the ING Bank UK Pension Fund and two other companies

**HARRY SHAW** (1952)
**Member since:** 2013
**Nationality:** British
**Profession:** Despatch operator
**External positions:** Member of the British worker's union

**SIMON SIMONSEN** (1970)
**Member since:** 2017
**Nationality:** Danish
**Profession:** Dairy farmer
**Internal positions:** Remuneration Committee
**External positions:** Dairy Ambassador for UN High Level Political Forum

**INGER-LISE SJÖSTRÖM** (1973)
**Member since:** 2017
**Nationality:** Swedish
**Profession:** Dairy farmer
**Internal positions:** Chairman of Arla Area Council Learning and Development Committee
**External positions:** Member of the Board of the Swedish Dairy Association 2017 -

# EXECUTIVE MANAGEMENT TEAM

The Executive Management Team consists of the CEO plus four functional experts and two commercial leaders, one for the European and one for the international commercial segments. With a range of different backgrounds and expertise, the Executive Management Team is responsible for Arla's day-to-day business operations, and developing Group strategies. The members of the Executive Management Team are also individually responsible for managing their respective business areas.

From left to right: Hanne Søndergaard, Sami Naffakh, Ola Arvidsson, Peder Tuborgh, Peter Giørtz-Carlsen, Natalie Knight, Tim Ørting Jørgensen

# EXECUTIVE MANAGEMENT TEAM (CONTINUED)

**HANNE SØNDERGAARD** (1965)
*CMO, Executive Vice President, Marketing, Innovation, Communications and Sustainability*
**Nationality:** Danish
Hanne has been with Arla for 30 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 various brands and categories before taking on her current role. She holds business degrees from Aarhus University's School of Business and Harvard Business School.
**Hanne is also:**
– Member of the Board of Arla Fonden and of Danish Technical University

**SAMI NAFFAKH** (1970)
*COO, Executive Vice President, Supply Chain*
**Nationality:** French
Sami joined Arla in January 2018. He has 25 years of experience in supply chain and operations from across several industries, and he worked in seven countries before joining Arla. His most recent position was SVP Global Supply Chain EMEA at the Estée Lauder Companies, but he also has thorough knowledge of the dairy industry, as he held multiple senior executive positions at Danone Early Life Nutrition. He holds a master's degree in engineering from the School of High Studies in Engineering in Lille, and a post-graduate business certification from IMD Business School.

**OLA ARVIDSSON** (1968)
*CHRO, Executive Vice President, HR and C orporate Affairs*
**Nationality:** Swedish
Ola joined Arla in 2006 as Corporate HR director, and has been the Chief HR officer of Arla since 2007. He came to Arla 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. He holds a master's degree in HR management from Lund University.
**Ola is also:**
– Member of the Board of AP Pension,
– Central Board Member of the Danish Industry

**PEDER TUBORGH** (1963)
*CEO, member of the Executive Board*
*Head of Milk, Members and Trading*
*CEO of Arla Foods Ingredients*
**Nationality:** Danish
Peder has been with Arla for 31 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. Peder holds a master's degree in economics and business administration from the University of Odense.
**Peder is also:**
– Member of the Global Dairy Platform

**PETER GIØRTZ-CARLSEN** (1973)
*Member of the Executive Board, Chief Commercial Officer, Europe*
**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. Peter holds a master's degree in business administration, organisation and management from Aarhus University's School of Business.
**Peter is also:**
– Vice Chairman of AIM, the European Brands Association
– Sits on the Policy and Issues Council (PIC) of the UK's Institute of Grocery Distribution (IGD)
– An executive advisor for FSN Capital Partners

**NATALIE KNIGHT** (1970)
*CFO, Executive Vice President, Finance, Legal and IT*
**Nationality:** American
Natalie joined Arla 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. She has also worked in five countries before joining Arla. Natalie holds a master's degree in economics from the Freie University of Berlin.
**Natalie is also:**
– Member of the Board and chairman of the Audit Committee of Grundfos
– Member of the Board of Biomar

**TIM ØRTING JØRGENSEN** (1964)
*Executive Vice President, International*
**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 the international commercial segment. Tim has been part of the international team since 2007. Tim holds a master's degree in Commerce from Copenhagen Business School.
**Tim is also:**
– Member of the Board of Mengiu, Arla's joint venture in China

# MANAGEMENT REMUNERATION

Arla's executive remuneration policy is designed to encourage high performance and support value creation. The policy ensures alignment of the Group's strategic direction with 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

Remuneration packages are constructed to ensure attraction, engagement and retention of the best senior leaders, and at the same time should drive strong performance in both short and long-term business results. Our remuneration package levels are reviewed annually by external advisors using market data sources. Although the majority of remuneration is fixed, in line with Scandinavian practice, an increasing portion in recent years has become variable to ensure that total remuneration is also dependent on achievement of Arla's short and long-term financial targets. 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. The Board of Representatives (BoR) is regularly updated on remuneration of the Board of Directors (BoD) and the development in variable pay for executives and senior management.

## Our performance measures

### Board of Directors (BoD)

The remuneration of the BoD comprises a fixed fee and is not incentive-based. We believe this ensures that the Board is primarily focused on the cooperative's long-term interests. The Chairman and the Vice Chairman (together: Chairmanship) receive a fee that is three times and two times the base fee respectively, and other Board members receive equal compensation. Beyond a minimal travel per diem, no additional compensation is paid for meeting attendance or committee service. The BoD's remuneration is assessed and adjusted on a bi-annual basis and approved by the Board of Representatives (BoR). The most recent adjustment made was in 2019. For more details on specific amounts please refer to page 113.

### Executive Board and Executive Management Team

The compensation elements and approach for the Executive Board and the Executive Management Team (together: executives) is identical, however levels vary.

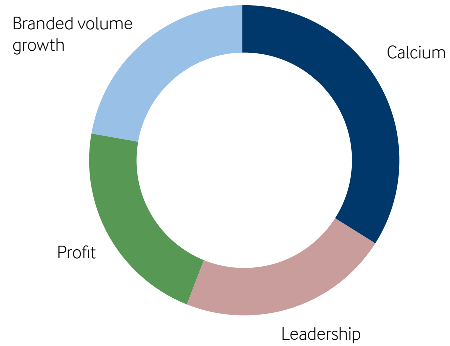
Remuneration paid to the Executive Board is assessed annually by the BoD, based on recommendations from the Chairmanship. For 2019, the fixed pay was maintained on par with last year. For more details on specific amount go to page 113. Remuneration paid to the Executive Management Team is reviewed annually by the CEO.

The remuneration package for the executives is based on external benchmarks against European and international FMCG companies, providing a competitive and sustainable mix of fixed and variable pay. A pension contribution and non-monetary benefits such as company car, telephone etc. are also part of the package.

Levels of fixed remuneration are set based on individual experience, contribution and function, while variable pay reflects performance against annual business targets.

The variable pay component consists of an annual short term incentive (STI) plan, and a long-term (three-year) incentive (LTI) plan. The STI is composed of the same elements for the executives, with weights on each element varying across individuals and years. The main components of the LTI are branded volume growth and the group's performance versus a peer group index (see graphs). The LTI programme started in 2018 also included a component related to our transformation and efficiency programme, Calcium.

**Short-term components**




**Long-term components**

# OUR TAX AFFAIRS

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

The OECD's project against base erosion and profit shifting (BEPS), meaning to shift profits from high-tax jurisdictions to law-tax ones) led to the development of new tax principles and documentation requirements for multinationals in recent years. Arla is fully committed to meeting all requirements on tax reporting and transparency. We strive for an open dialogue with tax authorities around the world regarding our business and our tax reporting.

### 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 reporting tax in a responsible way. The cornerstones for all tax-related matters in Arla are our key tax principles:

- We aim to report the right and proper amount of tax according to where the value is created
- We are committed to paying taxes legally due and to ensuring compliance with legislative requirements in all jurisdictions in which our business operates
- We do not use tax havens to reduce the group's tax liabilities
- We do not set up tax structures which have no commercial substance and do not meet the spirit of the law to avoid taxes
- We are 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 (IFRS)
- We develop good relationships with tax authorities and trust that transparency, collaboration and a proactive attitude minimises the occurrence and extent of tax disputes.

### Accountability and governance

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

We continuously work to improve the internal standards and controls required to adhere to our key tax principles. Accountability for tax processes, with a few exceptions, lies with the global tax function.

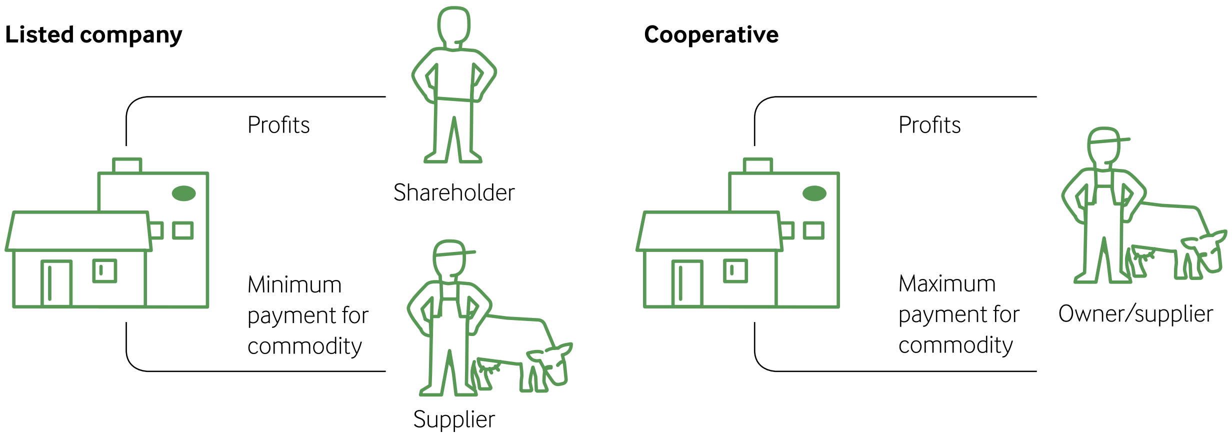
### Operating under a cooperative tax scheme

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

The owners of Arla will pay income tax on the amount received for their milk in accordance with the tax laws of their respective countries. Danish cooperative tax rules reflect the fact that the cooperative acts as its members' extended arm, and as such, Arla Foods amba pays income tax in Denmark based on its equity.

Arla group owns several subsidiaries globally. Our subsidiaries are typically limited liability and private limited companies subject to regular corporate taxation.

### WHAT IS THE MAIN DIFFERENCE BETWEEN A LISTED COMPANY AND A COOPERATIVE



# COMPANY INTEGRITY MANAGEMENT - POLICIES, CONTROLS AND COMPLIANCE

Acting responsibly is at the core of our character. We are committed to conducting business in a lawful, fair and ethical way, and expect the same from our business partners.

## Our compliance cycle

We operate a structured compliance framework to drive a risk aware dialogue across the business. It comprises: risk identification, policies and controls, education and awareness, investigations and reporting.

### Risk identification

We identify compliance risks through several processes, including: monitoring of regulatory developments, investigations upon alleged misconduct reports, compliance trainings, internal compliance reviews, and CSR due diligence. To read about our overall risk management go to page 48.

### Policies and controls

Our Code of Conduct is available in 12 languages and, together with a set of global policies, determines the principles for our activities and expresses our expectations towards our employees and business partners. We have zero tolerance towards the violation of these principles and secure this through a coherent system of internal controls, which are regularly assessed for effectiveness and adequacy. We continue to develop our internal control environment with system-embedded controls and segregation of duty monitoring. As a part of the control scheme, we work on data privacy control points, subjected to regular monitoring and review.

In 2019 we continued building a compliant culture and have increased our focus on operationalizing our risk management to mitigate risks across the core business processes. We completed a risk and control assessment for Order to Cash and Source to Pay processes, to determine the residual risk level and assess it versus our risk appetite. Based on this, we determined necessary improvements. We also began utilizing analytics and robotic process automation to strengthen compliance.

### Education and awareness

Our Code of Conduct and internal policies are communicated to employees with a range of activities, combining mandatory training programs and awareness announcements. All internal principles for business conduct are gathered in a central Policy Portal on Arla's intranet and are available to employees, also on mobile devices. We operate a combined scheme of training – including e-learnings on major compliance matters (e.g. competition law, information security) and classroom training as appropriate.

### Investigations

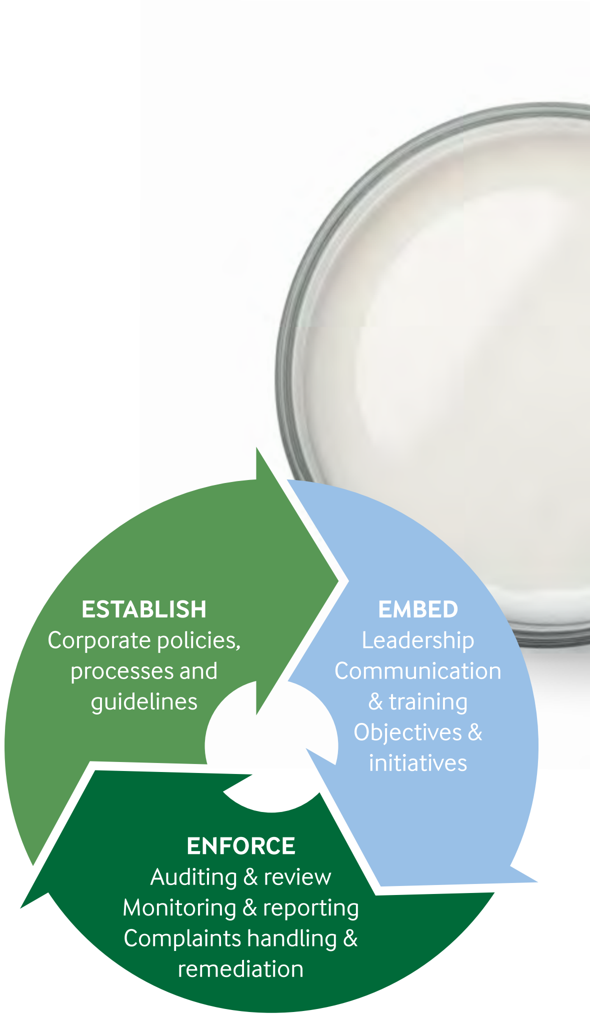
Openness and trust are among our core values, and incorporated into our Code of Conduct. If employees believe that the Code of Conduct has been violated, we encourage them to report these violations. Concerns can be raised by reporting to relevant management, HR or Risk Controls and Compliance. We also offer anonymous reporting possibility through our whistleblower system, applying strict principles of confidentiality and non-retaliation.

In 2019, we investigated 12 reported fraud allegations, compared to 35 in 2018. They resulted in no material financial losses to the group but did provide valuable inputs on the condition of our control environment. The observations related to purchasing and information security which continue to be core elements of our efforts to strengthen compliance and raise awareness.

### Reporting

Our compliance reporting sequence is arranged in an annual cycle at various organisational levels. In 2019 we introduced compliance scores into the executive management team's monthly performance dashboard, and country reporting is shared with relevant middle management. Compliance concerns are also reported quarterly at business board meetings, with the final observations from all compliance activities and investigations in the year reported in the Annual Compliance Report to the Board of Directors. Overall, compliance was further strengthened in 2019 and we are fully committed to continue this journey into 2020 and beyond.

You can find our Code of Conduct on our webpage.



# OUR RISK MANAGEMENT

At Arla, we recognise risk management as a means of mitigating adverse consequences of internal or external factors, and capturing opportunities for the business to maximise value creation. We take measures to identify, understand, assess and deal with risks effectively. Our focus is on risks that may threat the realization of our strategy in the mid-term, and we also look at short-term risks inherent in the business processes of the company.

## TYPE OF RISK

### STRATEGIC
Risks arising from external or internal trends or events that may have material impact on the realisation of our strategic objectives

### OPERATIONAL
Risks that may compromise execution of business functions

### FINANCIAL
Risks that may cause unexpected volatility in milk price, net sales, margins or market shares

### LEGAL AND REGULATORY
Risks related to legal or regulatory developments that may have material impact on our realisation of business objectives

## IMPACT

We differentiate risks within each major category by their potential impact. Impact indicates the level of monetary and/or reputational loss. In this report we focus on critical and major risks, however in our internal risk management we also track and mitigate risks below these materiality levels.

**Major:** Long term impairment of market position and/or national media coverage resulting in damage to brands/image and/or monetary loss 10-50 mEUR.

**Critical:** Permanent reduction of brand value and/or extensive international media coverage damaging the image of Arla and/or monetary loss in excess of 50 mEUR.

**Likelihood:** When we talk about the movement of risk, we refer to change in likelihood of the risk materialising, considering the mitigation activities and controls lowering that likelihood.

# OUR RISK MANAGEMENT (CONTINUED)

## Strategic risks

### Negative consequence of Brexit

UK is a significant market for Arla accounting for 25 per cent of sales, hence adverse effects from limiting the free movement of goods, as well as the devaluation of the GBP could have critical impact on Arla in short and long term.

: *Peter Giørtz-Carlsen, member of the Executive Board, and Executive Vice President for Europe*

: We have detailed scenario planning and mitigating action plans in place and are continually mapping potential impacts of various potential outcomes of Brexit negotiations. Hedging plans are in place to mitigate the short-term negative impacts on GBP. To read more go to page 50.

**Impact:** ■ **2019 movement:** ▼

### Transformation of consumer preferences

Consumers increasingly explore plant-based alternatives to dairy, and question dairy's place in a healthy and sustainable diet. Sales of plant based alternatives to dairy are expected to increase at double digit rates in the coming years.

: *Hanne Søndergaard, Chief Marketing Officer, Executive Vice President for Marketing, Innovations, Communications and Sustainability*

: Our innovation pipeline is focused on responding to consumer trends, with increasing options for flexitarian and carbon footprint-conscious consumers. In 2019 we launched a ready-to-drink Starbucks™ coffee with an almond base, and in cooperation with McDonalds we launched a grilled cheese burger for flexitarians. We constantly share information about the health and nutritional benefits of dairy. To read more about our innovative products, go to page 22. To read more about our sustainability efforts go to page 30.

**Impact:** ■ **2019 movement:** ▲

### Insufficient response to the societal push for sustainable production and/or non-compliance with climate regulations

Our operations have a negative environmental impact that needs to be managed and offset in compliance with local and global regulations, but with our sustainability strategy we aim to exceed existing regulatory requirements.

: *Hanne Søndergaard, Chief Marketing Officer, Executive Vice President for Marketing, Innovations, Communications and Sustainability*

: Our sustainability strategy is led by a dedicated sustainability board anchored at the executive management level. In 2019 we launched ambitious mid- and long-term environmental targets, approved by the Science Based Targets Initiative. Activities across our value chain are being done to fulfil our commitments. For example, we launched the first ever dairy products that fulfil the climate neutrality ISO standard, and 1 billion yoghurt and milk cartons were upgraded to make them more environmentally friendly. To read more go to page 31.

**Impact:** ■ **2019 movement:** ▲

### Disruptive pace of change due to e-commerce and new shopping habits

Development of new digital commercial channels enable consumers to order groceries, food kits and ready-made meals home more often. At the same time, sales in discounters and convenience stores are increasing, consequently lowering margins and pushing for new customer and distributor contracts.

: *Peter Giørtz-Carlsen, member of the Executive Board, and Executive Vice President for Europe*

: We innovate in our commercial channels and push the digital dialogue with consumers to e-commerce platforms. We increased focus on our foodservice business, and have plans in place to dial up focus in other growth channels. On our popular recipe sites we provide consumers the possibility to shop ingredients directly on retailers e-commerce platforms, to enhance adoption of new habits.

**Impact:** ■ **2019 movement:** ▼

## Operational risks

### Milk price and volume volatility

Dairy production is inherently exposed to volatility of volumes and prices with potential adverse impact on sales and returns. 2019 showed unprecedented stability in milk prices, with significant swings in the relative prices of fat and protein. The overall volatility of milk markets may return in 2020.

: *Peder Tuborgh, Chief Executive Officer*

: We manage our prices and portfolio actively, based on detailed market insights, with decision making anchored with the CEO. Our performance management is strongly linked to our peer group insights and group-wide EBIT targets.

**Impact:** ■ **2019 movement:** ▼

### Loss of key personnel in strategic positions

People are the key element of our organisation as we rely on their talents and engagement to execute our strategic objectives as well as daily business operations. Our ability to recruit and retain skilled employees is one of our key risk factors.

: *Ola Arvidsson, Chief HR Officer, Executive Vice President for HR and Corporate Affairs*

: We attract talent through employer branding and an efficient recruitment process, and retain talent by providing sufficient internal growth opportunities, taking employee's opinions into consideration through pulse checks three times a year, and a focus on continuously improving our working environment. To read more go to page 37.

**Impact:** ■ **2019 movement:** ▼

### Information security and cyber attack

We are an increasingly digital company, and the integration level of our IT systems exposes us to cyber security risks, such as non-availability or unauthorised access. This has the potential to result in disruption of business processes or adverse impact on our market position and reputation.

: *Natalie Knight, Chief Financial Officer, Executive Vice President for Finance, Legal and IT*

: We continuously educate employees through cyber risk awareness campaigns, including our 2019 relaunch of information security principles in the IT Code of Practice. We assess the risks related to IT platforms (including data privacy issues), and conduct system maintenance focusing on vulnerability scanning and systematically address identified weaknesses. We monitor access control processes centrally and improve the segregation of duties, which was recognized positively by our external auditors.

**Impact:** ■ **2019 movement:** ▲

*Risk Owner* *Mitigation*

# OUR RISK MANAGEMENT (CONTINUED)

### Delivery of our Calcium efficiency and transformation programme

Our transformation and efficiency programme, Calcium was launched in 2018 to accelerate our Good Growth strategy and deliver EUR 400 million savings. We recognise the risk arising from significant, organisation - wide changes. We aim to create an organisation able to embrace change to capture opportunities for the future.

: *Peder Tuborgh, Chief Executive Officer*
: In 2018 we set up a central transformation office dedicated to coordination and delivery of programme targets in close collaboration with business units. Decision making remains anchored at the executive management level. The programme is organised across 9 workstreams, with rigorous follow-up and firm performance and change management.
**Impact:** ■ **2019 movement:** Stable

## Financial risks

### Currency fluctuation

As 57 per cent of Arla's revenue is generated in currencies other than EUR or DKK, our key financial risk relates to the fluctuation of currencies in our global markets.

: *Natalie Knight, Chief Financial Officer, Executive Vice President for Finance, Legal and IT*
: We have centralized foreign currency exposure management in place, and reduce our short-term transactional exposure through hedging activities in our main currencies.
**Impact:** ■ **2019 movement:** Stable

### Tax risk

As a global cooperative, Arla is confronted with the continuously growing demand for transparency about our tax position and policies. In recent years this has led to a significant increase in the compliance requirements for multinationals like Arla, and increased the (automatic) information exchange between tax authorities. Tax authorities around the world also increased the number of tax audits. The above developments lead to more uncertainties and a higher workload on tax reporting.

: *Natalie Knight, Chief Financial Officer, Executive Vice President for Finance, Legal and IT*
: We continuously monitor group transactions to ensure alignment with local tax requirements, and a transparent dialogue with tax authorities. We monitor tax risks and ensure that these are sufficiently covered by provisions. Where possible, Arla enters enhanced relationships with tax authorities. We do not enter into aggressive tax planning and ensure that tax follows the business, not the reverse. To read more go to page 45.
**Impact:** ■ **2019 movement:** ▼

## Legal and regulatory risks

### Major product quality and/or safety issues resulting in product recall

Food safety and compliance with health and safety regulations is a top priority across our supply chain and commercial business. It is also part of our social responsibility commitments stated in our Code of Conduct.

: *Sami Naffakh, Chief Operations Officer*
: We constantly improve and extend our quality assurance programme for farmers, Arlagården. We have quality and food safety management programmes in place driven from a central QEHS department and monitor our core production performance indicators monthly. As part of our transformation programme, Calcium we transform our supply chain to be more efficient and safer. To read more about recalls go to page 131.
**Impact:** ■ **2019 movement:** Stable

### Legal non-compliance, corruption, fraud and unethical business conduct

Any instance of corruption or unethical business conduct raises risk of fines, criminal prosecution and reputational damage. Across all core business processes an inherent risk of misconduct exists and needs mitigation.

: *Natalie Knight, Chief Financial Officer, Executive Vice President for Finance, Legal and IT*
: We have zero tolerance for conduct which may compromise our reputation or corporate integrity. We constantly educate our employees on the principles of our Code of Conduct and internal policies (e.g: anti-bribery, fraud, third party entertainment policy). We monitor any misconduct through a system of internal controls in all business processes, and identify irregularities through reporting structures, including a group-wide whistleblower programme.
**Impact:** ■ **2019 movement:** Stable

### Data privacy

We need to ensure the privacy of our employees', customers' and other business partners' personal data in line with GDPR. Actual or perceived violations of GDPR or other data privacy and system security regulations could raise a risk of signficant regulatory fines and reputation damage.

: *Natalie Knight, Chief Financial Officer, Executive Vice President for Finance, Legal and IT*
: We review our business processes and IT systems and strengthen our internal policies and procedures annually. We implemented a control framework, which is supported by continuous education of employees and audits of relevant business partners. We have also improved our HR processes, policies and procedures to ensure data privacy of employees.
**Impact:** ■ **2019 movement:** Stable

*Risk Owner* *Mitigation*

# PREPARING FOR BREXIT

Potential consequences from Brexit continue to be the biggest risk Arla faces. Although the UK decided to leave the EU at the end of January 2020, the future trading relationship between the EU and the UK remains uncertain, and we need to continue to prepare handling all possible outcomes. As negotiations on the future trading relationship continue, Arla will keep on making our position clear to decision makers, as a company in favour of the free movement of goods and people.

It is important for Arla that our products and employees can move freely from and to the UK, also after the transition period is over. Successful brands in the UK market, including Lurpak®, Arla® Skyr and Lactofree, are imported to the UK, while others, like Castello® are exported from the UK. Changes to the EU-UK trade relationship may significantly challenge this business.

Throughout Arla's Brexit Task Force, compiled of senior leaders from affected business units, continued to monitor and assess various scenarios, considering possible impacts and mitigating actions. Our Executive Management Team and Board of Directors have been updated monthly, and relevant updates were shared with our owners.

At the time of finalising the annual report, our priorities in preparing for Brexit remain:

- Ensuring we maintain business continuity and supporting our EU employees in the UK, and UK employees in the EU
- Maintaining confidence with key stakeholders, including customers

We want the final trade deal between the UK and EU to be free from tariff and non-tariff barriers on milk and dairy. We are collaborating with partners in the dairy industry and the wider food and farming community to build a united position across Europe. To ensure our position is heard at the highest level, we are engaged with both the UK government and the EU.

Significant risks relate to negotiations on the regulatory alignment between EU and UK, extra costs in the form of customs duties and customs clearance being imposed on EU and UK exports that could negatively affect demand, as well as increased administrative burdens.

Another key risk relates to the Group's GBP/EUR-exposure, through transaction risk on export business and translation effect on value added by local UK business. To mitigate this uncertainty on a short-term basis, we have applied hedging instruments in 2019 to a larger extent than normal.

The uncertainty surrounding future implications have been incorporated when assessing asset values, e.g. on goodwill where EUR 489 million is allocated to UK (out of EUR 700 million goodwill in total). Following the Brexit process, expected cash flow supporting the carrying value of goodwill in the UK is inherently more uncertain. This was reflected in the risk-adjusted cash flow used for the impairment test. Read more about the details on impairment tests performed in note 3.1.1.

## ARLA IN THE UK

Revenue, billion EUR
**2.7**

Total assets, billion EUR
**1.3**

Share from the inflow of raw milk from owners
**26%**

Number of farmers in the UK
**2,190**

Number of employees in the UK
**3,407**

Number of production and packaging facilities
**10**

Key brands
Arla®, Lurpak®, Aanchor®, Cravandale®, Yeo Valley®

# OUR PERFORMANCE REVIEW

**Delivering stable milk price**

Our strategy paves our way to ensure our mission: to secure the highest value for our owner's milk. In 2019 we experienced unparalleled milk price stability.

# OUR PERFORMANCE REVIEW

Arla successfully delivered a stable and competitive milk price to our farmer owners, with our performance price reaching 36.6 EURcent/kg of milk. Moreover, with respect to quality of sales, cost efficiency and cash conversion, we achieved the top range of our targets for all key performance indicators. Branded volume growth increased above expectations, by 5.1 per cent, while volumes of lower margin products were reduced, which together with positive currency and M&A effects drove Arla's revenue increase of 1 per cent, to EUR 10.5 billion. Our transformation and efficiency programme, Calcium, delivered EUR 110 million in savings, which was EUR 10 million above the high-end of our target range. Efficiencies enabled by Calcium, as well as higher volumes in branded products led to a net profit of 3.0 per cent, ahead of the previous two years' results. Our leverage and cash flow also ended at healthy levels, despite the payout of our full 2018 profit to our farmer owners and record-high investments of EUR 704 million. These results show that our Good Growth 2020 strategy is working.

**Natalie Knight**
Chief Financial Officer

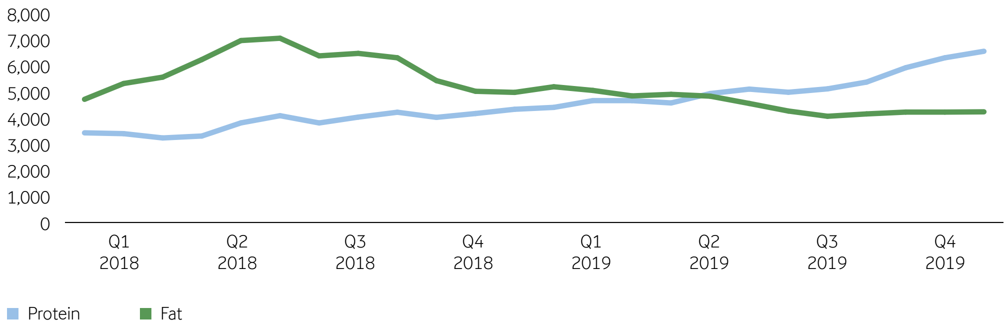
# MARKET OVERVIEW

In 2019, the global macroeconomic environment was characterised by lower GDP rates compared to the last year in most markets, continued uncertainty around the potential consequences of Brexit, a global trade conflict between the US and China, and intensifying tensions in the Middle East.

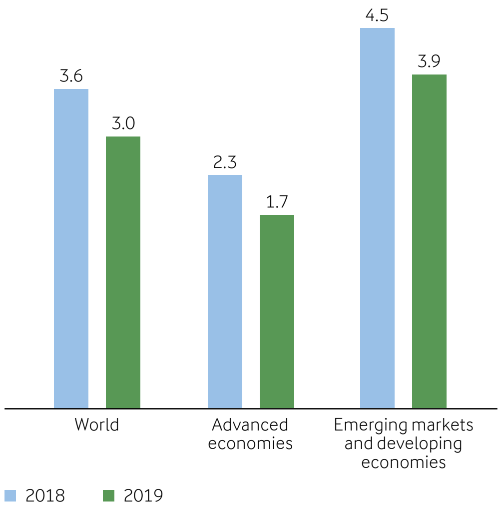
According to the IMF, global economic growth in 2019 was 3 per cent compared to 3.6 per cent last year, the slowest pace since the 2008 economic crisis. The trend was primarily driven by emerging markets and developing economies, which grew by 3.9 per cent, but still at a slower rate than last year (4.5 per cent). Meanwhile advanced economies grew by 1.7 per cent, compared to 2.3 per cent in 2018.

Arla's core currencies developed in an advantageous direction, or were mostly stable during 2019. The British Pound (GBP) and US Dollar (USD) improved modestly in their relative strength to Euro (EUR), while the Swedish Krona (SEK) devaluated slightly.

**Fat and protein prices 2018-2019**
(EUR/Tonne)




**Gross domestic product growth rate**
(per cent)*




** Source: IMF*

**Average exchange rates, 2018-2019**

| Currency | 2018 | 2019 | Change vs.2018 |
|---|---|---|---|
| EUR/USD | 1.180 | 1.119 | 5.1% |
| EUR/GBP | 0.885 | 0.877 | 0.9% |
| EUR/SEK | 10.253 | 10.587 | -3.3% |

**Unprecedented stability in milk prices and milk production across Europe**

Global and European milk prices showed unprecedented stability in 2019. This is the longest period of prepaid milk price stability in Europe since 2015, when production quotas were lifted.

However, this stability disguised an underlying shift in the basis of milk values. In the previous two years we experienced a significant shift between fat and protein values towards fat being the higher value milk solid. In 2019 we started to see this reverse, restoring the traditional picture of protein having a higher value than fat.

Fat prices continued to fall through the first half of 2019 before settling at a price level in line with historical averages, before the 2017-18 increases.

On the other hand, with the clearing out of final intervention stocks of skimmed milk powder (SMP) during the early part of 2019, demand for SMP outstripped supply, resulting in a significant price rise through the year. By the end of the year SMP prices in Europe were higher than they had been since mid-2014.

These massive shifts in the fat and protein prices changed the pricing dynamics hence changed the profitability by product category.

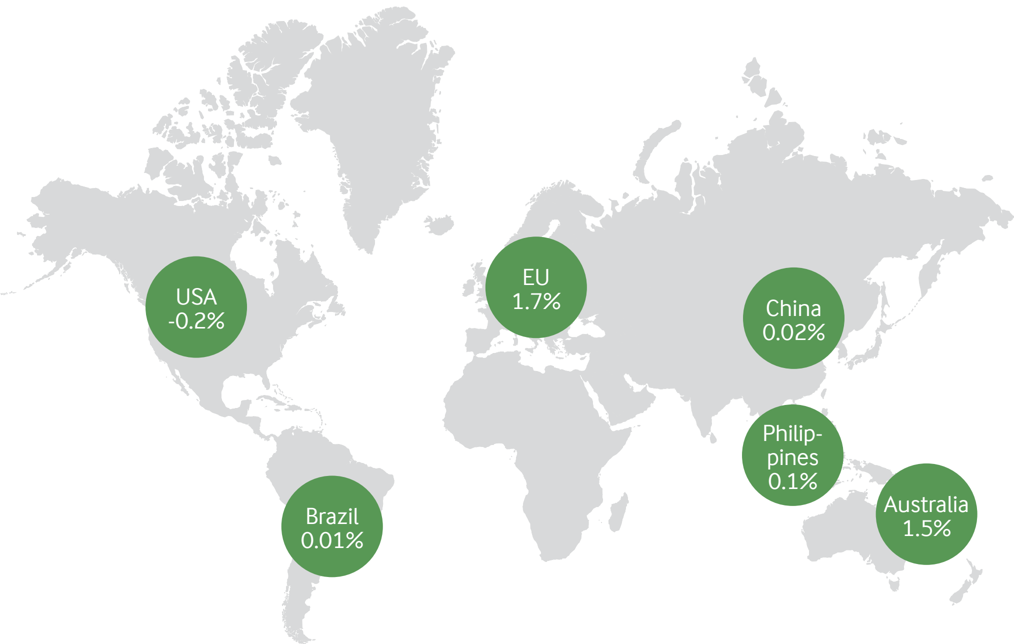
# MARKET OVERVIEW (CONTINUED)

## Demand and consumption growth

The latest available global dairy consumption numbers show a significant drop in the per capita consumption growth of Western markets, from 2.5 per cent in 2017 to 0.5 per cent in 2018.
Dairy consumption growth in emerging markets also slowed down from 4.4 per cent in 2017 to 3.3 per cent in 2018. In absolute numbers, approximately 85 per cent of dairy consumption growth was driven by emerging markets.

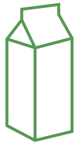
From a category perspective, cheese consumption increased by 0.8 per cent in the European markets, while milk and butter slightly decreased, with 0.4 and 0.2 per cent respectively. Volumes for ready-to-drink coffee and mozzarella grew across all major European markets.

**Dairy consumption growth in major markets** (per capita)*



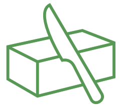

*Source: Dairy Economic Consultancy (clal.it), based on data from 2018. Category data pertain to Europe.*

**Change in per capita consumption by category***



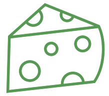
**Milk**

**-0.4%**



**Butter**

**-0.2%**



**Cheese**

**0.8%**

## Strong push for sustainability

In 2019, discourse about climate change and sustainability dominated the public sphere. School strikes for climate grew to be a global phenomenon with tens of thousands of students attending demonstrations across the globe. Governments and inter-governmental organizations made commitments and tangible plans for decreasing carbon emissions most notably the Green New Deal by the EU.

Global companies were also hugely affected by this trend, and more companies are actively integrating sustainability into their business model. They are doing so by pursuing goals that go far beyond earlier concerns for reputation management – for example, saving energy, developing sustainable products, changing to sustainable sourcing and increasing focus on diversity in the workforce. Dairy companies are no exceptions. We have seen our peers launching inspiring environmental targets in 2019, while we at Arla continued and accelerated our already ongoing journey towards becoming more sustainable, and announced our ambition to become carbon neutral by 2050.

# FINANCIAL PERFORMANCE

In 2019 Arla delivered at the high end or above our target range for all our key financial performance indicators, despite significant swings in the relative prices of fat and protein, which created volatility in profitability across product categories. We improved milk price performance and kept the prepaid milk price stable throughout the year. This was driven by strong sales in the international growth markets and an increase in the branded volumes in Europe, as well as a successful second year of our transformation and efficiency programme, Calcium.

## Stable owner milk price throughout 2019

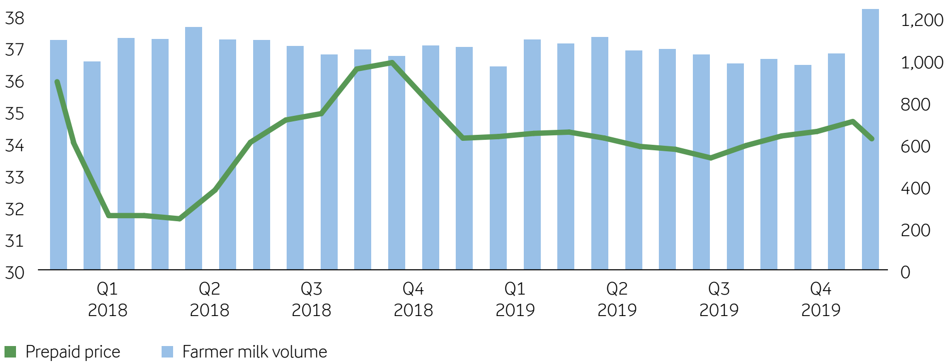
As a cooperative, Arla exists for the benefit of our farmer owners. Our mission is to secure the highest value for our farmers' milk while creating opportunities for their growth. Our commitment to maximise both short- and long-term value for our owners requires strong commercial execution at all levels of the business through active price management, delivering branded growth as well as firm cost control. In 2019 we delivered firm branded volume growth and significant cost savings due to our transformation and efficiency programme, Calcium, enabling us to pay a competitive milk price for our farmer owners.

Performance price is the most important KPI for Arla, measuring the value Arla creates per kilo of owner milk. During 2019, Arla's performance price improved to 36.6 EUR-cent/kg, compared to 36.4 EUR-cent in 2018 (0.5 per cent increase). We delivered this improvement despite increased competition in the core European markets. This achievement is a key indicator that our transformation and efficiency programme, Calcium, as well as our strategy are improving Arla's competitiveness in the European dairy market.

A key component of our performance price is the prepaid milk price, which represents the on-account average payment farmer owners receive per kilogram of milk delivered during the settlement period. The prepaid milk price paid to our farmer owners was virtually unchanged throughout the year, with only minor technical changes from February to December. Overall the average prepaid standard milk price was 34.1 EUR-cent/kg, unchanged compared to last year.

**Standard prepaid milk price and owner milk volumes**

(EURc/KG; tonnes)



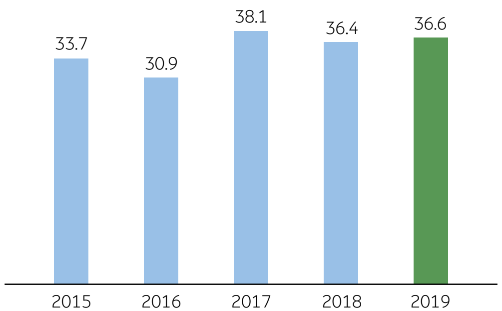

Arla owner milk intake decreased by 0.1 per cent compared to last year. However there were significant variances across core geographies. Milk intake from Danish and UK farmers remained virtually unchanged compared to last year, at 4.9 and 3.2 billion kilos respectively. Milk intake from farmers in Sweden and Central Europe decreased slightly.

The main driver for the decrease in milk intake in Central Europe was the mandatory transition of all owners in Arla Central Europe to non-GMO feed, following which a number of farmers decided to leave the cooperative. In Sweden milk intake has been declining for years, and in 2019 the decline was slightly accelerated by the impact of the 2018 drought, and in some regions, a drought in 2019.

Milk intake from sources other than our owners decreased at a higher pace, by 134 million kilos, from 1.5 billion kilos to 1.3 billion kg (9.2 per cent decrease), due to the divestments of our activities in Allgäu, Germany and therefore the elimination of contract milk from the region.

**Performance price**

(EURc/kg)



# FINANCIAL PERFORMANCE (CONTINUED)

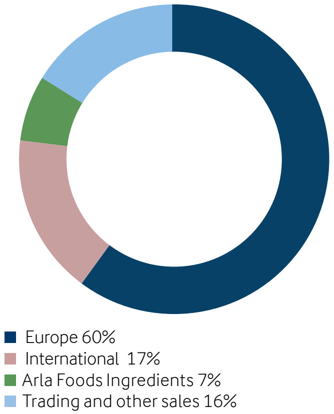
### Arla revenue at upper end of target

In 2019, Arla revenue increased by EUR 102 million to EUR 10.5 billion, compared to EUR 10.4 billion last year (1 per cent increase), which is at the upper end of our target range (EUR 10.2-10.6 billion). At Arla, there are four main components of revenue development: volume and product mix, sales prices, exchange rates, as well as changes due to acquisitions and/or divestments. In 2019, positive developments from M&A and currencies had the largest effect on the revenue development. Impact from increasing volumes, and a better product mix were largely offset by decreasing prices.

Volumes in our higher margin segments, such as the sales of our branded products increased, while volumes in our less profitable private label sales decreased, adding up to a slight total increase. In total, the price effect was slighltly negative in 2019, with varied price development across markets and segments. Prices strengthened in trading and our AFI whey business, which was offset by marginal price decline in selected core markets both in our European and international commercial segment.

Revenues generated from new acquisitions and full year effects from acquisitions completed in 2018 positively impacted revenue by EUR 61 million in 2019 compared to EUR 89 million last year. The primary driver of this development was our acquisition of the Kraft® cheese business and production site from Modeneléz International in the Middle East. Other contributors are the full-year effect of the Yeo Valley Dairies Ltd. licencing agreement in the UK, and the acquisition of the remaining 50 per cent shares in Arla Foods Ingredients SA in Argentina in 2018. This was

**Revenue split by commercial segment**




partially offset by the final divestment of our specialty cheese activities in Allgäu, Germany.

Currency fluctuations positively impacted revenue by EUR 57 million, mainly as a result of higher US dollar rates in some international markets. This compares to a negative effect of EUR 210 million in 2018. For more details on revenue development refer to Note 1.1.

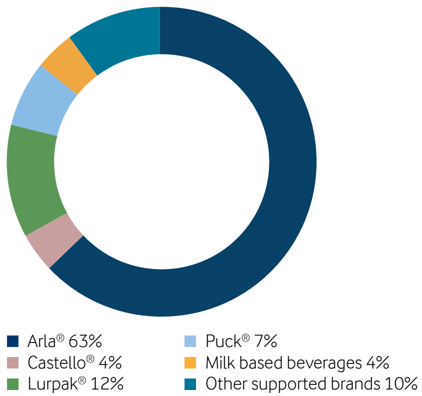
### Branded growth at historically high levels

Our brands are at the heart of our business and drive about two thirds of Arla's profitability. Increasing branded volume growth is critical for us to achieve stronger relative profitability on a medium- and long-term basis. We also know that branded revenue and profitability is less volatile, and brands drive a strong connection with consumers. In line with our strategy Good Growth 2020, Arla continues to focus on growing our branded share of volume and increasing our investments in product innovation.

In 2019, our branded volume grew 5.1 per cent, compared to 3.1 per cent last year. This result is significantly above our target range of 1.5-3.5 per cent and comes despite reductions in marketing spend compared to previous years. Initiatives inspired by our transformation and efficiency programme, Calcium led us to increase marketing spend efficiency. As an example, we created our own in-house creative agency, The Barn, which helped to reduce cost per reach by 50 per cent.

Branded growth was mainly driven by the Arla® brand, where branded volumes grew 5.1 per cent in 2019. Sub-brands focused on inspiring a sustainable diet performed especially well (For example, Arla&More products, aimed to provide nutritious choices to those with busy schedules grew

**Branded revenue, split by brands**




46 per cent, while Arla® Explorers with children's offerings grew volumes at 22.8 per cent. Lurpak® and Puck® also delivered strong branded volume growth of 4.3 and 4.8 per cent respectively. To learn more about our brands go to page 21, for more information about dairy's place in a sustainable diet go to page 33.

Our European commercial segment, which represents 60.3 per cent of the Arla business, delivered 2.9 per cent branded volume growth, compared to 2.5 per cent last year. All markets contributed positively, with our biggest market, the UK, growing at 8.8 per cent. Revenue in Europe declined by EUR 154 million due to planned reductions in the low margin private label business and negative currency impacts. To learn more about performance in our European business segment go to page 23.

In our international commercial segment, which represents 17.1 per cent of Arla's business, revenue grew by EUR 226 million, driven primarily by higher branded volume growth, which increased to 10.3 per cent compared to 4.6 per cent last year. To learn more about performance in our international business segment go to page 25.

**Branded volume growth development**

# FINANCIAL PERFORMANCE (CONTINUED)

## Our commercial segments

**Europe**:
Revenue in Europe decreased by EUR 154 million to EUR 6,353 million, compared to EUR 6,507 last year. Increased branded volume growth and a positive impact from the acquisition of Yeo Valley Ltd. in 2018 was offset by decreasing private label volumes, a negative price effect and the depreciation of the SEK. Decreasing private label volumes resulted from our strategic decision to step out from selected unprofitable contracts, primarily in our German market.

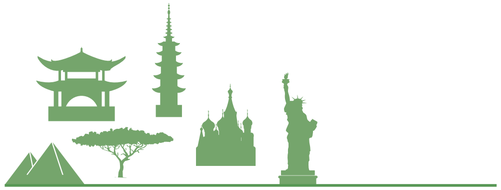
The Europe segment continued to push the sales of our higher margin, branded products, which resulted in a strong branded volume growth of 2.9 per cent. All of our European markets increased their branded volumes. The branded growth was particularly strong in the UK, the Netherlands and Finland, as well as our foodservice segment. Within product categories the main drivers were Arla® Lactofree, Skyr, cheese and milk based beverages under the Arla® and Starbucks™ brands.

For further details on the development in each of our strategic European markets, please refer to page 23.

**Strategic branded volume driven revenue growth**

**2.9%**

2018: 2.5%



**International:**
Revenue in international increased by EUR 226 million, to EUR 1,802 million, compared to EUR 1,576 last year, the highest increase in the past 3 years. All regions but North America contributed positively to the revenue increase, driven by branded volume growth, the positive development of the USD and the acquisition of the Kraft® branded cheese business in MENA.

Branded volumes grew 10.3 per cent, compared to 4.6 per cent last year. Successful introduction of new products in several markets, and a very strong performance of our biggest international market, MENA also contributed to the growth.

Sales and branded volume both declined in North America, where we shifted our strategic direction to a ensure a more stable growth course.

To read more about our international segment go to page 25.

**Strategic branded volume driven revenue growth**

**10.3%**

2018: 4.6%

**AFI:**
Revenue in AFI increased by EUR 58 million to EUR 710 million compared to EUR 652 million last year. This was driven by the increased sales of value-add products within the ingredients segment, higher prices and the full-year effect from the acquisition of the remaining 50 per cent share of Arla Foods Ingredients S.A. Argentina in 2018.

All business units within the ingredients segment – paediatric, health & performance and food – contributed to the positive revenue development, while the child nutrition business experienced lower revenue due to repercussions from major changes in Chinese infant formula regulations.

The sale of value added products grew by 9.4 per cent, driven by value-added protein segments such as alpha-lactalbumin used in infant formula to mimic human milk better, and whey protein hydrolysates used in clear protein waters in sports nutrition.

To read more about AFI's performance go to page 27.

**Growth in value-added products**

**9.4%**

2018: 12.8%

**Trading:**
Revenue in our trading business decreased slightly, by EUR 28 million to EUR 1,662 million compared to EUR 1,690 last year. A drop in trading sales volumes was offset by increasing protein prices. The increase of protein prices meant a major shift in commodity markets in 2019, coupled with continued weakening in fat prices. This indicates that fat and protein values are returning to their long term historical relationship. For most of the year, the increasing protein prices offset the reducing fat prices, meaning commodity milk prices held relatively stable, with a slight overall increase towards the end of the year..

To read more about our trading segment go to page 28.

**Trading share**

**25.0%**

2018: 26.5%

# FINANCIAL PERFORMANCE (CONTINUED)

## Our brands


### Arla®

The Arla® brand is central to our global business, and the key driver of our branded growth. In 2019 Arla®'s revenue grew to EUR 3,084 million compared to EUR 2,923 million last year, driven by the successfully re-launched Lactofree sub-brand, as well as the rapid growth of Skyr in our core European markets.

**Branded volume growth**

**5.1%**

2018: 1.8%

**Revenue** (EUR million)

**3,033**

2018: 2,875

### Lurpak®

In 2019, for the first time in decades our leading butter brand, Lurpak® sold over 100,000 tons of butter. The 4.3 per cent branded volume increase drove Lurpak®'s revenue to increase to EUR 588 million, compared to EUR 561 million last year.


**Branded volume growth**

**4.3%**

2018: 2.7%

**Revenue** (EUR million)

**588**

2018: 561


### Castello®

Sales of our Castello® specialty remained on pair with last year at EUR 179 million, due to challenging competitive environment across Europe and selected international markets.

**Branded volume growth**

**-2.1%**

2018: 3.8%

**Revenue** (EUR million)

**179**

2018: 179

### Milk based beverage brands

Our milk based beverages segment includes strong brands such as Cocio®, Matilde®, and most importantly, the licensed Starbucks™ brand. In 2019 sales of our branded milk based beverages to EUR 207 million, compared to EUR 187 million last year. Growth was mainly driven by Starbucks™, which successfully rolled out to new markets, and launched the first plant-based coffee.

**Branded volume growth**

**13.7%**

2018: 22.4%

**Revenue** (EUR million)

**207**

2018: 187


### Puck®

Despite challenging macroeconomic conditions, our leading brand in MENA, Puck®, grew revenue to EUR 363 million, compared to EUR 352 million last year. Growth was driven by a firm volume growth in the processed and cream cheese business.

**Branded volume growth**

**4.8%**

2018: 8.9%

**Revenue** (EUR million)

**363**

2018: 352

# FINANCIAL PERFORMANCE (CONTINUED)

### Calcium savings above expectations

In early 2018 we launched our comprehensive transformation and efficiency programme, Calcium, as our response to challenging external developments, and to increase efficiency across the business. More than halfway into Calcium, we can see that it contributes to a more competitive milk price to our owners, while also enabling us to invest in future growth markets and categories.

Calcium delivered strong results during 2019, with savings of EUR 110 million. This exceeded the high-end of our full year EUR 75-100 million savings target. As a result, we have achieved EUR 224 million in accumulated yearly Calcium savings since we initiated the program in 2018, and we are more than halfway towards our 2021 ambition of EUR 400 million.


The savings were primarily achieved through improved supply chain productivity, as well as decreased marketing and indirect spend savings. For more on Calcium, please go to page 17.

### Net profit improves

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 actively balance the retained capital for future investments and provide supplementary payment to our farmer owners while continuing to pay out the largest possible share of our profit via the prepaid milk price on an ongoing basis.

In 2019, Arla achieved a net profit of EUR 311 million, or 3.0 per cent of revenue. This was 0.2 percentage points ahead of last year's level and the first time we reached 3.0 per cent since 2016. This was driven primarily by lower costs, due to our transformation and effciency programme, Calcium, offset by a negative effect from other income cost related to one-offs in 2018. The net profit improvement is particularly strong when seen in combination with our competitive prepaid milk price during 2019.

### Leverage at the low end of our target range

Financial leverage is calculated as the ratio of net interest-bearing debt including pension liabilities to operating profit, 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 a long-term target range of 2.8 to 3.4.

In 2019 leverage increased to 2.8 compared to 2.4 last year, as a result of the extraordinary payout of the full 2018 profit to our farmer owners and record high investment levels, offset by solid development in earnings from the normal course of operations.

Net interest-bearing debt including pension liabilities increased by EUR 495 million to EUR 2,362 million compared to EUR 1,867 million last year ( 26 per cent increase). The increase is primarily due to the adoption of the IFRS 16 related to leases, high investment level including acquisitions, and pay-out of full profit related to 2018. EBITDA increased by EUR 70 million to EUR 837 million, compared to EUR 767 million last year (9.1 per cent increase), which was also impacted by the IFRS 16 standard.

Despite these developments, our financial position is very strong and within our targeted range. Our financial position is a critical lever for success. It provides Arla with the financial strength to invest in delivering our strategy, Good Growth 2020, and pursue our vision to create the future of dairy. Arla is considered a robust investment grade company, and we continually strive to uphold this status.

**"OUR FINANCIAL POSITION IS VERY STRONG AND WITHIN OUR TARGETED RANGE. IT GIVES US FINANCIAL STRENGTH TO INVEST IN DELIVERING OUR STRATEGY, GOOD GROWTH 2020 AND TO CREATE THE FUTURE OF DAIRY"**

# FINANCIAL PERFORMANCE (CONTINUED)

## Cash flow

Cash flow from operating activities improved by 19 per cent to EUR 773 million compared with EUR 649 million last year due to increased EBITDA and improved net working capital position. After operating investing activities which increased as a result of higher Capex and IT investments, free operating cash flow ended at EUR 317 million compared to EUR 224 million last year.

## Net working capital

Net working capital position decreased by EUR 79 million to EUR 823 million, compared to EUR 894 million last year. The decrease was primarily a result of lower value of trade receivables. Arla has improved the net working capital position continuously and 2019 was the third consecutive year of improvement. Increased working capital requirements primarily related to our international business was offset by the effect from utilisation of receivables and supply chain finance programmes and improved internal processes. Turnover days improved by 1.8 days in 2019 compared to 2018.

## Continuously strong investment level

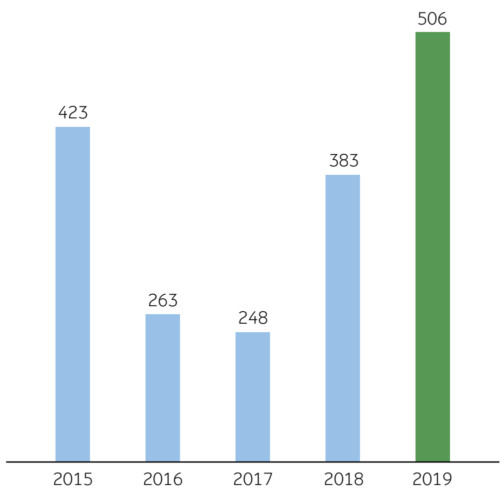
Our investments level has been increasing since 2018, reaching the highest level since 2014 this year. Our Capex investments, including right of use assets totalled at EUR 506 million in 2019.

Key Capex projects included the start of a capacity increase in mozzarella production at our site in Branderup, Denmark, and increased activities in the development of our powder tower in Pronsfeld, Germany. Both projects will continue into 2020, with increased investment levels compared to this year.

On top of our Capex investment, we acquired a cheese production site in Bahrain from Mondeléz International and subsequently entered into a long-term Kraft license agreement.

In 2019 we also initiated embedding the carbon footprint of Capex and M&A investments into our investment approval and prioritization process and creating a sustainability adjusted payback indicator for use in future business case evaluation.

**Investments in property, plant and equipment including right of use assets**
(EUR million)



# FINANCIAL OUTLOOK

In 2020, we will build on the momentum created in 2019, and further strengthen our position versus our peers with focus on branded growth, our transformation and efficiency programme, Calcium and our sustainability agenda. By the end of 2020 we will reach the end of our Good Growth 2020 strategic period, and we are confident that we will meet all the financial targets set at the launch of the strategy in 2015.

The macroeconomic and political outlook is challenging, but the outlook for dairy industry remains stable. However, with strong commercial execution, an accelerated innovation agenda and the dedication of Arla and our farmers to become more sustainable, we will again take big steps towards creating the future of dairy.

### Signs of global economy recovery, but growth remains modest

We enter 2020 with early signs of stabilisation of the global economy, nevertheless risks still remain prominent. The current geopolitical tensions, trade conflict escalation, risk of further slowdown in China due to the coronavirus outbreak, and Brexit cause uncertainty around global trading and investment flows. However, the recent more positive news the on US-China trade discussions, and eased fears of Brexit without deal led to more positive outlook for 2020 versus 2019. IMF Global economic outlook projects global growth at 3.3 per cent (3.0 per cent in 2019); emerging and developing economies at 4.4 per cent (3.7 per cent in 2019) and advanced economies at 1.6 per cent (1.7 per cent in 2019).

### Stable market milk price and production outlook

Global dairy demand is expected to be fairly stable in 2020, but changes of general economic situation may work against stability. As global supply and demand are anticipated to continue remaining fairly balanced, the expectation for dairy price outlook is stable. Change in trade agreements and other disruptions may have a negative impact on the dairy industry once materialized.

The main consumer trend we expect to impact dairy sales in 2020, especially in the Western markets will be the growing consumer demand for sustainably sourced foods, and for nutritious products fitting into increasingly busy and fragmented schedules, combined with a higher demand for transparency and accountability.

**Targets, achievements, outlook**

| | Target 2019 | Result 2019 | Expectations 2020 |
|---|---|---|---|
| **Revenue** (Billion EUR) | 10.2-10.6 | 10.5 | 10.4-10.8 |
| **Profit share** (of revenue) | 2.8-3.2% | 3.0% | 2.8-3.2% |
| **Calcium** (Million EUR) | 75-100 | 110 | 75-100 |
| **Leverage** | 2.8-3.4 | 2.8 | 2.8-3.4 |
| **Strategic branded volume driven revenue growth** | 1.5-3.5% | 5.1% | 2-4% |
| **Brand share** | ≥ 46.0% | 46.7% | ≥ 48.0% |
| **International share** | ≥ 20.0% | 21.9% | ≥ 23.0% |

# FINANCIAL OUTLOOK (CONTINUED)

## Further improving the quality of our business through strategic branded growth

We expect to further strengthen our branded volume growth in 2020, although at a more modest rate than in 2019. We expect to grow branded volumes in the range of 2-4 per cent and hence further improve the quality of our revenue and the competitiveness of our business portfolio. The 2020 branded growth target is expected to move our strategic branded share of revenue to 48 per cent, and our international share to 23 per cent, with another important move towards realising the ambitions set out in our Good Growth 2020 strategy. The continued strategic branded growth in 2020 is expected to be driven by strong development in our strategic brands across both in our European and international commercial segments.

## Cost improvements driven by Calcium

We expect to further strengthen Arla's competitiveness, driven by our transformation and efficiency programme, Calcium where our ambition for 2020 is to again achieve savings of EUR 75-100 million. In 2020, Calcium savings are expected to be largely driven by lower costs in our production, logistics and procurement activities. We expect saving accumulation to somewhat slow down as the programme matures, and as we execute efficiency transformations showing tangible financial effects in the long run. By the end of 2020, we expect total Calcium savings of at least EUR 300 million. Moreover, we expect to have put all initiatives in motion to ensure that we can deliver of our 2021 target of EUR 400+ million run-rate savings.

## Net profit of at least 2.8 per cent expected

As we always 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 net profit share for 2020 in the range of 2.8 to 3.2 per cent. Our net profit target range is a full year target, and results at half-year 2020 are expected to be below the annual target range due to seasonality in our profit creation.

## Significant investments planned

We expect 2020 to be another big investment year, with a Capex outlook of EUR 619 million driven by structural investments and Calcium efficiency initiatives. Our main project will be to work on our powder tower in Pronsfeld, Germany, to continue the mozzarella capacity increase project in Branderup, Denmark, and upgrade our recently acquired production site in Bahrain, as well as significant investments into capacity increase for AFI. Our strong balance sheet allows us to increasingly invest in the capacities and technologies required to succeed in the future, with an increasing focus on energy efficiency, such as combined heat-and-power facilities at our plants, and a range of Calcium initiatives driving line efficiency.

## Leverage expected within target range

The availability of sufficient financial manoeuvring room is a priority at Arla Foods, as it enables us to strategically position ourselves for future growth. Based on our ambitious investment plans for 2020, we expect leverage to increase slightly versus the 2019 level. However, continued improvement of our working capital position and a strong operational cash flow will allow us to stay firmly within our target range of 2.8 to 3.4.

## Strong delivery expected on our Good Growth 2020 strategic ambitions

We are now moving into the final year of the Good Growth 2020 Strategy. With the financial outlook for 2020 we expect to meet all the group financial and strategic KPIs. These include expanding our branded anfd international sales to increase the absolute and relative of the high-margin business for our farmer owners. We will also maintain a strong financial position, as evidenced by our financial leverage. We expect that the successful delivery on Good Growth 2020 will put Arla in a strong position to embark on our next strategic horizon beyond 2020.

**Good Growth 2020 ambitions and our 2020 outlook**

| | Starting point in 2014 | Strategic ambition | 2020 Outlook |
|---|---|---|---|
| **Step up branded growth** (i.e. SB VDRG) | **1-2%** annual growth | **3%** | > **3.5%** (accumulated 2014-2020 SBVDRG) |
| **Boost Strategic Brands** (i.e. Brand share of business) | **42.1%** | > **45.0%** | ≥ **48.0%** |
| **Grow International sales** (i.e. International share) | **16.9%** | ~ **23.0%** | ≥ **23.0%** |
| **Leverage** | **3.3** | **2.8-3.4** | **2.8-3.4** |

*The forward-looking statements in this annual report reflect our current expectations for future events and financial results. Such statements are inherently subject to uncertainty, and actual results may therefore differ from expectations. Factors which may cause the actual results to deviate from expectations include general economic developments and developments in the financial markets, changes or amendments to legislation and regulation in our markets, changes in demand for products, competition and the prices of raw materials. See also the section on risk (from page 47).*


# OUR CONSOLIDATED FINANCIAL STATEMENTS

**Advanced digital tools in finance save us time and money**
With the help of our advanced analytical tools, we are optimising our liquidity management to save a significant amount of time and several hundred thousand EUR annually. The analytical tool we are currently testing suggests how to allocate cash between banks and currency, taking into consideration conditions for credit lines, interest rates, credit margins and transaction costs as well as near term income and payments due. It works faster and analyses more factors simultanously than a human user possibly could.

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# INCOME STATEMENT

| (EURm) | Note | 2019 | 2018* | Development |
|---|---|---|---|---|
| Revenue | 1.1 | 10,527 | 10,425 | *1%* |
| Production costs | 1.2 | -8,325 | -8,341 | *0%* |
| **Gross profit** | | **2,202** | **2,084** | *6%* |
| | | | | |
| Sales and distribution costs | 1.2 | -1,416 | -1,362 | *4%* |
| Administration costs | 1.2 | -389 | -422 | *-8%* |
| Other operating costs | 1.3 | -64 | -43 | *49%* |
| Other operating income | 1.3 | 39 | 118 | *-67%* |
| Share of results after tax in joint ventures and associates | 3.4 | 34 | 29 | *17%* |
| **Earnings before interest and tax (EBIT)** | | **406** | **404** | *0%* |
| | | | | |
| *Specification:* | | | | |
| *EBITDA* | | 837 | 767 | *9%* |
| *Depreciation, amortisation and impairment losses* | 1.2 | -431 | -363 | *19%* |
| **Earnings before interest and tax (EBIT)** | | **406** | **404** | *0%* |
| | | | | |
| Financial income | 4.1 | 10 | 2 | *400%* |
| Financial costs | 4.1 | -69 | -64 | *8%* |
| **Profit before tax** | | **347** | **342** | *1%* |
| | | | | |
| Tax | 5.1 | -24 | -41 | *-41%* |
| **Profit for the year** | | **323** | **301** | *7%* |
| | | | | |
| Non-controlling interests | | -12 | -11 | *9%* |
| **Arla Foods amba's share of profit for the year** | | **311** | **290** | *7%* |

# COMPREHENSIVE INCOME

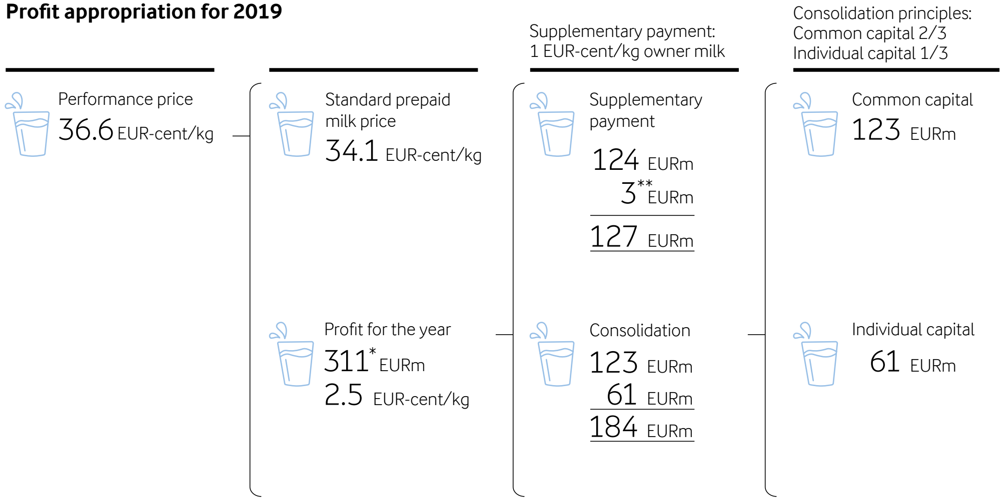
| (EURm) | Note | 2019 | 2018* |
|---|---|---|---|
| **Profit for the year** | | **323** | **301** |
| | | | |
| **Other comprehensive income** | | | |
| **Items that will not be reclassified to the income statement:** | | | |
| Re-measurements of defined benefit schemes | 4.7 | -50 | 25 |
| Tax on remeasurements of defined benefit schemes | | 11 | -6 |
| | | | |
| **Items that may be reclassified subsequently to the income statement:** | | | |
| Value adjustments of hedging instruments | 4.4 | -22 | 3 |
| Fair value adjustments of certain financial assets | | -2 | -3 |
| Adjustments related to foreign currency translation | | 42 | -10 |
| Tax on items that may be reclassified to the income statement | | -1 | -1 |
| **Other comprehensive income, net of tax** | | **-22** | **8** |
| | | | |
| **Total comprehensive income** | | **301** | **309** |
| | | | |
| **Allocated as follows:** | | | |
| Owners of Arla Foods amba | | 289 | 297 |
| Non-controlling interests | | 12 | 12 |
| **Total** | | **301** | **309** |

** Not restated following implementation of IFRS 16. See more details in note 5.6.*

# PROFIT APPROPRIATION

| (EURm) | 2019 | 2018 |
|---|---|---|
| Profit for the year | 323 | 301 |
| Non-controlling interests | -12 | -11 |
| **Arla Foods amba's share of net profit for the year** | **311** | **290** |
| *Profit appropriation:* | | |
| Supplementary payment for milk | 124 | 287 |
| Interest on contributed individual capital | 3 | 3 |
| **Total supplementary payment** | **127** | **290** |
| *Transferred to equity:* | | |
| Reserve for special purposes | 123 | - |
| Contributed individual capital | 61 | - |
| **Total transferred to equity** | **184** | - |
| **Appropriated profit** | **311** | **290** |

**Profit appropriation for 2019**




** Based on profit allocated to owners of Arla Foods amba*
*** Interest on contributed individual capital: 0.02 EUR-cent/kg owner milk based on profit allocated to owners of Arla Foods amba*

**Profit appropriation**

The proposed supplementary payment for 2019 is EUR 127 million, including interest, corresponding to 1 EUR-cent/kg owner milk. Interest on the carrying value of contributed individual capital amounted to EUR 3 million. Contributed individual capital carried an interest of 1.44 per cent in 2019.

In addition, EUR 184 million is transferred to equity and split into 1/3 to individual capital (contributed individual capital), amounting to EUR 61 million, and 2/3 to common capital (reserve for special purposes), amounting to EUR 123 million.

# BALANCE SHEET

| (EURm) | Note | 2019 | 2018* | Development |
|---|---|---|---|---|
| **Assets** | | | | |
| **Non-current assets** | | | | |
| Intangible assets and goodwill | 3.1 | 982 | 887 | *11%* |
| Property, plant, equipment and right of use assets | 3.2 | 2,710 | 2,308 | *17%* |
| Investments in associates and joint ventures | 3.3 | 468 | 439 | *7%* |
| Deferred tax | 5.1 | 43 | 30 | *43%* |
| Pension assets | 4.7 | 16 | 4 | *300%* |
| Other non-current assets | | 24 | 29 | *-17%* |
| **Total non-current assets** | | **4,243** | **3,697** | *15%* |
| **Current assets** | | | | |
| Inventory | 2.1 | 1,092 | 1,074 | *2%* |
| Trade receivables | 2.1 | 889 | 989 | *-10%* |
| Derivatives | 4.5 | 20 | 37 | *-46%* |
| Other receivables | 2.1 | 240 | 254 | *-6%* |
| Securities | 4.6 | 435 | 465 | *-6%* |
| Cash and cash equivalents | | 187 | 119 | *57%* |
| **Total current assets** | | **2,863** | **2,938** | *-3%* |
| **Total assets** | | **7,106** | **6,635** | *7%* |

| (EURm) | Note | 2019 | 2018* | Development |
|---|---|---|---|---|
| **Equity and liabilities** | | | | |
| **Equity** | | | | |
| Common capital | | 1,894 | 1,814 | *4%* |
| Individual capital | | 498 | 456 | *9%* |
| Other equity accounts | | -72 | -89 | *-19%* |
| Proposed supplementary payment to owners | | 127 | 290 | *-56%* |
| **Equity attributable to the owners of Arla Foods amba** | | **2,447** | **2,471** | *-1%* |
| Non-controlling interests | | 47 | 48 | *-2%* |
| **Total equity** | | **2,494** | **2,519** | *-1%* |
| **Liabilities** | | | | |
| **Non-current liabilities** | | | | |
| Pension liabilities | 4.7 | 249 | 224 | *11%* |
| Provisions | 3.4 | 23 | 17 | *35%* |
| Deferred tax | 5.1 | 81 | 84 | *-4%* |
| Loans | 4.2 | 1,951 | 1,369 | *43%* |
| **Total non-current liabilities** | | **2,304** | **1,694** | *36%* |
| **Current liabilities** | | | | |
| Loans | 4.2 | 776 | 860 | *-10%* |
| Trade and other payables | 2.1 | 1,158 | 1,169 | *-1%* |
| Provisions | 3.4 | 9 | 11 | *-18%* |
| Derivatives | 4.5 | 86 | 85 | *1%* |
| Current tax | | 5 | 5 | *0%* |
| Other current liabilities | | 274 | 292 | *-13%* |
| **Total current liabilities** | | **2,308** | **2,422** | *-6%* |
| **Total liabilities** | | **4,612** | **4,116** | *12%* |
| **Total equity and liabilities** | | **7,106** | **6,635** | *7%* |

** Not restated following implementation of IFRS 16. See more details in note 5.6.*

# EQUITY

| | Common capital | | Individual capital | | | | Other equity accounts | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| (EURm) | Capital account | Reserve for special purposes | Contributed individual capital | Delivery-based owner certificates | Injected individual capital | Supplementary payment | Reserve for value adjustment of hedging instruments | Reserve for fair value through OCI | Reserve for foreign exchange adjustments | Total before non-controlling interests | Non-controlling interests | Total Equity after non-controlling interests |
| **Equity at 1 January 2019** | **928** | **886** | **222** | **72** | **162** | **290** | **-72** | **14** | **-31** | **2,471** | **48** | **2,519** |
| Supplementary payment for milk | - | - | - | - | - | 124 | - | - | - | 124 | - | 124 |
| Interest on contributed individual capital | - | - | - | - | - | 3 | - | - | - | 3 | - | 3 |
| Reserve for special purposes | - | 123 | - | - | - | - | - | - | - | 123 | - | 123 |
| Contributed individual capital | - | - | 61 | - | - | - | - | - | - | 61 | - | 61 |
| Non-controlling interests | - | - | - | - | - | - | - | - | - | - | 12 | 12 |
| **Profit for the year** | **-** | **123** | **61** | **-** | **-** | **127** | **-** | **-** | **-** | **311** | **12** | **323** |
| Other comprehensive income | -39 | - | - | - | - | - | -22 | -2 | 41 | -22 | - | -22 |
| **Total comprehensive income** | **-39** | **123** | **61** | **-** | **-** | **127** | **-22** | **-2** | **41** | **289** | **12** | **301** |
| Payments to owners | - | - | -11 | -4 | -9 | - | - | - | - | -24 | - | -24 |
| Dividend to non-controlling interests | - | - | - | - | - | - | - | - | - | - | -15 | -15 |
| Supplementary payment related to 2018 | - | - | - | - | - | -289 | - | - | - | -289 | - | -289 |
| Foreign exchange adjustments | -4 | - | -1 | - | 6 | -1 | - | - | - | - | 2 | 2 |
| **Total transactions with owners** | **-4** | **-** | **-12** | **-4** | **-3** | **-290** | **-** | **-** | **-** | **-313** | **-13** | **-326** |
| **Equity at 31 December 2019** | **885** | **1,009** | **271** | **68** | **159** | **127** | **-94** | **12** | **10** | **2,447** | **47** | **2,494** |
| **Equity at 1 January 2018** | **895** | **886** | **243** | **79** | **180** | **127** | **-75** | **17** | **-19** | **2,333** | **36** | **2,369** |
| Supplementary payment for milk | - | - | - | - | - | 287 | - | - | - | 287 | - | 287 |
| Interest on contributed individual capital | - | - | - | - | - | 3 | - | - | - | 3 | - | 3 |
| Non-controlling interests | - | - | - | - | - | - | - | - | - | - | 11 | 11 |
| **Profit for the year** | **-** | **-** | **-** | **-** | **-** | **290** | **-** | **-** | **-** | **290** | **11** | **301** |
| Other comprehensive income | 19 | - | - | - | - | - | 3 | -3 | -12 | 7 | 1 | 8 |
| **Total comprehensive income** | **19** | **-** | **-** | **-** | **-** | **290** | **3** | **-3** | **-12** | **297** | **12** | **309** |
| Payments to owners | - | - | -17 | -6 | -15 | - | - | - | - | -38 | - | -38 |
| Dividend to non-controlling interests | - | - | - | - | - | - | - | - | - | - | -12 | -12 |
| Acquisition of non-controlling interests | - | - | - | - | - | - | - | - | - | - | 12 | 12 |
| Supplementary payment related to 2017 | - | - | - | - | - | -121 | - | - | - | -121 | | -121 |
| Foreign exchange adjustments | 14 | - | -4 | -1 | -3 | -6 | - | - | - | - | - | - |
| **Total transactions with owners** | **14** | **-** | **-21** | **-7** | **-18** | **-127** | **-** | **-** | **-** | **-159** | **-** | **-159** |
| **Equity at 31 December 2018** | **928** | **886** | **222** | **72** | **162** | **290** | **-72** | **14** | **-31** | **2,471** | **48** | **2,519** |

# EQUITY (CONTINUED)

## 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 below.

### Common capital

Common capital is by nature un-allocated to individual members 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 70, ensures that the account cannot be used for payments 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 recognised in this account.

### Individual capital

Individual capital is capital allocated to each owner based on their delivered milk volume. Individual capital consists of contributed individual capital, delivery-based owner certificates and injected individual 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 contributed individual capital as part of the annual profit appropriation are interest-bearing. The account for proposed supplementary payment that will be paid out following the approval of the annual report is also classified as individual capital.

### Other equity accounts

Other equity accounts include accounts prescribed by IFRS. These include reserves for value adjustments of hedging instruments, the reserve for fair value adjustments of certain financial assets and the reserve for foreign exchange adjustments.

*Non-controlling interests*
Non-controlling interests include the share of group equity attributable to holders of non-controlling interests in group companies.

**Equity share 34 per cent**

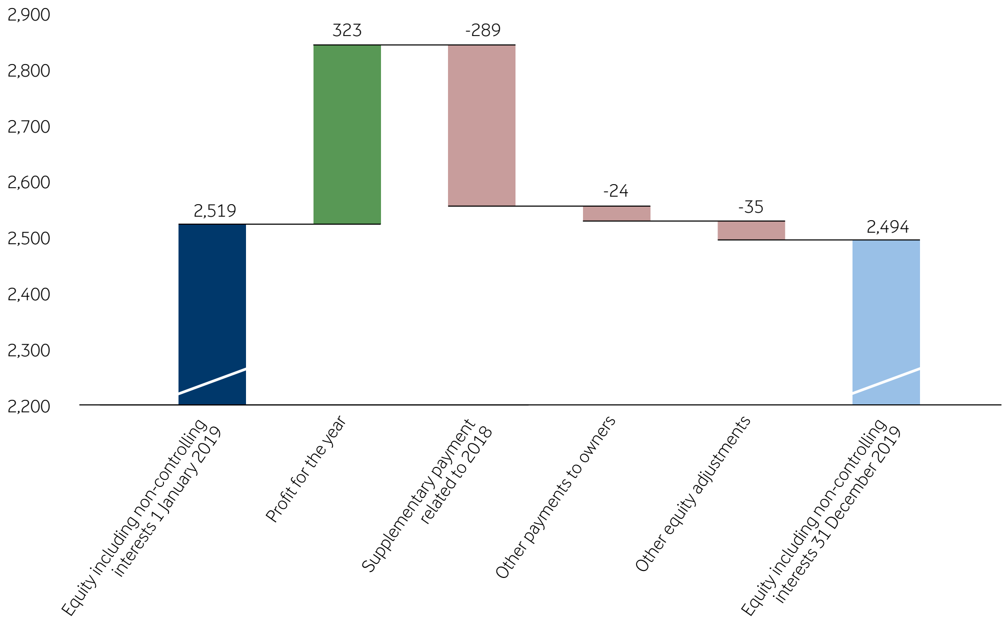
During 2019, equity decreased by EUR 25 million compared to last year.

*Other comprehensive income explained*
Other comprehensive income includes revenue, expenses, as well as gains and losses that are excluded from the income statement. Typically, they have not yet been realised. Other comprehensive income amounted to a net cost of EUR 22 million, which was attributable to actuarial losses on pension liabilities, negative value adjustments on hedging instruments as well as positive value adjustments on net assets measured in foreign currencies.

*Payments to and from owners*
An extraordinary supplementary payment relating to 2018 totalling EUR 289 million was paid out in March 2019. Additionally, EUR 24 million was paid out to owners resigning or retiring from the cooperative.

The Board of Directors proposes to pay-out EUR 127 million in March 2020 as supplementary payment for 2019. Furthermore, it is expected that EUR 19 million will be paid out in 2020 to owners resigning or retiring. Owner development is discussed further on page 36.

**Development in equity**
(EURm)



# EQUITY (CONTINUED)

**Regulations according to Articles of Association and IFRS**

### Common capital

Recognised within the *capital account* are technical items such as actuarial gains or losses on defined benefit pension schemes, effects from disposals and acquisitions of non-controlling interests in subsidiaries and exchange rate differences in the equity instruments issued to owners. Furthermore, the capital account is impacted by agreed contributions from new owners 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 20.1(iii) of the articles of association.

### Individual capital

Individual capital instruments are regulated in article 20 of the articles of association and the general membership terms.

Equity instruments issued as *contributed individual capital* relate to amounts transferred as part of the annual profit appropriation. The individual balances carry interest at CIBOR 12 months + 1.5 per cent that are approved and paid out together with the supplementary payment in connection with the annual profit appropriation.

*Delivery-based owner certificates* are equity instruments issued to the original Danish and Swedish owners. Issue of these instruments ceased in 2010.

*Injected individual capital* are equity instruments issued in connection with cooperative mergers and when new owners enter the company.

Balances on delivery-based owner certificates and injected individual capital instruments carry no interest.

Balances on contributed individual capital, delivery-based owners certificates and on injected individual capital can be paid out over three years upon termination of membership to Arla Foods amba in accordance with the articles of association, subject to the Board of Representatives' approval. Balances are denominated in the currency relevant to the country in which owners are registered. Foreign currency translation adjustments are calculated annually; the effect 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.

### Other equity accounts

*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 where the hedged transaction has not yet been realised.

*Reserve for fair value adjustments through OCI* comprise of the fair value adjustments of mortgage credit bonds classified as financial assets measured at fair value though other comprehensive income.

*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 securing the group's net investment.

*Non-impairment clause*

Under the articles 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 the 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.

*Non-controlling interests*

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

On initial recognition, non-controlling 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 non-controlling interests is selected on a transactional basis.

# CASH FLOW

| (EURm) | Note | 2019 | 2018* |
|---|---|---|---|
| EBITDA | | 837 | 767 |
| Reversal of share of results in joint ventures and associates | 3.3 | -34 | -29 |
| Change in net working capital | 2.1 | 79 | 90 |
| Change in other receivables and other current liabilities | | -37 | -73 |
| Reversal of other operating items without cash impact | | 16 | -43 |
| Dividends received, joint ventures and associates | | 8 | 11 |
| Interest paid | | -69 | -46 |
| Interest received | | 3 | 1 |
| Taxes paid | 5.1 | -30 | -29 |
| **Cash flow from operating activities** | | **773** | **649** |
| | | | |
| Investment in intangible fixed assets | 3.1 | -52 | -55 |
| Investment in property, plant and equipment | 3.2 | -425 | -383 |
| Sale of property, plant and equipment | 3.2 | 21 | 13 |
| Operating investing activities | | -456 | -425 |
| | | | |
| Sale of financial assets | | 37 | 44 |
| Acquisition of enterprises | 3.5 | -168 | -51 |
| Sale of enterprises | 3.5 | 16 | - |
| Financial investing activities | | -115 | -7 |
| | | | |
| **Cash flow from investing activities** | | **-571** | **-432** |

| (EURm) | Note | 2019 | 2018* |
|---|---|---|---|
| **Financing** | | | |
| Supplementary payment regarding the previous financial year | | -289 | -121 |
| Paid in and out from equity regarding individual capital instruments | | -24 | -38 |
| Paid out to non-controlling interests | | -15 | - |
| Loans obtained, net | 4.2.c | 295 | 5 |
| Payment of lease debt | 4.2.c | -66 | - |
| Payment to pension plans | 4.2.c | -37 | -37 |
| **Cash flow from financing activities** | | **-136** | **-191** |
| | | | |
| **Net cash flow** | | **66** | **26** |
| | | | |
| Cash and cash equivalents at 1 January | | 119 | 91 |
| Exchange rate adjustment of cash funds | | 2 | 2 |
| **Cash and cash equivalents at 31 December** | | **187** | **119** |
| | | | |
| **Free operating cash flow** | | | |
| Cash flow from operating activities | | 773 | 649 |
| Operating investing activities | | -456 | -425 |
| **Free operating cash flow** | | **317** | **224** |
| | | | |
| **Free cash flow** | | | |
| Cash flow from operating activities | | 773 | 649 |
| Cash flow from investing activities | | -571 | -432 |
| **Free cash flow** | | **202** | **217** |

** Not restated following implementation of IFRS 16. See more details in note 5.6.*

# CASH FLOW (CONTINUED)

### Strong operational cash flow and increased investments

Free operating cash flow is a measure of the amount of cash generated by normal business operations. Cash flow from operating activities improved by 19 per cent to EUR 773 million compared with EUR 649 million last year. Improved net working capital contributed with a positive net cash release of EUR 79 million. In addition, following transition to the new lease accounting standard, IFRS 16, cash flow from operating activities has increased EUR 66 million, which is due to the reclassification of lease payments into depreciation and interest. See note 5.6.

After operating investments of EUR 456 million, due to higher CAPEX investments, compared with EUR 425 million last year, the free operating cash flow ended at EUR 317 million.

Free cash flow is a measure of the amount of cash generated after investing activities. As a result of our investing activities, primarily related to the acquisition of the cheese business in MENA from Mondelez International, the free cash flow amounted to EUR 202 million.

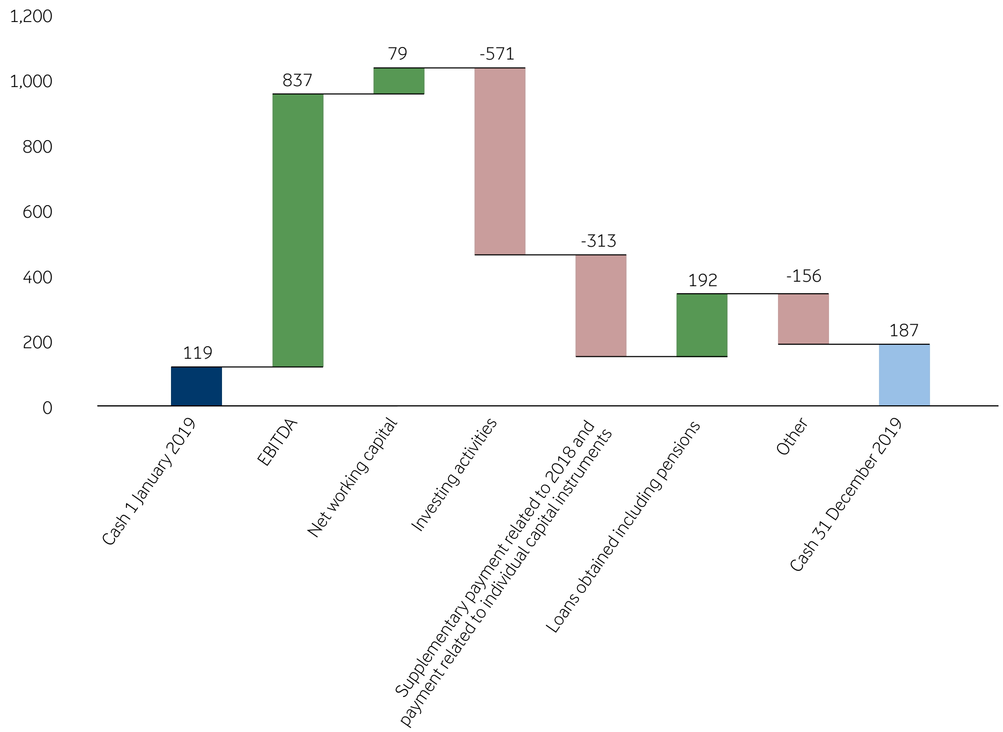
Cash flow from financing activities was EUR -136 million. An extraordinary high supplementary payment of EUR 289 million was made in relation to the 2018 profit allocation and further payments, representing EUR 24 million in individual capital, was paid out to owners who resigned or retired.

Combined cash and cash equivalents as at 31 December 2019 were EUR 187 million, compared to EUR 119 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, changes in working capital items and other items without cash impact.

**Development in cash flow**
(EURm)



# INTRODUCTION TO NOTES

The following sections provide additional disclosures supplementing the primary financial statements.

## Basis for preparation

The annual report is based on the group's monthly reporting procedures. group entities are required to report using standard accounting principles in accordance with the International Financial Reporting Standards as adopted by EU (IFRS).

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, refer to note 5.6.

## Alternative performance measures

The group discloses a number of key performance indicators (KPIs) supplementing the financial figures calculated and presented in accordance with IFRS. Some of these are classified as alternative performance measures most importantly the performance price.

Refer to note 1.4 and the Glossary page 135-136 for more details on alternative performance measures.

## Applying materiality

When preparing the annual report, our focus is on presenting information that is considered of material importance for our stakeholders.

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, however, is not applied for items where disclosures are required for control purposes.

## Currency exposure

The group's financial position 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. Refer to Note 4.3.2 for more detail.

## Significant accounting estimates and assessments

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 estimates and judgements are performed 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. Refer to Note 1.1 for more detail.

*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 goodwill is allocated to activities in the UK. Given the continued uncertainty of potential consequences of Brexit, expected cash flows supporting the carrying value of goodwill is inherently more uncertain. Refer to Note 3.1.1 for more detail.

*Assessing the level of influence and classification of investments*

The group have significant influence through representation in COFCO Dairy Holdings Limited and China Mengniu dairy company Limited. Based on this, the investment is classified as an associated company. Refer to Note 3.3 for more detail.

*Valuation of inventory*

Estimates are applied in assessing net realisable inventory values. 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. Refer to Note 2.1 for more detail.

*Valuation of pension plans*

Judgements are applied when setting actuarial assumptions such as the 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 ensure that they are set consistently on an annual basis and in compliance with best practice. Refer to Note 4.7 for more detail.

# NOTE 1.1 REVENUE

### Stronger sales in international growth markets and improved brand positions

Revenue increased by 1.0 per cent to EUR 10,527 million, compared to EUR 10,425 million last year primarily due to currencies and M&A activities. The underlying stable revenue reflects stronger sales in the international growth markets and more sales of branded products in Europe offset by lower volumes in less profitable private label business. Arla Foods Ingredients sales also grew at near double-digit rates.

Revenue related to strategic branded volume grew by 5.1 per cent, compared to 3.1 per cent last year, driven by Arla®, Lurpak®, Puck® and other supported brands. Price levels decreased by 0.3 per cent for the full year.

Europe is Arla's largest commercial segment, comprising 60.3 per cent of total revenue, compared to 62.4 per cent last year. The strategic branded revenue in Europe grew 2.9 per cent with increases coming from all markets. Branded volumes grew to 53.0 per cent of revenue compared to 50.4 per cent last year. Despite higher branded volumes revenue in Europe decreased by EUR 154 million, driven by negative effects from lower private lable volumes, and to a lesser extent by prices and currencies. This development was partially offset by the full year effect from acquisition of Yeo Valley Dairies Ltd, UK, in 2018 and divestment of the remaining Allgäu-activities in Germany.

The international segment accounted for 17.1 per cent of total revenue, compared to 15.1 per cent last year. The strategic branded revenue in international represented 82.7 per cent of revenue compared to 85.0 per cent last year. The revenue in international increased by EUR 226 million, driven primarily by higher volumes.

The revenue in international was positively affected by acquisition of the cheese business in MENA from Mondelez International and currency, primarily due to the development in the USD.

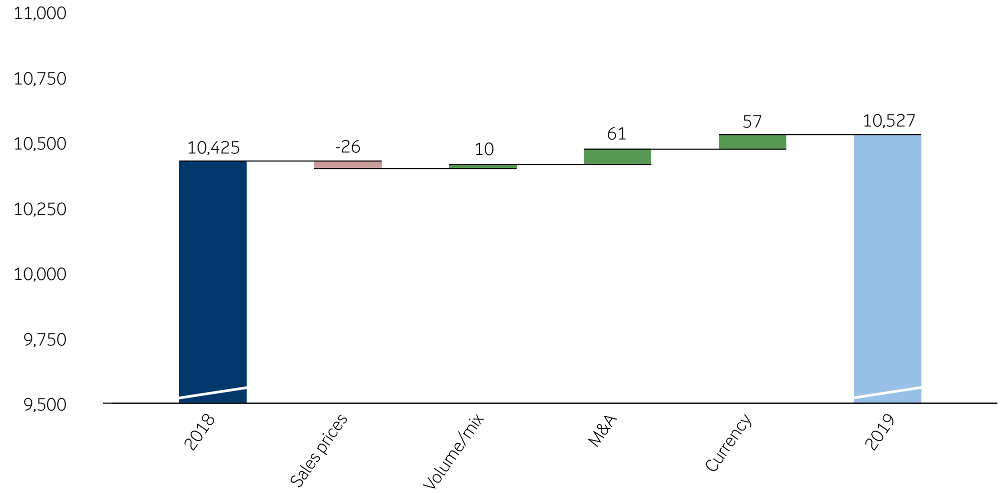
Arla Foods Ingredients comprised 7.1 per cent of the total revenue, compared to 6.3 percent last year. Revenue increased due to more sales of value-added products within the ingredients segment, higher prices and the full-year effect from the acquisition of the remaining 50 per cent share of Arla Foods Ingredients S.A., Argentina in 2018.

The trading and other segment represented 15.8 per cent of the total revenue and decreased by 1.7 per cent to EUR 1.662 million versus EUR 1,690 million last year.

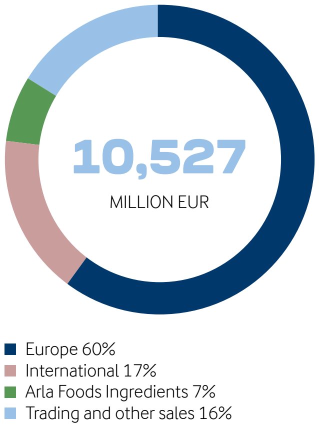
M&A activities including purchase of the Kraft branded cheese business in MENA and the divestment of the remaining Allgäu-activities in Germany, both in 2019 combined with the full year effects from acquisitions in 2018, contributed to a revenue increase of EUR 61 million.

Total revenue was positively affected by exchange rate developments of EUR 57 million, driven primarily by USD.

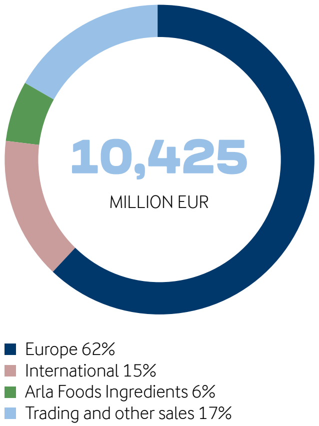
**Development in revenue**
(EURm)




**Revenue split by commercial segment, 2019**




**Revenue split by commercial segment, 2018**



# NOTE 1.1 REVENUE (CONTINUED)

| **Table 1.1.a Revenue split by country** (EURm) | **2019** | **2018** | **Share of revenue in 2019** |
|---|---|---|---|
| United Kingdom | 2,716 | 2,725 | 26% |
| Sweden | 1,464 | 1,481 | 14% |
| Germany | 1,343 | 1,447 | 13% |
| Denmark | 1,054 | 1,094 | 10% |
| Netherlands | 507 | 507 | 5% |
| China | 331 | 276 | 3% |
| Finland | 324 | 320 | 3% |
| Saudi Arabia | 282 | 244 | 3% |
| Belgium | 211 | 240 | 2% |
| USA | 176 | 171 | 2% |
| Other* | 2,119 | 1,920 | 19% |
| **Total** | **10,527** | **10,425** | |

**Other countries include, amongst others, Oman, Canada, UAE, Spain, France, Australia*

Table 1.1.a 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 23 to 28.

| **Table 1.1.b Revenue split by brand** (EURm) | **2019** | **2018** |
|---|---|---|
| Arla®** | 3,033 | 2,875 |
| Lurpak®** | 588 | 561 |
| Puck®** | 363 | 352 |
| Castello®** | 179 | 179 |
| Milk based beverage brands** | 207 | 187 |
| Other supported brands | 452 | 437 |
| Arla Foods Ingredients | 710 | 652 |
| Non-strategic brands and other | 4,995 | 5,182 |
| **Total** | **10,527** | **10,425** |

***Included in strategic branded revenue*

## Accounting policies

All revenue is derived from contracts with customers through the production and transfer of dairy products across various product categories and within several geographical regions. Revenue per commercial segment or market is based on the group's internal financial reporting practices.

Revenue is recognised in the income statement when the performance obligation is satisfied, and when all obligations stated in the contract are fulfilled. This is defined as the point in time when control of the products has been transferred to the buyer, the amount of revenue can be measured reliably and collection is probable. The transfer of control to customers takes place according to trade agreement terms, i.e. the Incoterms and can vary depending on the customer or specific trade.

Revenue comprises invoiced sales for the year less customer-specific payments, such as sales rebates, cash discounts, listing fees, promotions, VAT and duties. Contracts with customers can contain various types of discounts. Historical experience is used to estimate discounts, in order to correctly recognise revenue.

Furthermore, revenue is only recognised when it is highly probable that a material reversal in the amount of revenue will not occur. This is generally the case when the control of the product is transferred to the customer also taking into consideration the level of rebates.

The vast majority of all contracts have short payment terms with an average of 35 days. Therefore, an adjustment of the transaction price with regards to a financing component in the contracts with customers is not required.

## Uncertainties and estimates

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

Since Arla's main line of business is the sale of fresh dairy products, returns of goods rarely occur and therefore do not require specific accounting disclosure.

Based on current milk price, Arla contractually secured approximately EUR 219 million revenue related to raw milk sales for 2020 and approximately EUR 119 million for 2021 and later.

# NOTE 1.2 OPERATIONAL COSTS

### Calcium deliver cost savings

Operational costs were EUR 10,130 million which is broadly the same level as prior year.

Production costs decreased by 0.2 per cent to EUR 8,325 million from EUR 8,341 million last year. Excluding costs relating to raw milk, production costs decreased to EUR 3,499 million compared to EUR 3,534 million last year. Despite an increased focus on sales of branded products, resulting in a volume/mix effect of EUR 57 million in additonal cost, Calcium initiatives led to savings within production. Refer to pages 17-18 for more on Calcium. Due to increasing milk prices, inventory increased by EUR 11 million compared to last year. Finally production cost increased by EUR 30 million due to M&A activities.

Sales and distribution costs increased 4.0 per cent to EUR 1,416 million compared to EUR 1,362 million last year, mainly due to higher transportation and salary costs partly offset by lower marketing costs. Research and development cost amounted to EUR 66 million, compared to EUR 47 million last year. In addition EUR 13 million related to capitalised development activities.

Administration costs decreased 7.8 per cent to EUR 389 million compared to EUR 422 million last year, primarily due to cost control and non-recurring one-offs in 2018.

**Cost of raw milk**
The cost of raw milk increased to EUR 4,826 million compared to EUR 4,807 million. The increase was a result of higher average pre-paid milk prices to owners offset by lower volumes on other purchased milk.

*Owner milk*
Costs related to owner milk increased by EUR 32 million. Average pre-paid milk price increased costs by EUR 54 million while slightly lower volumes decreased costs by EUR 22 million.

*Other milk*
Costs of other milk decreased by EUR 13 million due to lower volumes. Other milk consists of speciality milk and other contract milk acquired to meet local market demands.

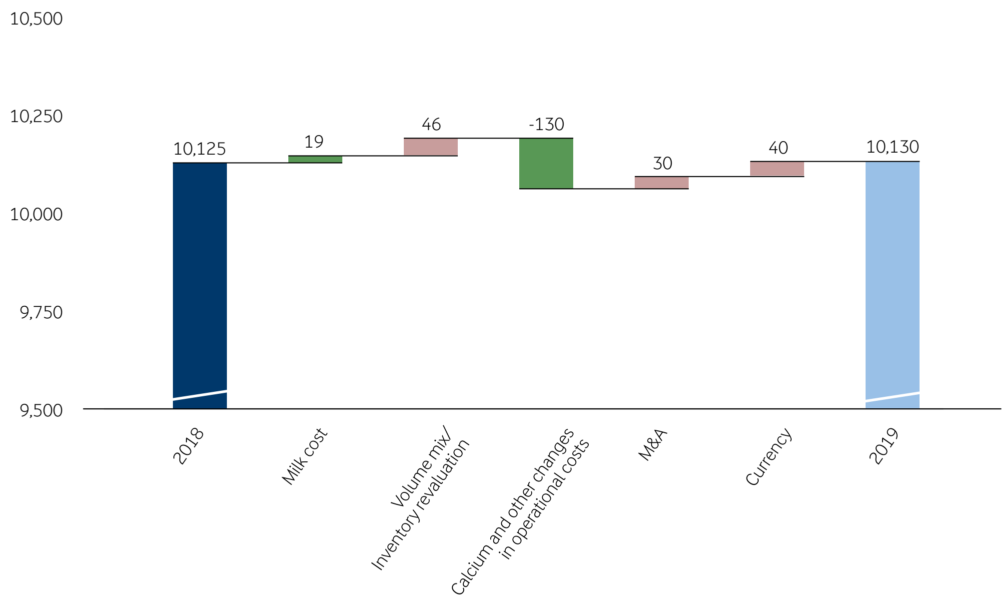
**Staff costs and FTE**
Staff costs increased 2.4 per cent to EUR 1,276 million compared to EUR 1,246 million last year. Staff costs increased due to additional FTE's from the acquisition of new entities, insourcing of transportation activities, inflation and due to new principles for vacation allowance in Denmark.

Staff cost within production and sales and distribution increased 2.7 per cent and 7.3 per cent respectively, while staff cost in administration decreased by 6.1 per cent. The total number of FTE's decreased to 19,174 despite significant expansion and acquisitions in International and Arla Foods Ingredients.

**Marketing spend**
Marketing spend decreased 4.9 per cent to EUR 250 million compared to EUR 263 million last year. Continued focus on efficiency improvements enabled by the Calcium transformation and efficiency programme including insourcing and upscaling of "The Barn" our in-house content studio, allowed us to reduce spend. Major marketing achievements included the continued vitalisation of the Arla brand through "Inner strength", the launch of Lurpak® Butterbox in the UK and reaching the 500 million on digital engagement milestone one year ahead of plan. Refer to page 22 for more detail.

**Depreciation, amortisation and impairment**
Depreciation, amortisation and impairment increased 18.7 per cent to EUR 431 million compared to EUR 363 million last year. This was primarily due to implementation of the new lease accounting standard, IFRS 16, and higher levels of CAPEX.

**Development in operational costs**
(EURm)

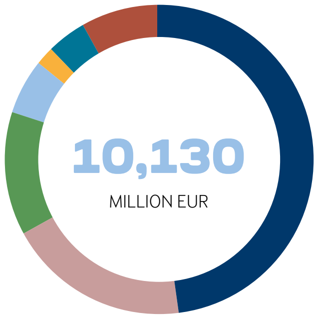


# NOTE 1.2 OPERATIONAL COSTS (CONTINUED)

| **Table 1.2.a Operational costs split by function and type** (EURm) | **2019** | **2018*** |
|---|---|---|
| Production costs | 8,325 | 8,341 |
| Sales and distribution costs | 1,416 | 1,362 |
| Administration costs | 389 | 422 |
| **Total** | **10,130** | **10,125** |
| *Specification:* | | |
| Weighed-in raw milk | 4,826 | 4,807 |
| Other production materials** | 1,911 | 1,945 |
| Staff costs | 1,276 | 1,246 |
| Transportation costs | 570 | 560 |
| Marketing costs | 250 | 263 |
| Depreciation, amortisation and impairment | 431 | 363 |
| Other costs*** | 866 | 941 |
| **Total** | **10,130** | **10,125** |

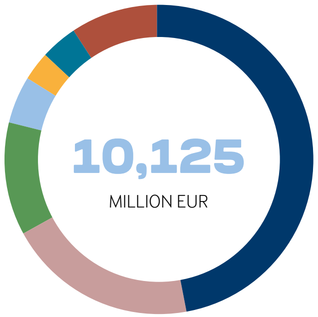
***Other production materials includes packaging, additives, consumables and changes in inventory*
****Other costs mainly includes maintenance, utilities and IT*

**Cost split by type, 2019**




- Weighed-in raw milk 48%
- Other production materials* 19%
- Staff costs 13%
- Transportation costs 6%
- Marketing costs 2%
- Depreciation, amortisation and impairment 4%
- Other costs** 8%

**Cost split by type, 2018**




- Weighed-in raw milk 47%
- Other production materials* 20%
- Staff costs 12%
- Transportation costs 5%
- Marketing costs 3%
- Depreciation, amortisation and impairment 4%
- Other costs** 9%

| **Table 1.2.b Weighed-in raw milk** | **2019** | | **2018** | |
|---|---|---|---|---|
| | Weighed in mkg | EURm | Weighed in mkg | EURm |
| Owner milk | 12,382 | 4,318 | 12,446 | 4,286 |
| Other milk | 1,323 | 508 | 1,457 | 521 |
| **Total** | **13,705** | **4,826** | **13,903** | **4,807** |

| **Table 1.2.c Staff costs** (EURm) | **2019** | **2018** |
|---|---|---|
| Wages, salaries and remuneration | 1,089 | 1,055 |
| Pensions - defined contribution plans | 79 | 74 |
| Pensions - defined benefit plans | 3 | 11 |
| Other social security costs | 105 | 106 |
| **Total staff costs** | **1,276** | **1,246** |
| Staff costs relate to: | | |
| Production costs | 722 | 703 |
| Sales and distribution costs | 355 | 331 |
| Administration costs | 199 | 212 |
| **Total staff costs** | **1,276** | **1,246** |
| Average number of full-time employees | 19,174 | 19,190 |

| **Table 1.2.d Depreciation, amortisation and impairment** (EURm) | **2019** | **2018*** |
|---|---|---|
| Intangible assets, amortisation | 64 | 57 |
| Property, plant and equipment including right of use assets, depreciation | 367 | 306 |
| **Total depreciation, amortisation and impairment** | **431** | **363** |
| *Depreciation, amortisation and impairment relate to:* | | |
| Production costs | 310 | 277 |
| Sales and distribution costs | 74 | 40 |
| Administration costs | 47 | 46 |
| **Total depreciation, amortisation and impairment** | **431** | **363** |

** Not restated following implementation of IFRS 16. See more details in note 5.6.*

# NOTE 1.2 OPERATIONAL COSTS (CONTINUED)

### Accounting policies

*Production costs*
Production costs include direct and indirect costs related to production including movements in volumes on inventory and related inventory revaluation. Direct costs comprise purchase of milk from owners, inbound transportation costs, packaging, additives, consumables, energy and variable salaries directly related to the production. Indirect costs comprise other costs related to the production of goods including depreciation and impairment losses on production-related material and other supply chain related costs. 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 relating to sales staff, the write-down of receivables, sponsorship, research and development, depreciation and impairment losses, are recognised as sales and distribution costs. Sales and distribution costs include marketing expenses relating to investment in the group's brands and comprise the development of marketing campaigns, advertisement, exhibits, sponsorships and others.

*Administration costs*
Administration costs relate to management and administration, including administrative staff, office premises and office costs, as well as depreciation and impairment.

# NOTE 1.3 OTHER OPERATING INCOME AND COSTS

### Positive development in currencies resulted in a negative hedging impact

Net other operating costs amounted to EUR 25 million, compared to a net other operating income of EUR 75 million last year. The decrease is attributable to negative effects from hedging activities due to positive currency developments, primarily in USD. In 2018 settlement of disputes and recognition of a revaluation gain from step acquisition of entities had a positive effect of EUR 76 million. Other items include the net result from the sale of surplus energy and effects from other items not part of the regular dairy activities.

### Accounting policies

Other operating income and costs consist of items outside the regular course of dairy business activities. It includes items such as gains and losses relating to the settlement of disputes, revaluation gains from step acquisition of entities, the net result from financial hedging activities and the net result from the production and sale of energy from our biogas plants. Furthermore, it includes gains and losses from the disposal of fixed assets no longer used within our dairy operations.

| **Table 1.3 Other operating income, net** (EURm) | **2019** | **2018** |
|---|---|---|
| Other operating income | 39 | 118 |
| Other operating costs | -64 | -43 |
| | -25 | 75 |
| *Specification:* | | |
| Settlement of legal disputes | - | 47 |
| Revaluation gain from step acquisition of entities | - | 29 |
| Effect from hedging activities, net | -30 | -5 |
| Other items, net | 5 | 4 |
| **Total other operating income, net** | **-25** | **75** |

# NOTE 1.4 PERFORMANCE PRICE

### Competitive performance price supported by Calcium savings

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 the milk volume weighed-in in 2019. The performance price was 36.6 EUR-cent/kg owner milk, compared to 36.4 EUR-cent/kg owner milk last year.

| **Table 1.4 Performance price** | **2019** | | | **2018** | | |
|---|---|---|---|---|---|---|
| | EURm | Volume in mio. kg | EUR-cent/ kg | EURm | Volume in mio. kg | EUR-cent/ kg |
| Owner milk | 4,318 | 12,382 | 34.9 | 4,286 | 12,446 | 34.4 |
| Adjustment to standard milk (4.2% fat, 3.4% protein) | | | -0.8 | | | -0.3 |
| Arla Foods amba's share of profit for the year | 311 | | 2.5 | 290 | | 2.3 |
| **Total** | | **12,382** | **36.6** | | **12,446** | **36.4** |

# NOTE 2.1 NET WORKING CAPITAL

**Net working capital position improved**

Net working capital decreased by EUR 71 million to EUR 823 million, which represents an improvement of 7.9 per cent compared to last year. Adjusted for M&A and currency effects the cash release from net working capital was EUR 109 million. This positive development was a result of Arla's continuous efforts towards optimising net working capital, including initiatives such as increased use of global procurement agreements, improved payments terms, as well as utilization of finance programmes with our customers and suppliers. Overall the net working capital, measured in days on a trailing 3-months basis, improved 1,8 days compared to last year.

Excluding payables relating to owner milk, net working capital decreased by EUR 103 million.

*Inventory*
Inventory increased by EUR 18 million to EUR 1,092 million, compared to EUR 1,074 million last year. Excluding currency and M&A effects, inventory decreased by EUR 13 million. A combination of inventory management across the business and stable milk prices resulted in inventory levels broadly in line with last year.

*Trade receivables*
Trade receivables decreased by EUR 100 million to EUR 889 million, compared to EUR 989 million last year. Excluding currency and M&A effects, trade receivables decreased EUR 115 million. The decrease was driven by utilization of customers offering of supply chain finance programmes and customer factoring programs on selected customers. The group utilised these programmes to manage liquidity and to reduce the credit risk on trade receivables.

Managing credit risk exposure on trade receivables is guided by group-wide policies. Credit limits are set based on the customer's financial position and current market conditions. The customer portfolio is diversified in terms of geography, industry sector and customer size. In 2019, the group was not extraordinarily exposed to credit risk related to significant individual customers, but to the general credit risk in the retail sector. Read more about credit risk in note 4.3.5.

Historically, amounts written off as irrecoverable were relatively low, which was also the case in 2019. EUR 6 million was recognized in the income statement as a loss arising on bad debt compared to EUR 2 million last year.

*Trade and other payables*
Trade and other payables amounted to EUR 1,158 million, compared to EUR 1,169 million last year. Continued utilisation of global contracts, focus on payment terms and use of supply chain finance programmes resulted in trade and other payables being in line with last year.

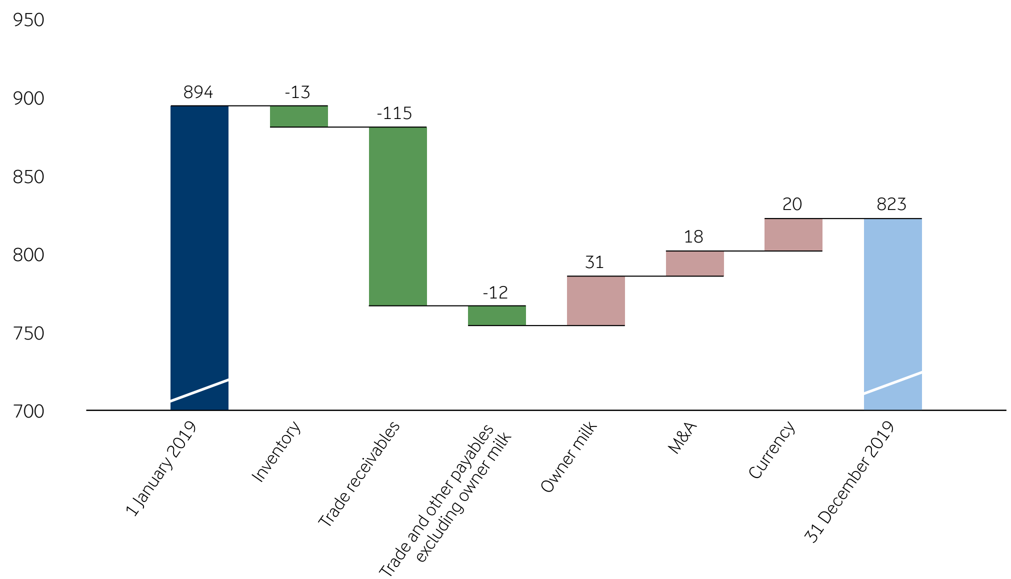
A number of Arla's strategic suppliers participates in supply chain finance programmes, where the supply chain finance provider and related financial institutions act as a funding partner. When suppliers participate in these programmes, the supplier has the option, at their own discretion and flexibility, to receive early payment from the funding partner based on invoices sent to Arla. There is also a requirement that Arla has recognised and approved delivery of the goods or services and irrevocably accepted to pay the invoice at maturity date via the funding partner. The arrangement of early payment is an exclusive transaction between the supplier and the supply chain finance provider.

The liability for Arla, represented by the invoice, is recognised within trade and other payables until maturity. The programme is one of many components in the overall relationship between strategic suppliers and Arla to improve the cash position for both parties. Extended payment terms are not embedded in the programmes themselves but agreed with vendors directly. The liquidity risk for Arla by termination of programmes is limited. The payment terms for suppliers participating in the programmes are no more than 180 days. Utilisation of the supply chain finance programmes was at the same level as last year and had no significant impact on the net working capital level compared to last year.

*Other receivables and other current liabilities*
Other receivables decreased EUR 14 million to EUR 240 million compared to EUR 254 million last year. Other receivables include, but are not limited to, VAT receivables, deposits and subsidies.

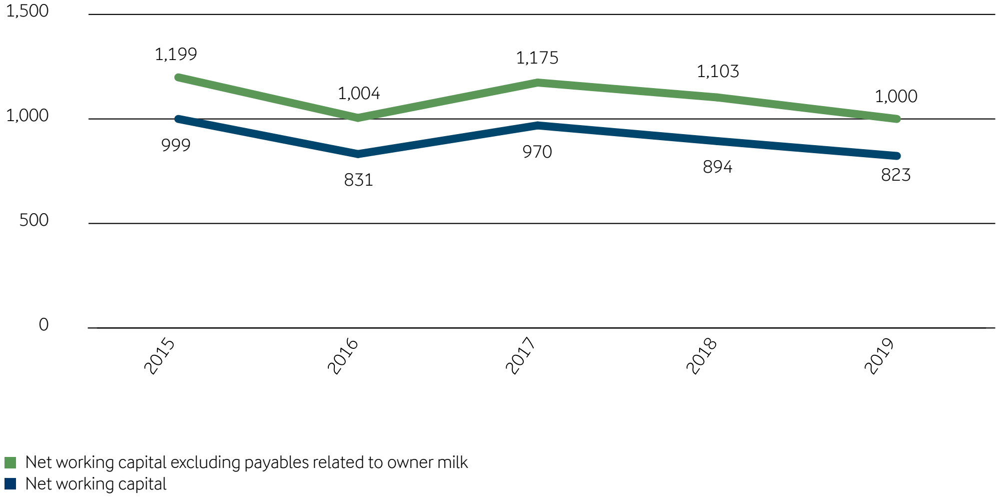
Other current liabilities decreased EUR 38 million to EUR 254 million compared to EUR 292 million last year. Other current liabilities include HR related payables of EUR 174 million.

**Development in net working capital**
(EURm)



# NOTE 2.1 NET WORKING CAPITAL (CONTINUED)

**Net working capital**
(EURm)




| **Table 2.1.a Net working capital** (EURm) | **2019** | **2018** |
|---|---|---|
| Inventory | 1.092 | 1,074 |
| Trade receivables | 889 | 989 |
| Trade and other payables | -1.158 | -1,169 |
| **Net working capital** | **823** | **894** |

| **Table 2.1.b Inventory** (EURm) | **2019** | **2018** |
|---|---|---|
| Inventory before write-downs | 1.112 | 1,099 |
| Write-downs | -20 | -25 |
| **Total inventory** | **1.092** | **1,074** |
| Raw materials and consumables | 279 | 260 |
| Work in progress | 339 | 332 |
| Finished goods and goods for resale | 474 | 482 |
| **Total inventory** | **1.092** | **1,074** |

| **Table 2.1.c Trade receivables** (EURm) | **2019** | **2018** |
|---|---|---|
| Trade receivables before provision for expected losses | 904 | 1,000 |
| Provision for expected losses | -15 | -11 |
| **Total trade receivables** | **889** | **989** |

| **Table 2.1.d Trade receivables age profile** (EURm) | **2019** | | **2018** | |
|---|---|---|---|---|
| | Gross carrying amount | Expected loss rate | Gross carrying amount | Expected loss rate |
| Not overdue | 703 | 0% | 808 | 0% |
| Overdue less than 30 days | 130 | 0% | 131 | 0% |
| Overdue between 30 & 89 days | 39 | 5% | 33 | 3% |
| Overdue more than 90 days | 32 | 41% | 28 | 29% |
| **Total trade receivables** | **904** | | **1,000** | |

Historically, experienced loss rates on balances not due or less than 30 days are below 1 per cent.

# NOTE 2.1 NET WORKING CAPITAL (CONTINUED)

## Accounting policies

*Inventory*
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 inventory marketability and an 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 expected losses in accordance with the simplified approach for amounts considered irrecoverable (amortised cost). Expected losses are measured as the difference between the carrying amount and the present value of anticipated cash flow.

Expected losses are assessed on major individual receivables or in groups at a portfolio level, based on the receivables' age and maturity profile as well as historical records of losses. Calculated expected losses are adjusted for specific significant negative developments in geographical areas.

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

*Other receivables and other current liabilities*
Other receivables and other current liabilities are measured at amortized cost usually corresponding to the nominal amount.

## Uncertainties and estimates

*Inventory*
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 on European or global commodity markets.

*Receivables*
Calculation of expected losses are based on a mathematical computation, including several parameters, for example, number of days overdue adjusted for significant negative developments in certain geographical areas.

The financial uncertainty associated with provision for expected losses is usually considered to be limited. However, if a customer's ability to pay were to deteriorate 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 3.1 INTANGIBLE ASSETS AND GOODWILL

### Intangible asset and goodwill increased due to acquisitions

Intangible assets and goodwill amounted to EUR 982 million, representing an increase of EUR 95 million compared to last year.

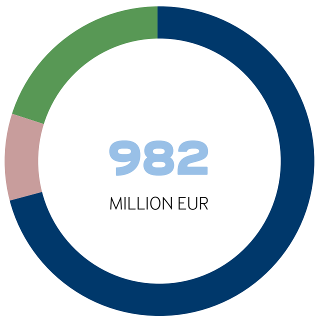
*Goodwill*
The carrying value of goodwill amounted to EUR 700 million, compared to EUR 597 million last year. Goodwill increased by EUR 80 million at aquistion date due to the acquisition of the cheese business in MENA from Mondelez International. Of the total carrying value of goodwill, EUR 489 million related to activities in the UK, compared to EUR 463 million last year. This increase in goodwill was due to exchange rate adjustments. Refer to Note 3.1.1 for more detail.

*Licenses and trademarks*
The carrying value of licences and trademarks recognised amounted to EUR 90 million, compared to EUR 96 million last year. The decrease was due to amortisation of trademarks. Major brands include Yeo Valley®, Anchor® and Hansano®.

The strategic brands, Arla®, Lurpak®, Castello® and Puck®, are internally generated trademarks and consequently no carrying value is recognised for these. Arla has the license to manufacture, distribute, and market Starbucks™ premium ready-to-drink coffee beverage under a long-term strategic license agreement which is not capitalised. After the acquisition from Mondelez, Arla signed a long term license agreement to manufacture, distribute and market Kraft branded cheese products in the MENA region. No value was recognised following this licensing agreement.

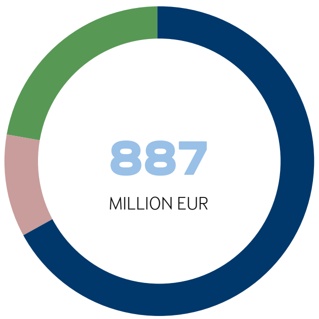
*IT and other development projects*
The carrying value of IT and other development projects was EUR 192 million, compared to EUR 194 million last year. The group continued to invest in the development of IT. In 2019 IT investments related to support of promotion planning and a freight cost management solution. Other capitalised development costs include innovation activities and the development of new products.

**Intangible assets, 2019**




■ Goodwill 71%
■ Licences and trademarks 9%
■ IT and other development projects 20%

**Intangible assets, 2018**




■ Goodwill 67%
■ Licences and trademarks 11%
■ IT and other development projects 22%

| **Table 3.1.a Intangible assets and goodwill** (EURm) | Goodwill | Licenses and trademarks | IT and other development projects | Total |
|---|---|---|---|---|
| **2019** | | | | |
| Cost at 1 January | 598 | 170 | 431 | 1.199 |
| Exchange rate adjustments | 25 | 3 | - | 28 |
| Additions | - | - | 52 | 52 |
| Mergers and acquisitions | 80 | - | - | 80 |
| Reclassification | - | - | 1 | 1 |
| Disposals | -2 | - | -12 | -14 |
| **Cost at 31 December** | **700** | **173** | **472** | **1.345** |
| Amortisation and impairment at 1 January | -1 | -74 | -237 | -312 |
| Exchange rate adjustments | - | -1 | - | -1 |
| Amortisation and impairment for the year | -1 | | -55 | -64 |
| Amortisation on disposals | 2 | -8 | 12 | 14 |
| **Amortisation and impairment at 31 December** | **-** | **-83** | **-280** | **-363** |
| **Carrying amount at 31 December** | **700** | **90** | **192** | **982** |
| **2018** | | | | |
| Cost at 1 January | 597 | 99 | 380 | 1,076 |
| Exchange rate adjustments | -8 | -2 | -2 | -12 |
| Additions | - | - | 55 | 55 |
| Mergers and acquisitions | 9 | 74 | - | 83 |
| Reclassification | - | -1 | 4 | 3 |
| Disposals | - | - | -6 | -6 |
| **Cost at 31 December** | **598** | **170** | **431** | **1,199** |
| Amortisation and impairment at 1 January | -1 | -73 | -191 | -265 |
| Exchange rate adjustments | - | 4 | - | 4 |
| Amortisation and impairment for the year | - | -5 | -52 | -57 |
| Amortisation on disposals | - | - | 6 | 6 |
| **Amortisation and impairment at 31 December** | **-1** | **-74** | **-237** | **-312** |
| **Carrying amount at 31 December** | **597** | **96** | **194** | **887** |

# NOTE 3.1 INTANGIBLE ASSETS AND GOODWILL (CONTINUED)

## Accounting policies

*Goodwill*
Goodwill represents the premium paid by Arla 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 can 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 or exploration phase in carrying out general assessments of requirements 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.

**Table 3.1.b Goodwill split by commercial segment and country**
(EURm)

| | | 2019 | 2018 |
|---|---|---|---|
| Europe | UK | 489 | 463 |
| | Finland | 40 | 40 |
| | Sweden | 21 | 23 |
| | Europe other | 59 | 60 |
| **Europe total** | | **609** | **586** |
| International | MENA | 80 | - |
| | Russia | 2 | 2 |
| **International total** | | **82** | **2** |
| Arla Foods Ingredients | Agentina | 9 | 9 |
| **Arla Foods Ingredients total** | | **9** | **9** |
| **Total** | | **700** | **597** |

## Note 3.1.1 Impairment test of goodwill

### Goodwill supported by positive market development despite Brexit

Goodwill is allocated to relevant cash-generating units primarily to our activities in the UK within the commercial segment Europe.

*Basis for impairment test and applied estimates*
Impairment tests are based on expected future cash flow derived from forecasts and targets supporting the Good Growth strategy 2020. Revenue growth rates are projected for individual markets, based on expected developments as well as past experience. The impairment tests do not include revenue growth in the terminal value. A new strategy is expected to be launched in early 2021, it is however not expected to have any adverse impact on basis for the impairment test.

*Procedure for impairment tests*
Impairment tests of goodwill are based on an assessment of their value in use. 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.

*Test results*
Impairment testing showed that there was no need for impairment in 2019. In this regard, sensitivities to changes in milk prices and discount rates were calculated.

Continued uncertainties relating to potential consequences of Brexit were reflected as risk adjusted cash flow in the impairment test. The discount rate could rise up to 4 percentage points, before goodwill in the UK would be at risk of being impaired. Goodwill allocated to other markets was tested applying similar assumptions.

**Table 3.1.1 Impairment tests**
(EURm)

| | Applied key assumptions | |
|---|---|---|
| | Discount rate, net of tax | Discount rate, before tax |
| **2019** | | |
| UK | 7.0% | 7.8% |
| Finland | 6.0% | 6.7% |
| Sweden | 6.3% | 7.0% |
| Europe other* | 5.9% | 6.6% |
| Arla Foods ingredients | 7.0% | 7.8% |
| **2018** | | |
| UK | 7.1% | 8.7% |
| Finland | 6.3% | 7.8% |
| Sweden | 6.4% | 8.2% |
| Europe other* | 6.3% | 7.1% |

**Europe other includes an immaterial amount of goodwill related to Russia*

# NOTE 3.1 INTANGIBLE ASSETS AND GOODWILL (CONTINUED)

## Accounting policies

Impairment occurs 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. For goodwill which does not generate largely independent cash inflows, impairment tests are prepared at the level where cash flows are considered to be generated largely independently.

The group of cash-generating units is determined based on the management structure and internal financial reporting. Cash-generating units and their groupings are reassessed each year. The carrying amount of goodwill is tested for impairment together with 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 group of cash-generating units 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 its 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 group of cash-generating units to 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 recognised can only be 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

The impairment test of goodwill is performed for the group of cash-generating units to which goodwill is allocated. The group of cash-generating units is defined based on the management structure for commercial segments and is linked to individual markets. The structure and groups of cash-generating units are assessed on a yearly basis.

The impairment test of goodwill is performed at least annually for each group of cash-generating units to which goodwill is allocated.

To determine the value in use, the expected cash flow approach is applied. 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 for 2020. To reflect uncertainties following Brexit, the budget period for UK has been prolonged to 2023. These are determined at cash-generating units level in the forecast and target planning process, and are based on external sources of information and industry-relevant observations such as macroeconomic and market conditions. All applied assumptions are challenged through the forecast and target planning process based on management's best estimates and expectations, which are judgmental by nature. They include expectations during the strategy period regarding revenue growth, EBIT margins and capital expenditures. The assumptions include 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 and assumes no nominal growth.

Following the Brexit process, expected cash flow supporting the carrying value of goodwill in the UK is inherently more uncertain. This was reflected in the risk-adjusted cash flow used for the impairment test. Refer to page 50 for more on Brexit.

*Discounts rates*
A discount rate, namely weighted average cost of capital (WACC), is applied for 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.

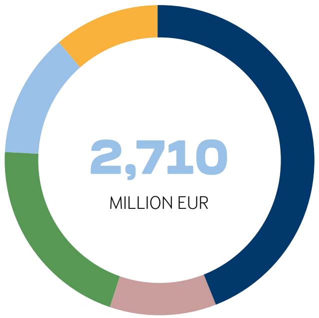
# NOTE 3.2 PROPERTY, PLANT, EQUIPMENT AND RIGHT OF USE ASSETS

### Significant investments

Arla's main tangible assets are located in Denmark, the UK, Germany and Sweden. The carrying value increased to EUR 2,710 million compared to EUR 2,308 million last year. Adjusted for the effect of implementation of IFRS 16, the increase amounted to EUR 203 million driven by increased CAPEX investment levels and acquisition of a cheese production facility in Bahrain from Mondelez International.

CAPEX investments excluding new leases and extension of existing leases increased 11.0 per cent to EUR 425 million compared to EUR 383 million last year. This reflects significantly increased CAPEX investment levels compared to previous years. Major investments in 2019 included an expansion of production facilities with a particular focus on our ingredients business, investments in powder capacity expansion as well as optimising production capacity within the yoghurt and nutrition categories..

**Property, plant and equipment by country, 2019**




**Property, plant and equipment by country, 2018**

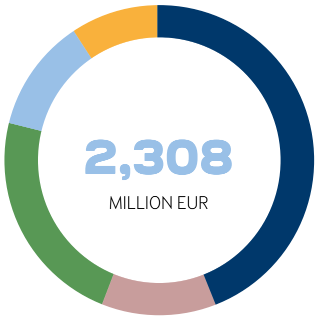
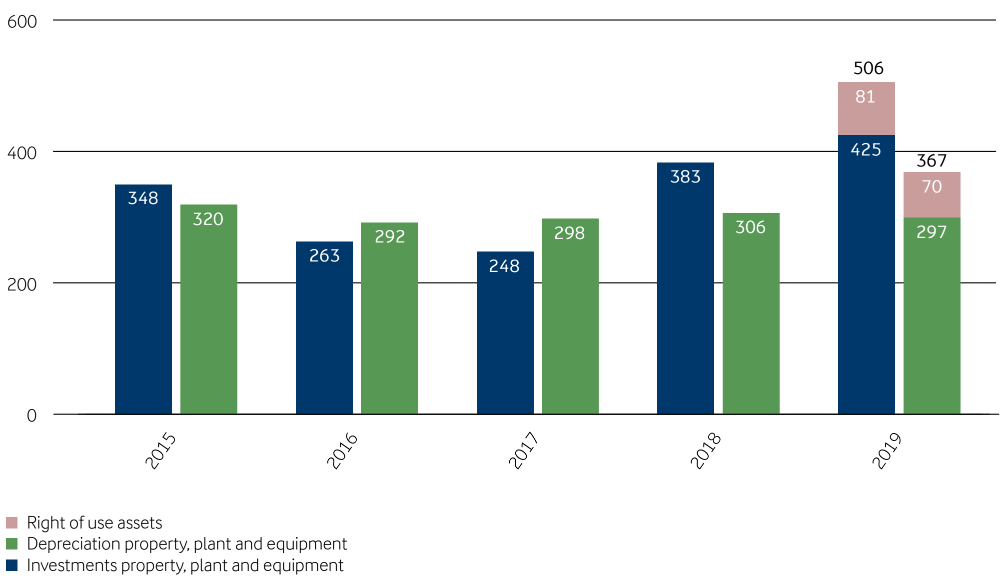



**Table 3.2.a Property, plant and equipment**
(EURm)

| | Land and building | Plant and machinery | Fixture and fitting, tools and equipment | Asset in course of con-struction | Total |
|---|---|---|---|---|---|
| **2019** | | | | | |
| Cost at 1 January | 1,461 | 2,907 | 552 | 289 | **5,209** |
| Change in accounting policies | 95 | 27 | 77 | - | **199** |
| Adjusted cost at 1 January | 1,556 | 2,934 | 629 | 289 | **5,408** |
| Exchange rate adjustments | 18 | 15 | 10 | 2 | **45** |
| Additions | 47 | 78 | 45 | 336 | **506** |
| Mergers and acquisitions | 23 | 23 | 2 | - | **48** |
| Transferred from assets in course of construction | 36 | 162 | 22 | -220 | **-** |
| Disposals | -14 | -60 | -23 | - | **-97** |
| **Cost at 31 December** | **1,666** | **3,152** | **685** | **407** | **5,910** |
| Depreciation and impairments at 1 January | -645 | -1,841 | -415 | - | **-2,901** |
| Exchange rate adjustments | -4 | -7 | -7 | - | **-18** |
| Depreciation and impairments for the year | -70 | -223 | -74 | - | **-367** |
| Depreciation on disposals | 8 | 56 | 22 | - | **86** |
| Reclassification | 6 | -6 | - | - | **-** |
| **Depreciations and impairment at 31 December** | **-705** | **-2,021** | **-474** | **-** | **-3,200** |
| **Carrying amount at 31 December** | **961** | **1,131** | **211** | **407** | **2,710** |
| Right of use assets included in the carrying amount | 109 | 21 | 78 | | **208** |
| | | | | | |
| **2018*** | | | | | |
| Cost at 1 January | 1,442 | 2,766 | 502 | 152 | **4,862** |
| Exchange rate adjustments | -15 | -29 | -1 | -2 | **-47** |
| Additions | 13 | 73 | 8 | 289 | **383** |
| Mergers and acquisitions | 9 | - | 34 | 1 | **44** |
| Transferred from assets in course of construction | 21 | 103 | 20 | -144 | **-** |
| Disposals | -9 | -13 | -10 | -1 | **-33** |
| Reclassification | - | 7 | -1 | -6 | **-** |
| **Cost at 31 December** | **1,461** | **2,907** | **552** | **289** | **5,209** |
| Depreciation and impairments at 1 January | -602 | -1,658 | -390 | - | **-2,650** |
| Exchange rate adjustments | 7 | 17 | 7 | - | **31** |
| Depreciation and impairments for the year | -53 | -212 | -41 | - | **-306** |
| Depreciation on disposals | 3 | 12 | 9 | - | **24** |
| **Depreciations and impairment at 31 December** | **-645** | **-1,841** | **-415** | **-** | **-2,901** |
| **Carrying amount at 31 December** | **816** | **1,066** | **137** | **289** | **2,308** |

# NOTE 3.2 PROPERTY, PLANT, EQUIPMENT AND RIGHT OF USE ASSETS (CONTINUED)

**Investments and depreciation property, plant and equipment and right of use assets**
(EURm)




| **Table 3.2.b Estimated useful life in years** (EURm) | **2019** | **2018** |
|---|---|---|
| Office buildings | 50 | 50 |
| Production buildings | 20-30 | 20-30 |
| Technical facilities | 5-20 | 5-20 |
| Other fixtures and fittings, tools and equipment | 3-7 | 3-7 |

## 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 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 accounting estimates, the effect of which is adjusted only in 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 3.2 PROPERTY, PLANT, EQUIPMENT AND RIGHT OF USE ASSETS (CONTINUED)

## Note 3.2.1 Right of use assets

### Implementation of IFRS 16 leases

From 1 January 2019 all leases are recognised as right of use assets with corresponding lease liabilities. Central processes for capturing and handling leases have been established and anchored across the group.

Arla leases various offices, warehouses, equipment, trucks and cars. Lease contracts are typically agreed for a fixed duration but may have an option to extend at a future date. Significant right of use assets are office buildings and warehouses in Denmark, Germany, Sweden and UK with remaining useful lives between 10 and 20 years. Filling machinery and other technical facilities represent another major right of use asset category. Filling machines typically have useful lives of 7 years, whereas other technical facilities are depreciated between 1 to 7 years. Cars and trucks have on average useful lives of 4 and 5 years respectively. In total the group has approximately 4,000 lease contracts.

Additions on right of use assets during the year amounted to EUR 81 million. Extension of the lease period for an office building in Viby, Denmark and a new office lease in Stockholm, Sweden were the main drivers. The total carrying amount of right of use assets was EUR 208 million as specified in table 3.2.1.a. Lease liabilities are specified in note 4.3.

Total cash outflow from right of use assets amounted to EUR 116 million. This comprised, lease debt payments of EUR 66 million, non-capitalised short-term and low value lease costs of EUR 43 million and interest expenses on lease liabilities of EUR 7 million.

**Table 3.2.1.a Right of use assets**
(EURm)

| | Land and building | Plant and machinery | Fixture and fitting, tools and equipment | Total |
|---|---|---|---|---|
| **2019** | | | | |
| Change of accounting policy | 95 | 27 | 77 | 199 |
| Additions | 38 | 7 | 36 | 81 |
| Depreciation and impairment for the year | -22 | -13 | -35 | -70 |
| Carrying amount at 31 December | 109 | 21 | 78 | 208 |

### Accounting policies

Lease contracts are typically agreed for a fixed duration, but may have an option to extend at a future date.

Until 2018, leases of property, plant and equipment were classified as either finance or operating leases. Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss on a straight-line basis over the period of the lease. From 1 January 2019, all leases are recognised as a right of use asset and a corresponding liability at the date at which the leased asset is available for use by the group.

A lease liability is initially measured on a present value basis, which comprises the net present value of the following:

- fixed lease payments (including in-substance fixed payments), less any lease incentives receivable
- variable lease payment based on an index or a rate
- amounts expected to be payable by the group under residual value guarantees
- the exercise price of a purchase option if the group is reasonably certain to exercise that option, and
- payments of penalties for terminating the lease, if the group is reasonably certain to exercise that exit option

The lease payments are discounted using an incremental borrowing rate, being the rate that the Group would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

The corresponding right of use asset is measured at cost comprising the following:

- the amount of the initial measurement of the lease liability
- any lease payments made at or before the commencement date less any lease incentives received
- any initial direct costs, and
- restoration costs

The right of use asset is subsequently depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. In addition, the value of the right of use asset is adjusted for certain remeasurements of the lease liability.

Each lease payment comprises a reduction of the lease liability and a finance cost. The finance cost is charged to profit or loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Short-term leases and leases of low-value assets are recognised as an expense in the income statement. Short-term leases are those with a lease term of less than 1 year. Leases of low-value assets are those with an underlying asset value less than EUR 5 thousand.

### Uncertainties and estimates

The group has applied estimates and judgements with impact on the recognition and measurement of right of use assets and lease liabilities. This includes assessment of the incremental borrowing rate, service components and facts and circumstances that could create an economic incentive to utilise extension options of lease arrangements.

# NOTE 3.3 JOINT VENTURES AND ASSOCIATES

**Financial comments**

The share of result in joint ventures and associates increased 17 per cent to EUR 34 million compared to EUR 29 million last year, mainly recognised results from our investments in Mengniu and Lantbrukarnas Riksförbund (LRF).

*COFCO Dairy Holdings Limited (COFCO) and China Mengniu Dairy company Limited (Mengniu)*
The group's proportionate share of the net asset value of COFCO including the investment in Mengniu is EUR 340 million, compared to EUR 311 million last year. The carrying amount of the investment in COFCO includes goodwill amounting to EUR 151 million, compared to EUR 146 million last year driven by the development in USD and CNY.

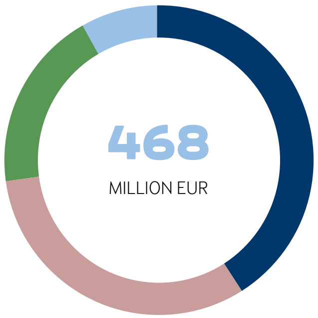
The fair value of the indirect share in Mengniu equals EUR 755 million, compared to EUR 567 million last year based on the official listed share price at 31 December 2019.

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, the 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 no indication of impairment.

Mengniu reported a group revenue of EUR 8,832 million and a result of EUR 410 million in 2018. Consolidated figures are not available for the COFCO group. See table 3.3.b for more details on COFCO.

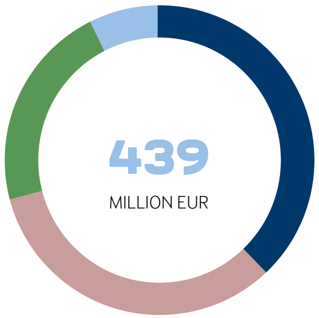
*Joint ventures*
The carrying value of joint ventures increased to EUR 38 million compared to EUR 32 million last year. The value primarily relate to the German joint ventures Biolac and ArNoCo. The carrying value does not include goodwill.

**Recognised value of associates and joint ventures, 2019**




- Share of equity in COFCO/Mengniu 41%
- Goodwill in COFCO/Mengniu 32%
- Share of equity in immaterial associates 19%
- Share of equity in immaterial joint ventures 8%

**Recognised value of associates and joint ventures, 2018**




- Share of equity in COFCO/Mengniu 38%
- Goodwill in COFCO/Mengniu 33%
- Share of equity in immaterial associates 22%
- Share of equity in immaterial joint ventures 7%

| **Table 3.3.a Associates and Joint ventures**<br>**Value of associates and joint ventures**<br>(EURm) | **2019** | **2018** |
|---|---|---|
| Share of equity in COFCO/Mengniu | 189 | 165 |
| Goodwill in COFCO/Mengniu | 151 | 146 |
| Share of equity in other associates | 90 | 96 |
| **Recognised value of associates** | **430** | **407** |
| Share of equity in other joint ventures | 38 | 32 |
| **Recognised value of associates and joint ventures** | **468** | **439** |

| **Table 3.3.b Material associates**<br>**Financial information for associates that are considered material to the Group***<br>(EURm) | COFCO Dairy Holdings Limited<br>**2019** | COFCO Dairy Holdings Limited<br>**2018** |
|---|---|---|
| Revenue | 11 | 5 |
| Results after tax | 11 | 5 |
| Non-current assets | 683 | 683 |
| Dividends received | 5 | 3 |
| Ownership share | 30% | 30% |
| Group share of result after tax | 28 | 19 |
| Recognised value | 340 | 311 |

*COFCO has no other significant assets or liabilities *Based on latest available financial reporting*

| **Table 3.3.c Transactions with associates and joint ventures**<br>(EURm) | **2019** | **2018** |
|---|---|---|
| Sale of goods to associates and joint ventures | 55 | 41 |
| Purchase of goods from joint ventures and associates | 65 | 62 |
| Trade receivables associates and joint ventures* | 10 | 12 |
| Trade payables associates and joint ventures* | -10 | -2 |

** Included in other receivables and other payables*

# NOTE 3.3 JOINT VENTURES AND ASSOCIATES (CONTINUED)

### Accounting policies

Investments where 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 Arla'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 zero. If Arla 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 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.

*COFCO and 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 these underlying agreements, it is our assessment that Arla has significant influence in Mengniu.

*Lantbrukarnas Riksforbund, 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, owner representation on the Board of Directors. Furthermore, 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.

# NOTE 3.4 PROVISIONS

### Provisions

Provisions amounted to EUR 32 million in 2019, compared to EUR 28 million last year. Provisions primarily relate 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. The general provision for occupational injuries of EUR 9 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 3.5 PURCHASE AND SALE OF BUSINESS OR ACTIVITIES

## Acquisitions and divestments

*Acquisitions during 2019*
In May 2019 Arla acquired the operations of the cheese business in MENA from Mondeléz International including production facilities in Bahrain and related working capital items. The acquisition was in line with the strategy to expand branded cheese production in the MENA region and to improve overall efficiency in the group's supply chain.

The fair value of the net assets acquired was EUR 66 million and consisted of production facilities and inventories. Goodwill totalled EUR 80 million and presents the benefit of access to production facilities in Bahrain, a location well-positioned to support our strategic ambition in MENA and the posibility to further optimise Arla's supply chain structure.

In 2019 the revenue contribution from the Mondeléz acquisition was EUR 51 million.

*Divestments during 2019*
In March 2019 Arla divested both its minority interests in NGF Nature Energy Videbæk A/S, Denmark and Martin Sengele Produits Laitiers SAS, France (the Allgäu business), for total proceeds of EUR 16 million.

*Acquisitions during 2018*
In 2018 Arla acquired the remaining 50 per cent of the shares in the joint venture, Arla Foods Ingredients S.A., Argentina, 100 per cent of the shares in Yeo Valley Dairies Ltd, UK, and gained control in Swedish Mjölk Ekonomisk förening.

The total purchase price for these transactions was EUR 127 million, of which EUR 51 million was paid in 2018 and another EUR 22 million was paid in 2019. Net assets acquired amounted to EUR 118 million, resulting in additions to goodwill of EUR 9 million.

**Table 3.5.a Mergers and acquisitions**
(EURm)

| | 2019 | 2018 |
|---|---|---|
| Intangible assets | 0 | 74 |
| Property, plant and equipment | 48 | 44 |
| Inventory | 18 | 12 |
| Other assets | 0 | 36 |
| Liabilities | 0 | -48 |
| **Total net assets acquired** | **66** | **118** |
| Goodwill | 80 | 9 |
| **Purchase price, net** | **146** | **127** |
| Cash in acquired company | 0 | 16 |
| Fair value of previous held investments | 0 | -57 |
| Fair value of non-controlling interests | 0 | -13 |
| Deferred payment | 22 | -22 |
| **Cash payment during the year** | **168** | **51** |

## 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 considerations 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.

In a business combination achieved in stages (step acquisition), the shareholding held immediately before the step acquisition where control is gained is remeasured at fair value at the acquisition date. Any gains or losses arising from such remeasurement are recognised in the income statement. The total fair value of the shareholding held immediately after the step acquisition is estimated and recognised as the cost of the total shareholding in the company.

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 identified goodwill is not subject to amortization, but 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 when fair values of the assets are transferred and equity instruments are 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. Gains 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.

## Uncertainties and estimates

To determine the classification of investments, an assessment of the level of influence is required. Judgement is necessary to determine whether the group actually has control of a company, and then timing considerations are needed as from when this should be effective.

For acquisitions where the group acquires control of the company in question, the purchase method is applied. However, there can be uncertainty regarding the identification of assets, liabilities and contingent liabilities, as well as measuring the fair value of the company at the time of acquisition.

# NOTE 4.1 FINANCIAL ITEMS

## Net interest bearing debt development increased interest cost

Net financial costs decreased by EUR 3 million, to EUR 59 million mainly due to fair value adjustments, which were partly offset by higher interest cost.

Net interest costs amounted to EUR 70 million, representing an increase of EUR 8 million compared to last year due to a higher average level of net interest-bearing debt driven by the implementation of new lease accounting standard IFRS 16 and investments. The average interest cost, excluding pension liabilities, was 3.0 per cent compared to 2.6 per cent last year. Interest cover decreased to 12.0 per cent compared to 14.8 per cent last year.

Exchange rate losses were at the same level as last year.

**Table 4.1 Financial income and financial costs**
(EURm)

| | 2019 | 2018* |
|---|---|---|
| *Financial income:* | | |
| Interest securities, cash and cash equivalents | 3 | 1 |
| Fair value adjustments and other financial income | 7 | 1 |
| **Total financial income** | **10** | **2** |
| *Financial costs:* | | |
| Interest on financial instruments measured at amortised cost | -69 | -57 |
| Net exchange rate losses | -3 | -3 |
| Interest on pension liabilities | -4 | -6 |
| Interest transferred to property, plant and equipment | 8 | 6 |
| Fair value adjustments and other financial costs, net | -1 | -4 |
| **Total financial costs** | **-69** | **-64** |
| **Net financial costs** | **-59** | **-62** |

** Not restated following implementation of IFRS 16. See more details in note 5.6.*

## 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 are 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 are therefore not included in financial cost.

Capitalisation of interest was performed by using an interest rate, matching the group's average external interest rate in 2019. 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

## Increased net interest-bearing debt

Net interest-bearing debt, excluding pension liabilities, increased to EUR 2,113 million compared to EUR 1,647 million last year. The increase was driven by the implementation of IFRS 16 (EUR 213 million), historical high capital expenditure, acquisitions and the extraordinary supplementary payment to farmer owners of EUR 289 million related to 2018. Cash flow from operating activities improved in 2019.

Pension liabilities increased by EUR 29 million to EUR 249 million mainly due to lower interest rate levels and currency effects. As a result, net interest-bearing debt, including pension liabilities, amount to EUR 2,362 million compared to EUR 1,867 million last year. The UK pension scheme net asset was EUR 16 million at the end of 2019. This asset was not included in the calculation of net interest-bearing debt and leverage.

Arla's leverage ratio was 2.8, an increase of 0.4 compared to last year. This was solidly within the long-term target range of 2.8 to 3.4, underpinning a strong financial position.

The average maturity of interest-bearing borrowings decreased by 0.4 years to 5.2 years. Average maturity is impacted by a lapse of time to maturity, refinancing or obtaining new committed facilities including bond issues, and the level of net interest-bearing debt.

The equity ratio decreased to 34 per cent, compared to 37 per cent last year.

*Funding*
The group applies a diversified funding strategy to balance the liquidity and refinancing risk, with the desire to achieve a low financing cost. Major acquisitions or investments are funded separately.

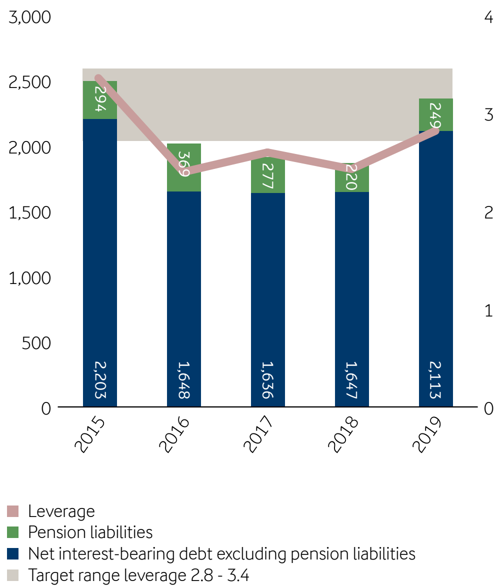
A diverse funding strategy includes diversification of markets, currencies, instruments, banks, lenders and maturities to secure broad access to funding and to ensure that the group is independent of one single funding partner or one single market. All funding opportunities are benchmarked against EURIBOR 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 individual loans.

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 2019.

During 2019 the group raised the following mix of funding:

- A new five-year bond issue totaling SEK 1.5 billion (EUR 143 million), to refinance a SEK 1.5 billion bond issue that matured in 2019
- A EUR 160 million mortgage loan
- A EUR 100 million term loan
- Arla has a commercial paper program in Sweden denominated in SEK and EUR. The average utilization in 2019 was EUR 209 million
- During the year, Arla entered into sale and repurchase arrangements based on its holdings in listed AAA-rated Danish mortgage bonds. Refer to Note 4.6 for more detail.

**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 and EBITDA, 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. Leverage in 2016 was extraordinarily affected by the divestment of Rynkeby. Adjusted for this leverage would have been 2.8.*

**Leverage**

**2.8**

2018: 2.4

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

| | 2019 | 2018* |
|---|---|---|
| Securities, cash and cash equivalents | -622 | -584 |
| Other interest-bearing assets | -5 | -10 |
| Long-term borrowings | 1,951 | 1,369 |
| Short-term borrowings | 789 | 872 |
| **Net interest-bearing debt excluding pension liabilities** | **2,113** | **1,647** |
| Pension liabilities | 249 | 220 |
| **Net interest-bearing debt including pension liabilities** | **2,362** | **1,867** |

** Not restated following implementation of IFRS 16. See more details in note 5.6.*

# NOTE 4.2 NET INTEREST-BEARING DEBT (CONTINUED)

**Table 4.2.b Borrowings**
(EURm)

| | 2019 | 2018* |
|---|---|---|
| *Long-term borrowings:* | | |
| Issued bonds | 382 | 244 |
| Mortgage credit institutions | 957 | 796 |
| Bank borrowings | 458 | 329 |
| Lease liabilities | 154 | - |
| **Total long-term borrowings** | **1,951** | **1,369** |
| *Short-term borrowings:* | | |
| Issued bonds | - | 146 |
| Commercial papers | 192 | 112 |
| Bank borrowings | 525 | 600 |
| Lease liabilities | 59 | 2 |
| Other current interest-bearing liabilities | 13 | 12 |
| **Total short-term borrowings** | **789** | **872** |
| **Total interest-bearing borrowings** | **2,740** | **2,241** |

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

| | | Cash flow | Non-cash changes | | | | |
|---|---|---|---|---|---|---|---|
| | 1 January | Included in financing activities | Acqui-sitions and additions | Reclasses | Foreign exchange move-ments | Fair value changes | 31 December |
| **2019** | | | | | | | |
| Pension liabilities | 224 | -10 | - | -1 | -5 | 41 | 249 |
| Long-term borrowings | 1,510 | 408 | 57 | -38 | -8 | 22 | 1,951 |
| Short-term borrowings | 930 | -179 | - | 38 | - | - | 789 |
| **Total interest-bearing debt** | **2,664** | **219** | **57** | **-1** | **-13** | **63** | **2,989** |
| UK pension assets | -4 | -27 | - | 16 | -2 | 17 | - |
| Securities and other Interest-bearing assets | -475 | 37 | - | -3 | 1 | - | -440 |
| Cash | -119 | -66 | - | - | -2 | - | -187 |
| **Net interest-bearing debt** | **2,066** | **163** | **57** | **12** | **-16** | **80** | **2,362** |

*Long- and short-term borrowing payments totalling EUR 229 million (EUR 408 million and EUR -179 million respectively) equals net impact of cash flow received from new loans, EUR 295 million, and cash payments related to lease arrangements EUR -66 million.*

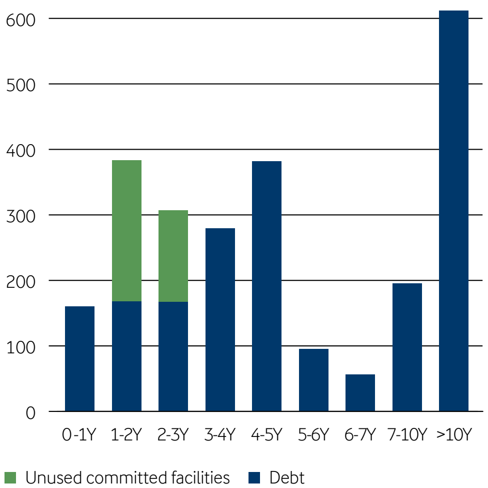
| | 1 January | Included in financing activities | Acqui-sitions and additions | Reclasses | Foreign exchange move-ments | Fair value changes | 31 December |
|---|---|---|---|---|---|---|---|
| **2018*** | | | | | | | |
| Pension liabilities | 277 | -37 | 1 | -1 | -7 | -9 | 224 |
| Long-term borrowings | 1,206 | 247* | 6 | -78 | 3 | -15 | 1,369 |
| Short-term borrowings | 1,040 | -242* | - | 77 | -3 | - | 872 |
| **Total interest-bearing debt** | **2,523** | **-32** | **7** | **-2** | **-7** | **-24** | **2,465** |
| Pension assets | - | - | - | -4 | - | - | -4 |
| Securities and other Interest-bearing assets | -519 | 42 | - | 1 | 1 | - | -475 |
| Cash | -91 | -26 | -22 | 22 | -2 | - | -119 |
| **Net interest-bearing debt** | **1,913** | **-16** | **-15** | **17** | **-8** | **-24** | **1,867** |

*Long- and short-term borrowings payments totalling EUR 5 million (EUR 247 million and EUR -242 million respectively) can be reconciled to the cash flow statement, Loans obtained, net EUR 5 million.*

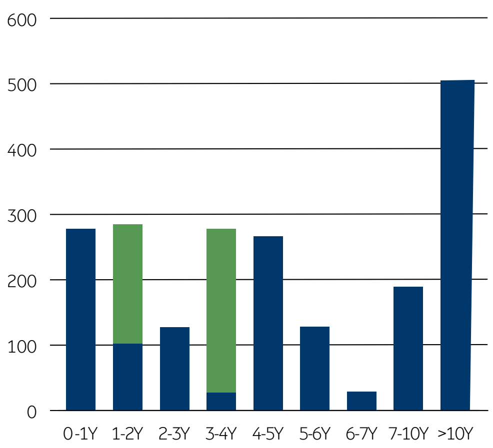
** Not restated following implementation of IFRS 16. See more details in note 5.6.*

# NOTE 4.2 NET INTEREST-BEARING DEBT (CONTINUED)

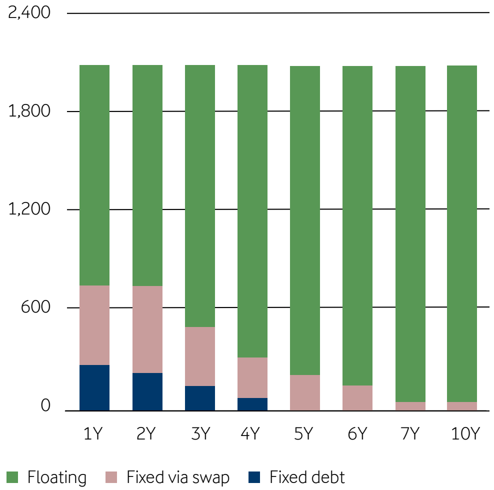
**Maturity of net interest-bearing debt excluding pension liabilities at December 2019**
(EURm)




**Maturity of net interest-bearing debt excluding pension liabilities at December 2018**
(EURm)




**Interest profile for net interest-bearing debt excluding pension liabilities at 31 December 2019**
(EURm)




**Interest profile for net interest-bearing debt excluding pension liabilities at 31 December 2018**
(EURm)

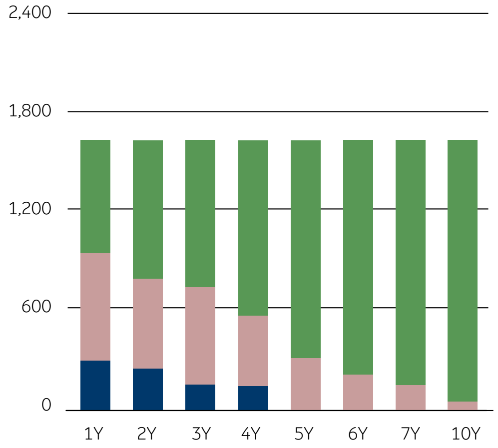



**Table 4.2.d Net interest-bearing debt excluding pension liabilities and the effect of hedging, maturity**
(EURm)

| 2019 | Total | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027-2029 | After 2029 |
|---|---|---|---|---|---|---|---|---|---|---|
| DKK | 809 | -27 | 22 | 21 | 19 | 17 | 89 | 52 | 183 | 433 |
| SEK | 612 | 200 | 102 | 6 | 148 | 147 | 1 | 1 | 4 | 3 |
| EUR | 451 | 19 | 29 | 12 | 106 | 103 | 2 | 1 | 6 | 173 |
| GBP | 158 | 10 | 10 | 124 | 3 | 2 | 2 | 2 | 2 | 3 |
| Other | 83 | -43 | 5 | 4 | 3 | 113 | 1 | - | - | - |
| **Total** | **2,113** | **159** | **168** | **167** | **279** | **382** | **95** | **56** | **195** | **612** |

| 2018 | Total | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026-2028 | After 2028 |
|---|---|---|---|---|---|---|---|---|---|---|
| DKK | 769 | -12 | 2 | 18 | 21 | 20 | 20 | 25 | 185 | 490 |
| SEK | 525 | 277 | 4 | 98 | - | 146 | - | - | - | - |
| EUR | 271 | 53 | 90 | 6 | 3 | 100 | - | - | 4 | 15 |
| GBP | 9 | 1 | 3 | 2 | 3 | - | - | - | - | - |
| Other | 73 | -41 | 3 | 3 | - | - | 108 | - | - | - |
| **Total** | **1,647** | **278** | **102** | **127** | **27** | **266** | **128** | **25** | **189** | **505** |

**Table 4.2.e Currency profile of net interest-bearing debt excluding pension liabilities**
(EURm)
Disclosed before and after the effect of derivative financial instruments

| 2019 | Original principal | Effect of swap | After swap |
|---|---|---|---|
| DKK | 809 | - | 809 |
| SEK | 612 | -566 | 46 |
| EUR | 451 | 334 | 785 |
| GBP | 158 | 232 | 390 |
| Other | 83 | - | 83 |
| **Total** | **2,113** | **-** | **2,113** |

| 2018 | Original principal | Effect of swap | After swap |
|---|---|---|---|
| DKK | 769 | - | 769 |
| SEK | 525 | -487 | 38 |
| EUR | 271 | 341 | 612 |
| GBP | 9 | 146 | 155 |
| Other | 73 | - | 73 |
| **Total** | **1,647** | **-** | **1,647** |

# NOTE 4.2 NET INTEREST-BEARING DEBT (CONTINUED)

**Table 4.2.f Interest rate risk excluding effect of hedging**
(EURm)

| | Interest rate | Average interest rate | Fixed for | Carrying amount | Interest rate risk |
|---|---|---|---|---|---|
| **2019** | | | | | |
| *Issued bonds:* | | | | | |
| SEK 500m maturing 31.05.2021 | Fixed | 1.88% | 1-2 years | 48 | Fair value |
| SEK 750m maturing 03.07.2023 | Fixed | 1.51% | 3-4 years | 72 | Fair value |
| SEK 750m maturing 03.04.2024 | Fixed | 1.58% | 4-5 years | 71 | Fair value |
| SEK 500m maturing 31.05.2021 | Floating | 1.76% | 0-1 years | 48 | Cash flow |
| SEK 750m maturing 03.07.2023 | Floating | 1.11% | 0-1 years | 71 | Cash flow |
| SEK 750m maturing 03.04.2024 | Floating | 0.88% | 0-1 years | 72 | Cash flow |
| Commercial papers | Fixed | 0.32% | 0-1 years | 192 | Fair value |
| **Total issued bonds** | | **1.04%** | | **574** | |
| *Mortgages credit institutions:* | | | | | |
| Fixed-rate | Fixed | 0.82% | 1-2 years | 78 | Fair value |
| Floating-rate | Floating | 0.56% | 0-1 years | 879 | Cash flow |
| **Total mortgage credit institutions** | | **0.58%** | | **957** | |
| *Bank borrowings:* | | | | | |
| Fixed-rate | Fixed | -0.39% | 0-1 years | 431 | Fair value |
| Floating-rate | Floating | 0.79% | 0-1 years | 552 | Cash flow |
| **Total bank borrowings** | | **0.27%** | | **983** | |
| *Other borrowings:* | | | | | |
| Lease liabilities | Fixed | 3.16% | 0-20 years | 213 | Cash flow |
| Other borrowings | Floating | 3.59% | 0-1 years | 13 | Cash flow |
| **Total other borrowings** | | **3.18%** | | **226** | |

**Table 4.2.f Interest rate risk excluding effect of hedging**
(EURm)

| | Interest rate | Average interest rate | Fixed for | Carrying amount | Interest rate risk |
|---|---|---|---|---|---|
| **2018*** | | | | | |
| *Issued bonds:* | | | | | |
| SEK 800m maturing 28.05.2019 | Fixed | 2.63% | 0-1 years | 78 | Fair value |
| SEK 500m maturing 31.05.2021 | Fixed | 1.88% | 2-3 years | 49 | Fair value |
| SEK 750m maturing 03.07.2023 | Fixed | 1.51% | 4-5 years | 74 | Fair value |
| SEK 700m maturing 28.05.2019 | Floating | 0.74% | 0-1 years | 68 | Cash flow |
| SEK 500m maturing 31.05.2021 | Floating | 1.31% | 0-1 years | 48 | Cash flow |
| SEK 750m maturing 03.07.2023 | Floating | 0.51% | 0-1 years | 73 | Cash flow |
| Commercial papers | Fixed | -0.08% | 0-1 years | 112 | Fair value |
| **Total issued bonds** | | **1.09%** | | **502** | |
| *Mortgages credit institutions:* | | | | | |
| Fixed-rate | Fixed | 1,15% | 2-3 years | 44 | Fair value |
| Floating-rate | Floating | 0.65% | 0-1 years | 752 | Cash flow |
| **Total mortgage credit institutions** | | **0.68%** | | **796** | |
| *Bank borrowings:* | | | | | |
| Fixed-rate | Fixed | -0.44% | 0-1 years | 460 | Fair value |
| Floating-rate | Floating | 1.25% | 0-1 years | 469 | Cash flow |
| **Total bank borrowings** | | **0.41%** | | **929** | |
| *Other borrowings:* | | | | | |
| Finance leases | Floating | 2.15% | 0-1 years | 2 | Cash flow |
| Other borrowings | Floating | 3.39% | 0-1 years | 12 | Cash flow |
| **Total other borrowings** | | **3.21%** | | **14** | |

** Not restated following implementation of IFRS 16. See more details in note 5.6.*

# NOTE 4.2 NET INTEREST-BEARING DEBT (CONTINUED)

## 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.

*Financial assets*
Financial assets are classified at initial recognition and subsequently measured at: amortised cost, fair value through other comprehensive income or fair value through the income statement.

The classification of financial assets at initial recognition depends on the financial asset's contractual cash flow characteristics and how these are managed.

Financial assets where the group intends to collect the contractual cashflow are classified and measured at amortised cost.

Financial assets that are part of liquidity management are classified and measured at fair value through other comprehensive income. All other financial assets are classified and measured at fair value through the income statement.

*Financial assets measured at amortised cost*
Financial assets measured at amortised cost 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 an insignificant risk of change in value and can be readily converted to cash or cash equivalents.

*Financial assets measured at fair value through other comprehensive income*
Financial assets measured at fair value through other comprehensive income consist of mortgage credit bonds, which correspond in part to raised mortgage debt.

They 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 fair value reserve in equity.

Interest income, impairment and foreign currency translation adjustments of debt instruments are recognised in the income statement on a continuous basis, under financial income and financial costs. In connection with the sale of financial assets classified at fair value through other comprehensive income, accumulated gains or losses, previously recognised in the fair value reserve, are recycled to financial income and financial costs.

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

*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 loan proceeds and the nominal value recognised in the income statement over the expected life of the loan.

Capitalised residual lease obligations related to lease agreements are recognised under liabilities, measured at amortised cost. Other financial liabilities are measured at amortised cost. For details on pension liabilities, refer to 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 an appropriate financial risk management approach in place 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 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.

The Board of Directors receives a report on the group's financial risk exposure on a monthly basis. Hedging the volatility of milk prices is not within the scope of financial risk management, but is an inherent component of the group's business model.

### Note 4.3.1 Liquidity risk

**Adequate liquidity reserves**

Liquidity reserves remained at the samel level as last year. Ensuring availability of sufficient operating liquidity and credit facilities for operations is the primary goal of managing liquidity risk. Inspired by the liquidity models suggested by the rating agencies, Arla's liquidity reserves have been assessed as adequate for the coming 12 months.

Supply chain finance programmes and factoring relating to customers form part of the group's liquidity management.

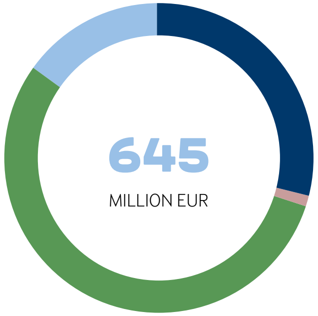
Selected suppliers have access to the group's supply chain finance facilities, which allows those suppliers to benefit from the group's credit profile.

More than 95 per cent of the day-to-day liquidity flow of the group is managed by the treasury department and the internal bank, via cash pooling arrangements. This secures a scalable and efficient operating model. As a result, the group has been able to achieve a cost-efficient utilisation of credit facilities.

**Table 4.3.1.a Liquidity reserves**
(EURm)

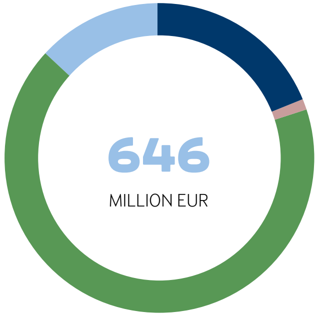
| | 2019 | 2018 |
|---|---|---|
| Cash and cash equivalents | 187 | 119 |
| Securities (free cash flow) | 6 | 7 |
| Unutilised committed loan facilities | 355 | 434 |
| Unutilised other loan facilities | 97 | 86 |
| **Total** | **645** | **646** |

**Liquidity reserves, 2019**




- Cash and cash equivalents 29%
- Securities (free cash flow) 1%
- Unutilised committed loan facilities 55%
- Unutilised other loan facilities 15%

**Liquidity reserves, 2018**




- Cash and cash equivalents 19 %
- Securities (free cash flow) 1%
- Unutilised committed loan facilities 67%
- Unutilised other loan facilities 13%

# NOTE 4.3 FINANCIAL RISKS (CONTINUED)

**Table 4.3.1.b Contractual expected non-discounted cashflow on gross financial liabilities**
(EURm)

| | | Non-discounted contractual cash flow | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Carrying amount | Total | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027-2029 | After 2029 |
| **2019** | | | | | | | | | | | |
| Issued bonds | 382 | 382 | - | 96 | - | 143 | 143 | - | - | - | - |
| Mortgage credit institutions | 957 | 976 | 1 | 9 | 12 | 12 | 12 | 87 | 50 | 183 | 610 |
| Credit institutions | 1,175 | 1,176 | 717 | 21 | 125 | 101 | 212 | - | - | - | - |
| Lease liabilities | 213 | 213 | 62 | 42 | 31 | 23 | 15 | 8 | 6 | 13 | 13 |
| Other non-current liabilities | 13 | 13 | 13 | - | - | - | - | - | - | - | - |
| Interest expense - interest bearing debt | - | 110 | 13 | 11 | 10 | 9 | 6 | 5 | 5 | 15 | 36 |
| Trade and other payables | 1,158 | 1,158 | 1,158 | - | - | - | - | - | - | - | - |
| Derivative instruments | 86 | 86 | 40 | 12 | 10 | 9 | 3 | 1 | 1 | 2 | 8 |
| **Total** | **3,984** | **4,114** | **2,004** | **191** | **188** | **297** | **391** | **101** | **62** | **213** | **667** |

| | | Non-discounted contractual cash flow | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Carrying amount | Total | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026-2028 | After 2028 |
| **2018*** | | | | | | | | | | | |
| Issued bonds | 390 | 390 | 146 | - | 98 | - | 146 | - | - | - | - |
| Mortgage credit institutions | 796 | 808 | - | 1 | 17 | 20 | 20 | 20 | 51 | 167 | 512 |
| Credit institutions | 1,041 | 1,042 | 715 | 99 | 13 | 7 | 100 | 108 | - | - | - |
| Finance lease liabilities | 3 | 3 | 2 | 1 | - | - | - | - | - | - | - |
| Other non-current liabilities | 13 | 13 | 13 | - | - | - | - | - | - | - | - |
| Interest expense - interest bearing debt | - | 107 | 11 | 10 | 9 | 8 | 7 | 5 | 5 | 15 | 37 |
| Trade and other payables | 1,169 | 1,169 | 1,169 | - | - | - | - | - | - | - | - |
| Derivative instruments | 85 | 85 | 32 | 11 | 9 | 8 | 6 | 2 | 1 | 4 | 12 |
| **Total** | **3,497** | **3,617** | **2,088** | **122** | **146** | **43** | **279** | **135** | **57** | **186** | **561** |

Contractual 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.

** Not restated following implementation of IFRS 16. See more details in note 5.6.*

# NOTE 4.3 FINANCIAL RISKS (CONTINUED)

### Risk mitigation

*Risk*
Liquidity and funding are vital for the group to be able to pay its financial liabilities as they become due. It also impacts our ability to attract new funding in the longer term and is crucial to fulfilling 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.

**Average maturity**

| | | | Policy | |
|---|---|---|---|---|
| | **2019** | **2018** | Minimum | Maximum |
| Average maturity, gross debt | 5.2 years | 5.6 years | 2 years | - |
| Maturity < 1 year, net debt | 0% | - | - | 25% |
| Maturity > 2 year, net debt | 93% | 92% | 50% | - |

**How we act and operate**
In addition to the treasury and funding policy, the Board of Directors have approved a long-term financing strategy, which defines the direction for financing of the Group. This includes 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.

## Note 4.3.2 Currency risk

### Currency impact on revenue, costs and financial position

The group is exposed to both transaction and translation effects from currencies.

Transaction effects relate to sales in currencies other than the functional currencies of the individual entities. The group is mainly exposed to USD and USD pegged currencies as well as GBP. Revenue increased by EUR 32 million compared to last year due to positive transaction effects. Part of this exposure was hedged by costs in the same currency. Financial instruments such as trade receivables, trade payables and other items denominated in currencies other than the individual entities' functional currencies are also exposed to currency risks. The net effect from the revaluation of these financial instruments is recognised within financial income or financial costs. A net loss of EUR 3 million was recognised in financial costs which was at a same level compared as last year. To manage short term volatility from currency fluctuations, derivatives are used to hedge currency exposure. When settling the hedging instrument, a positive or negative amount is recognised within other income or other costs respectively. A net loss of EUR 24 million was recognised within other cost compared to a loss of EUR 14 million last year. A loss from hedges will be expected in years where export currencies strengthen during the year.
The group is exposed to translation effects from entities reporting in currencies other than EUR. The group is mainly exposed to translation of entities reporting in GBP, DKK, SEK, CNY and USD. Due to translation effects, revenue increased by EUR 25 million compared to the revenue reported last year. Correspondingly, costs were increased by EUR 26 million compared to last year's reported cost. The group's financial position is similarly exposed, impacting the value of assets and liabilities reported in currencies other than EUR. The translation effect on net assets is recognised within other comprehensive income as foreign exchange adjustments. In 2019 a net increase of EUR 42 million was recognised in other comprehensive income compared to a net loss of EUR 10 million last year.

Indirectly the prepaid milk price absorbs both transaction and translation effects and the net result therefore has limited exposure to currency risks. The prepaid milk is set based on achieving an annual profit of 2.8 to 3.2 per cent. The prepaid price is initially measured and paid out based on a EUR amount and consequently exposed to EUR fluctuations against GBP, SEK and DKK.

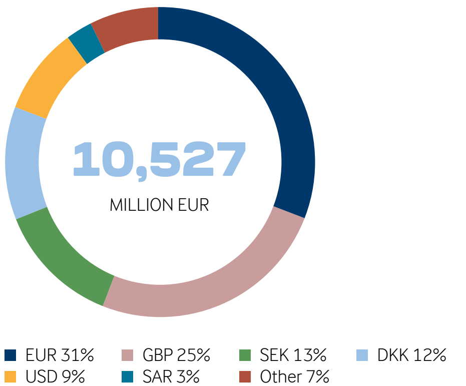
Compared to last year, the average rate of the USD strengthened by 5 per cent, the GBP strengthened 1 per cent and the SEK weakened by 3 per cent.

25 per cent of the group's revenue is in GBP. Due to potential consequences related to Brexit and the forth coming trade negotiations Arla has continuously hedged a significant proportion of the 2020 export to the UK.

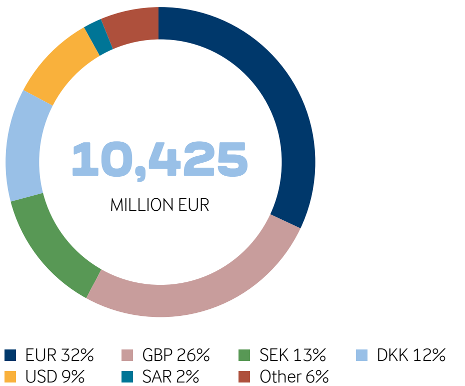
The group is increasingly involved in emerging markets where efficient hedging is often not feasible due to currency regulations, illiquid financial markets or expensive hedging costs. These markets are mainly Nigeria, the Dominican Republic, Bangladesh, Lebanon, the Ivory Coast, Senegal and Egypt. These seven countries represented 2 per cent of the group's revenue in 2019.

Our business in Saudi Arabia is a large part of the group's export to MENA. the SAR has been pegged to the USD since 1986. However, given the current uncertainty regarding the Saudi Arabia economy and geopolitical situation, Arla monitors the currency situation closely and is hedged a longer period of time to mitigate the higher perceived risk of large fluctuations.

**Revenue split by currency, 2019**




**Revenue split by currency, 2018**



# NOTE 4.3 FINANCIAL RISKS (CONTINUED)

**Table 4.3.2.a Exchange rates**

| | Closing rate | | | Average rate | | |
|---|---|---|---|---|---|---|
| | **2019** | **2018** | **Change** | **2019** | **2018** | **Change** |
| EUR/GBP | 0.854 | 0.901 | 5.2% | 0.877 | 0.885 | 0.9% |
| EUR/SEK | 10.470 | 10.261 | -2.0% | 10.587 | 10.253 | -3.3% |
| EUR/DKK | 7.472 | 7.467 | -0.1% | 7.466 | 7.453 | -0.2% |
| EUR/USD | 1.120 | 1.145 | 2.2% | 1.119 | 1.180 | 5.1% |
| EUR/SAR | 4.201 | 4.293 | 2.1% | 4.199 | 4.426 | 5.1% |

**Table 4.3.2.b Currency exposure**

| | Balance sheet exposure | | | Sensitivity | | |
|---|---|---|---|---|---|---|
| | Open positions | Hedge of future cash flow | External exposure | Applied sensitivity | Income statement | Other compre-hensive income |
| **2019** | | | | | | |
| EUR/DKK | -346 | 0 | -346 | 1% | -3 | 0 |
| USD/DKK* | 219 | -276 | -56 | 5% | 11 | -14 |
| GBP/DKK | 39 | -311 | -273 | 5% | 2 | -16 |
| SEK/DKK | -24 | 0 | -24 | 5% | -1 | 0 |
| SAR/DKK | -165 | -24 | -189 | 5% | -8 | -1 |
| **2018** | | | | | | |
| EUR/DKK | -458 | 0 | -458 | 1% | -5 | 0 |
| USD/DKK* | 157 | -379 | -222 | 5% | 8 | -19 |
| GBP/DKK | 61 | -279 | -218 | 5% | 3 | -14 |
| SEK/DKK | 33 | 0 | 33 | 5% | 2 | 0 |
| SAR/DKK | -152 | 0 | -152 | 5% | -8 | 0 |

**Incl. AED*

### Risk mitigation

The group's 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 also applies to the group's net internal exposure. The aggregate of the group's external and internal currency exposure, represents the net exposure, which is outlined in Table 4.3.2.b.

Net foreign currency investments in subsidiaries, as well as instruments hedging those investments, are excluded.

### Assumptions for sensitivity analysis

*Risk*

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.

*Policy*

According to the treasury and funding policy, the treasury department may hedge:

- Up to 15 months of the net forecasted cash receipts and payables
- Up to 100 per cent of net recognised trade receivables and trade payables

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 do 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.

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 FINANCIAL RISKS (CONTINUED)

### Note 4.3.3 Interest rate risk

**Limited hedging activities**

The average duration of the group's interest on interest-bearing debt, including derivatives but excluding pension liabilities, has decreased by 0.8 to 2.4. The duration is reduced due to matured interest rate hedges, a reduction in time to maturity on the remaining hedges and an increased in net interest-bearing debt predominately funded by floating interest rate.

Even though interest rates were low in 2019, our hedging activity was limited.

**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 |
| **2019** | | | | |
| Financial assets | -627 | 1% | 5 | -2 |
| Derivatives | - | 1% | 4 | 31 |
| Financial liabilities | 2,740 | 1% | -23 | - |
| **Net interest-bearing debt excluding pension liabilities** | **2,113** | | **-14** | **29** |
| **2018** | | | | |
| Financial assets | -594 | 1% | 4 | -2 |
| Derivatives | - | 1% | 7 | 38 |
| Financial liabilities | 2,241 | 1% | -18 | - |
| **Net interest-bearing debt excluding pension liabilities** | **1,647** | | **-7** | **36** |

**Risk mitigation**

*Risk*
The group is exposed to interest rate risk on interest-bearing borrowings, pension liabilities, interest-bearing assets and on the value of non-current assets where an impairment test is performed. 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 the potential impairment of non-current 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 2019. A decrease in the interest rate would have the opposite 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 | |
|---|---|---|---|---|
| | **2019** | **2018** | Minimum | Maximum |
| **Duration** | 2.4 | 3.2 | 1 | 7 |

**How we act and operate**
The purpose of interest rate hedging is to mitigate risk and secure relatively stable and predictable financing costs. 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 independently 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. To date, the group has not traded in any options contracts.

# NOTE 4.3 FINANCIAL RISKS (CONTINUED)

## Note 4.3.4 Commodity price risk

### Limited hedging activities

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

Hedging activities concentrate on the most significant risks, including electricity, natural gas and diesel. The total energy commodity spend, excluding taxes and distribution costs, amounted to approximately EUR 85 million.

The purpose of hedging is to reduce volatility in costs related to energy. In 2019, hedging activities have resulted in loss of EUR 6 million vs a gain on EUR 9 million last year. The result of hedging activities, classified as hedge accounting, is recognised in other income and costs.

At the end of 2019, 35 per cent of the energy spend for 2020 was hedged. A 25 per cent increase in commodity prices would negatively impact profit by approximately EUR 14 million. Conversely, other comprehensive income would be positively impacted by EUR 10 million.

**Table 4.3.4 Hedged commodities**
(EURm)

| | | | Potential accounting impact | |
|---|---|---|---|---|
| | Sensitivity | Contract value | Income statement | Other comprehen-sive income |
| **2019** | | | | |
| Diesel / natural gas | 25% | -4 | -8 | 6 |
| Electricity | 25% | -1 | -6 | 4 |
| | | -5 | -14 | 10 |
| **2018** | | | | |
| Diesel / natural gas | 25% | -3 | -8 | 12 |
| Electricity | 25% | 4 | -8 | 6 |
| | | 1 | -16 | 18 |

### 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.

*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 25 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, of which 100 per cent can be hedged for the first 18 months, with a limited proportion thereafter.

**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.

Arla's energy exposure and hedging are 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.

Dairy derivative market in EU and New Zealand remain small but are evolving quickly and the group has engaged in insignificant hedging price risk on selected commodity products. As the dairy derivative market develops, we expect this to play a role in managing fixed price contracts with customers, in the coming years.

# NOTE 4.3 FINANCIAL RISKS (CONTINUED)

## Note 4.3.5 Credit risk

### Limited losses

In 2019 the group continued to experience very limited losses from defaulting counterparties such as customers, suppliers and financial counterparties.

All major financial counterparties had satisfactory credit ratings at year-end. 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. In a small number of geographical locations 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.

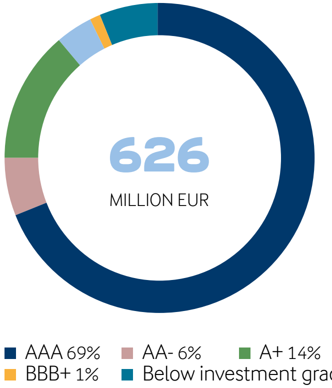
The maximum exposure to credit risk is approximately equal to the carrying amount.

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.

**External rating of financial counterparties, 2019**




**External rating of financial counterparties, 2018**

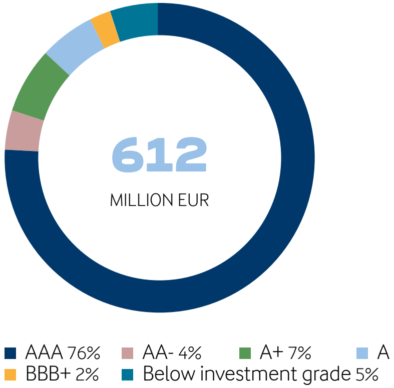



**Table 4.3.5 External rating of financial counterparties**
(EURm)

| | Counterparty rating | | | | | | |
|---|---|---|---|---|---|---|---|
| | AAA | AA- | A+ | A | BBB+ | Below investment grade | Total |
| **2019** | | | | | | | |
| Securities | 435 | - | - | - | - | - | 435 |
| Cash | - | 30 | 78 | 19 | 7 | 37 | 171 |
| Derivatives | - | 7 | 7 | 5 | - | 1 | 20 |
| **Total** | **435** | **37** | **85** | **24** | **7** | **38** | **626** |
| **2018** | | | | | | | |
| Securities | 465 | - | - | - | - | - | 465 |
| Cash | - | 16 | 37 | 16 | 11 | 30 | 110 |
| Derivatives | - | 8 | 4 | 20 | 5 | - | 37 |
| **Total** | **465** | **24** | **41** | **36** | **16** | **30** | **612** |

### Risk mitigation

*Risk*
Credit risks arise from operating activities and engagement with financial counterparties. 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.

*Policy*
Financial counterparties must be approved by the Executive Director 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 for the financial counterparty to have a liability towards Arla. 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 given levels of investment in 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*
The group uses forward currency to hedge currency risks on 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.a Hedging of future cash flow from highly probable forecast transactions**
(EURm)

| | | | Expected recognition in income statement | | | | |
|---|---|---|---|---|---|---|---|
| | Carrying value | Fair value recognised in other comprehensive income | 2020 | 2021 | 2022 | 2023 | After 2023 |
| **2019** | | | | | | | |
| Currency contracts | -14 | -14 | -14 | - | - | - | - |
| Interest rate contracts | -71 | -71 | -13 | -12 | -11 | -9 | -26 |
| Commodity contracts | -4 | -4 | -4 | - | - | - | - |
| **Hedging of future cash flow** | **-89** | **-89** | **-31** | **-12** | **-11** | **-9** | **-26** |

| | | | Expected recognition in income statement | | | | |
|---|---|---|---|---|---|---|---|
| | Carrying value | Fair value recognised in other comprehensive income | 2019 | 2020 | 2021 | 2022 | After 2022 |
| **2018** | | | | | | | |
| Currency contracts | -3 | -3 | -3 | - | - | - | - |
| Interest rate contracts | -67 | -67 | -15 | -10 | -9 | -8 | -25 |
| Commodity contracts | 1 | 1 | 1 | - | - | - | - |
| **Hedging of future cash flow** | **-69** | **-69** | **-17** | **-10** | **-9** | **-8** | **-25** |

| **Table 4.4.b Value adjustment of hedging instruments** (EURm) | **2019** | **2018** |
|---|---|---|
| Deferred gains and losses on cash flow hedges arising during the year | -21 | -7 |
| Value adjustments of hedging instruments reclassified to other operating income and costs | -22 | -5 |
| Value adjustments of hedging instruments reclassified to financial items | 21 | 15 |
| **Total value adjustment of hedging instruments recognised in other comprehensive income during the year** | **-22** | **3** |

**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.

*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 in other comprehensive income as a 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 basic adjustment for the hedged item. 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. For derivative financial instruments that do not meet the criteria for classification as hedging instruments, changes in fair value are recognised on a continuous basis in the income statement, under financial income and costs.

# NOTE 4.5 FINANCIAL INSTRUMENTS

| **Table 4.5.a Categories of financial instruments** (EURm) | **2019** | **2018** |
|---|---|---|
| Derivatives | 18 | 28 |
| Shares | 9 | 10 |
| **Financial assets measured at fair value through the income statement** | **27** | **38** |
| Securities | 435 | 465 |
| **Financial assets measured at fair value through other comprehensive income** | **435** | **465** |
| Currency instruments | 1 | 4 |
| Interest rate instruments | - | - |
| Commodity instruments | 1 | 5 |
| **Derivative assets used as hedging instruments** | **2** | **9** |
| Trade receivables | 889 | 989 |
| Other receivable | 240 | 254 |
| **Financial assets measured at amortised cost** | **1,129** | **1,243** |
| Derivatives | 22 | 7 |
| **Financial liabilities measured at fair value through the income statement** | **22** | **7** |
| Currency instruments | 15 | 7 |
| Interest rate instruments | 44 | 67 |
| Commodity instruments | 5 | 4 |
| **Derivative liabilities used as hedging instruments** | **64** | **78** |
| Long term borrowings | 1,951 | 1,369 |
| Short term borrowings | 789 | 872 |
| Trade payables and other payables | 1,158 | 1,169 |
| **Financial liabilities measured at amortised cost** | **3,898** | **3,410** |

| **Table 4.5.b Fair value hierarchy - carrying amount** (EURm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **2019** | | | | |
| *Financial assets:* | | | | |
| Bonds | 435 | - | - | 435 |
| Shares | 9 | - | - | 9 |
| Derivatives | | 20 | - | 20 |
| **Total financial assets** | **444** | **20** | **-** | **464** |
| *Financial liabilities:* | | | | |
| Derivatives | - | 86 | - | 86 |
| **Total financial liabilities** | **-** | **86** | **-** | **86** |
| **2018** | | | | |
| *Financial assets:* | | | | |
| Bonds | 466 | - | - | 466 |
| Shares | 10 | - | - | 10 |
| Derivatives | - | 37 | - | 37 |
| **Total financial assets** | **476** | **37** | **-** | **513** |
| *Financial liabilities:* | | | | |
| Derivatives | - | 85 | - | 85 |
| **Total financial liabilities** | **-** | **85** | **-** | **85** |

# NOTE 4.5 FINANCIAL INSTRUMENTS (CONTINUED)

**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 SALE AND REPURCHASE AGREEMENTS

**Attractive funding arrangement**

The group has invested in listed Danish 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, compared with current market interest rates on mortgage debt, by entering into a sale and repurchase agreement on the mortgage bonds. The aforementioned mortgage bonds have been classified as fair value through other comprehensive income.

The receipt of proceeds from these bonds create a repurchase obligation which has been recognised within short-term loans.

In addition to mortgage bonds, the group holds other securities with a carrying value of EUR 5 million.

**Table 4.6 Transfer of financial assets**
(EURm)

| | Carrying value | Notional amount | Fair value |
|---|---|---|---|
| **2019** | | | |
| Mortgage bonds | 430 | 425 | 430 |
| Repurchase liabilities | -429 | -424 | -429 |
| **Net position** | **1** | **1** | **1** |
| **2018** | | | |
| Mortgage bonds | 461 | 455 | 461 |
| Repurchase liabilities | -461 | -454 | -461 |
| **Net position** | **-** | **1** | **-** |

# NOTE 4.7 PENSION LIABILITIES

**Net pension liabilities on same level as last year**

Arla's pension liabilities consist 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 233 million, which represent an increase of EUR 13 million compared to last year. Remeasurements of pensions plans in the group totalling a net loss of EUR 50 million, consisted of an actuarial loss of 180 mEUR offset by a remeasurement gain on pension assets of EUR 130 million.

*Pension plans in Sweden*
The defined benefit plan in Sweden does not currently require the group to make further cash contributions. The recognised net liability was EUR 223 million, an increase of EUR 24 million compared to last year. An actuarial loss of EUR 29 million was recognised due to a lower discount rate.

These pension plans are contribution-based plans, guaranteeing a defined benefit pension at retirement. Contributions have been 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.

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 pension asset in the UK was EUR 16 million, representing an improvement of EUR 12 million compared to last year. The improvement was primarily related to a positive movement in the value of plan assets by EUR 122 million offset by actuarial losses of EUR 139 million, due to a applied lower discount rate.

The defined benefit plans in the UK are administered by an independent pension trust that invests deposited amounts to cover future pension payments. The assets under management amounted to EUR 1.420 million at end of 2019 compared to EUR 1.231 million last year.

These pension plans are defined benefit final salary schemes. The schemes are closed to both new entrants and future accrual. Defined contribution schemes are in place for other employees. Employer 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 (of which Arla appoints the majority) 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 scheme is managed under a risk-controlled investment strategy, which includes a liability-driven investment approach that seeks to match, where appropriate, the profile of the liabilities. By the end of 2019 the level of interest hedging against the liabilities was 65 per cent compared to 57 per cent last year while the inflation hedging was 65 per cent compared to 61 per cent last year. This hedging reduces the overall level of risk within the scheme.

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 |
|---|---|---|---|---|
| **2019** | | | | |
| Present value of funded liabilities | 232 | 1,420 | 46 | 1,698 |
| Fair value of plan assets | -12 | -1,436 | -27 | -1,475 |
| **Deficit of funded plans** | **220** | **-16** | **19** | **223** |
| Present value of unfunded liabilities | 3 | - | 7 | 10 |
| **Net pension liabilities recognised on the balance sheet** | **223** | **-16** | **26** | **233** |
| *Specification of total liabilities:* | | | | |
| Present value of funded liabilities | 232 | 1,420 | 46 | 1,698 |
| Present value of unfunded liabilities | 3 | - | 7 | 10 |
| **Total liabilities** | **235** | **1,420** | **53** | **1,708** |
| *Presented as:* | | | | |
| Pension assets | - | -16 | - | -16 |
| Pension liabilities | 223 | - | 26 | 249 |
| **Net pension liabilities** | **223** | **-16** | **26** | **233** |
| **2018** | | | | |
| Present value of funded liabilities | 208 | 1,231 | 36 | 1,475 |
| Fair value of plan assets | -12 | -1,235 | -18 | -1,265 |
| **Deficit of funded plans** | **196** | **-4** | **18** | **210** |
| Present value of unfunded liabilities | 3 | - | 7 | 10 |
| **Net pension liabilities recognised on the balance sheet** | **199** | **-4** | **25** | **220** |
| *Specification of total liabilities:* | | | | |
| Present value of funded liabilities | 208 | 1,231 | 36 | 1,475 |
| Present value of unfunded liabilities | 3 | - | 7 | 10 |
| **Total liabilities** | **211** | **1,231** | **43** | **1,485** |
| *Presented as:* | | | | |
| Pension assets | - | -4 | - | -4 |
| Pension liabilities | 199 | - | 25 | 224 |
| **Net pension liabilities** | **199** | **-4** | **25** | **220** |

# NOTE 4.7 PENSION LIABILITIES (CONTINUED)

**Table 4.7.b Development in pension liabilities**
(EURm)

| | 2019 | 2018 |
|---|---|---|
| Present value of liability at 1 January | 1,485 | 1,597 |
| Reclassification | - | -6 |
| New pension liability from acquired companies | - | 1 |
| Current service cost | 3 | 10 |
| Interest cost | 40 | 38 |
| Actuarial gains and losses from changes in financial assumptions (OCI) | 177 | -69 |
| Actuarial gains and losses from changes in demographic assumptions (OCI) | 3 | 4 |
| Benefits paid | -70 | -65 |
| Exchange rate adjustment | 70 | -25 |
| **Present value of pension liability at 31 December** | **1,708** | **1,485** |

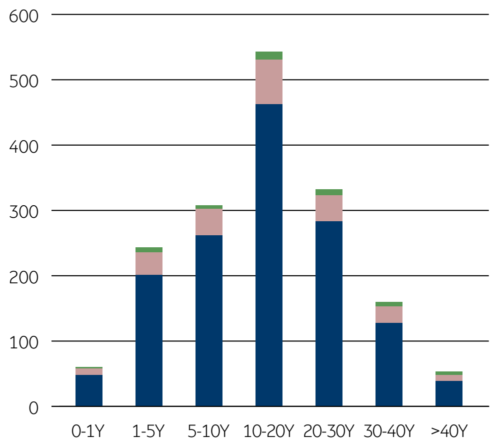
**Table 4.7.c Development in fair value of plan assets**
(EURm)

| | 2019 | 2018 |
|---|---|---|
| Fair value of plan assets at 1 January | 1,265 | 1,320 |
| Interest income | 36 | 32 |
| Return on plan assets, excluding amounts included in net interest on the net defined benefit liability | 130 | -40 |
| Contributions to plans | 27 | 27 |
| Benefits paid | -60 | -55 |
| Administration expenses | - | -1 |
| Exchange rate adjustments | 77 | -18 |
| **Fair value of plan assets at 31 December** | **1,475** | **1,265** |

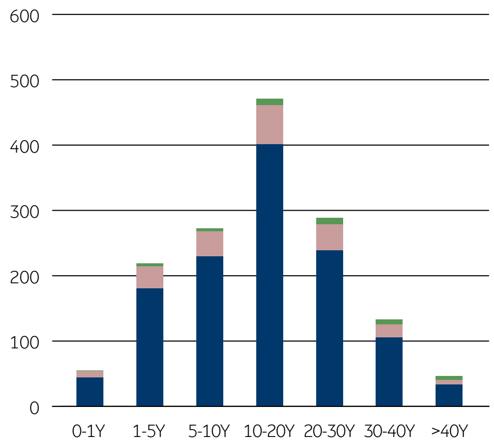
The Group expects to contribute EUR 26 million to the plan assets in 2020 and EUR 96 million in 2021-2024.

| | 2019 | 2018 |
|---|---|---|
| *Actual return on plan assets:* | | |
| Calculated interest income | 36 | 32 |
| Return excluding calculated interest | 130 | -40 |
| **Actual return** | **166** | **-8** |

**Maturity of pension liability, at 31 December 2019**
(EURm)




**Maturity of pension liability, at 31 December 2018**
(EURm)




UK Sweden Other

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

| | 2019 | 2019 | 2018 | 2018 |
|---|---|---|---|---|
| **Impact on pension liabilities at 31 December** | + | - | + | - |
| Discount rate +/- 10bps | -27 | 27 | -22 | -20 |
| Expected salary increases +/- 10bps | 3 | -3 | 2 | -2 |
| Life expectancy +/- 1 year | 77 | -77 | 59 | -58 |
| Inflation +/- 10 bps | 18 | -17 | 15 | -14 |

# NOTE 4.7 PENSION LIABILITIES (CONTINUED)

| Table 4.7.e Pension assets recognised (EURm) | 2019 | % | 2018 | % |
|---|---|---|---|---|
| Liability hedge portfolio | 296 | 20% | 364 | 29% |
| Debt vehicles | 412 | 28% | 274 | 21% |
| Bonds | 239 | 16% | 200 | 16% |
| Equity instruments | 214 | 15% | 166 | 13% |
| Properties | 138 | 9% | 117 | 9% |
| Infrastructure | 80 | 5% | 59 | 5% |
| Other assets | 96 | 7% | 85 | 7% |
| **Total assets** | **1,475** | **100%** | **1,265** | **100%** |

| Table 4.7.f Recognised in the income statement for the year (EURm) | 2019 | 2018 |
|---|---|---|
| Current service cost | 3 | 10 |
| Administration cost | - | 1 |
| **Recognised as staff costs** | **3** | **11** |
| Interest cost on pension liability | 40 | 38 |
| Interest income on plan assets | -36 | -32 |
| **Recognised as financial cost** | **4** | **6** |
| **Total amount recognised in the income statement** | **7** | **17** |

| Table 4.7.g Recognised in other comprehensive income (EURm) | 2019 | 2018 |
|---|---|---|
| Actuarial gains and losses on liabilities from changes in financial assumptions (OCI) | -177 | 69 |
| Actuarial gains and losses on liabilities from changes in demographic assumptions (OCI) | -3 | -4 |
| Return on plan assets, excluding amounts included in net interest on the net defined benefit liability | 130 | -40 |
| **Re-measurements of defined benefit schemes** | **-50** | **25** |

| Table 4.7.h Assumptions for the actuarial calculations | 2019 | 2018 |
|---|---|---|
| Discount rate, Sweden | 1.5% | 2.4% |
| Discount rate, UK | 2.1% | 2.9% |
| Expected payroll increase, Sweden | 2.3% | 2.3% |
| Expected payroll increase, UK | 2.3% | 2.5% |
| Inflation (CPI), Sweden | 1.8% | 1.9% |
| Inflation (CPI), UK | 1.8% | 3.1% |

# NOTE 4.7 PENSION LIABILITIES (CONTINUED)

## Accounting policies

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

*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 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 retired, 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'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 in 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 carrying amount related to defined benefit pension plans is 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 5.1 TAX

## Current and deferred tax

*Tax in the income statement*
Tax costs decreased to EUR 24 million, compared to EUR 41 million last year primarily due to changes of the deferred tax positions.

*Current income tax*
Cost related to current income taxes increased to EUR 28 million compared to EUR 22 million last year primarily due to higher profits. Prepaid current income tax and payments related to current tax previous years totaled EUR 30 million, which was very similar to last year.

*Deferred tax*
Net deferred tax liabilities amounted to EUR 38 million, which represents a decrease of EUR 16 million compared to last year. This was driven by recognition of tax assets due to a higher profit outlook and by changes in temporary differences compared to last year. Net deferred tax liabilities consisted of gross deferred tax liabilities of EUR 81 million and related to temporary differences on intangible fixed assets, property, plant and equipment and other items. These were offset by deferred tax assets of EUR 43 million relating to property, plant and equipment, tax losses carried forward and pension liabilities.

For more information on tax governance, please refer to page 45.

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

| | 2019 | 2018 |
|---|---|---|
| *Current income tax* | | |
| Current income tax on result for the year relating to: | | |
| Cooperative tax | 8 | 7 |
| Corporate income tax | 19 | 17 |
| Adjustment for current tax of previous years | 1 | -2 |
| **Total current income tax costs** | **28** | **22** |
| *Deferred tax* | | |
| Change in deferred tax for the year | -6 | 20 |
| Adjustment for deferred tax of previous years | 2 | 1 |
| Impact of changes in tax rates and laws | - | -2 |
| **Total deferred tax costs/income** | **-4** | **19** |
| **Total tax costs in the income statement** | **24** | **41** |

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

| | 2019 | | 2018 | |
|---|---|---|---|---|
| Profit before tax | | 347 | | 348 |
| Tax applying the statutory Danish corporate income tax rate | 22.0% | 76 | 22.0% | 76 |
| Effect of tax rates in other jurisdictions | -0.9% | -3 | -2.7% | -9 |
| Effect of companies subject to Cooperative taxation | -9.2% | -32 | -15.5% | -54 |
| Tax-exempt income, less non-deductible expenses | -1.4% | -5 | -2.4% | -8 |
| Impact of changes in tax rates and laws | 0.0% | - | -0.6% | -2 |
| Adjustment for tax cost of previous years | 0.9% | 3 | -0.3% | -1 |
| Other adjustments | -4.4% | -15 | 11.3% | 39 |
| **Total** | **6.9%** | **24** | **11.8%** | **41** |

**Table 5.1.c. Deferred tax**
(EURm)

| | 2019 | 2018 |
|---|---|---|
| Net deferred tax asset/(liability) at 1 January | -54 | -16 |
| Deferred tax recognised in income statement | 4 | -21 |
| Deferred tax recognised in other comprehensive income | 10 | -7 |
| Acquisitions in connection with business combinations | - | -12 |
| Impact of change in tax rates | - | 2 |
| Exchange rate adjustments | 2 | 0 |
| **Net deferred tax asset/(liability) at 31 December** | **-38** | **-54** |
| **Deferred tax, by gross temporary difference** | | |
| Intangible assets | -8 | -10 |
| Property, plant & equipment | 25 | 3 |
| Provisions, pension liabilities and other assets | -12 | -7 |
| Tax losses carried forward | 12 | 8 |
| Other | -55 | -48 |
| **Total deferred tax, by gross temporary difference** | **-38** | **-54** |
| *Recognised in the balance sheet as:* | | |
| Deferred tax assets | 43 | 30 |
| Deferred tax liabilities | -81 | -84 |
| **Total** | **-38** | **-54** |

## NOTE 5.1 TAX (CONTINUED)

The group recognises deferred tax assets, including the value of tax losses carried forward, where Management assesses that the tax assets may be utilised in the foreseeable future by offset against taxable income. The assessment is performed on an annual basis and is based on the budgets and business plans for future years.

The group has recognised deferred tax assets in respect of tax losses carried forward totaling EUR 12 million. Temporary differences on which deferred tax assets have not been recognised totaled EUR 27 million, all related to tax losses carried forward.

### Accounting policies

*Tax in the income statement*
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 (income or costs) recognised directly in other comprehensive income.

*Current tax*
Current tax is assessed based on tax legislation for entities in the group subject to cooperative or corporate income taxation. Cooperative taxation is based on the capital of the cooperative, while corporate income tax is assessed based on the company's taxable income for the year. Current tax liabilities comprises the expected tax payable/ receivable on the taxable income or loss for the year, any adjustment to the tax payable or receivable in respect of previous years, and for tax paid on account.

*Deferred tax*
Deferred tax is measured in accordance with the balance sheet liability method for all temporary differences between the tax base of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not recognised on temporary differences on initial recognition of goodwill, 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 M&A activities.

Deferred tax is determined applying tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred tax asset is realised or deferred tax liability is settled. Changes in deferred tax assets and liabilities due to changes in the tax rate are recognised in the income statement except for items recognised in other comprehensive income.

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 assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

### Uncertainties and estimates

*Deferred tax*
Deferred tax reflects assessments of actual future tax due on items in the financial statements, considering timing and probability. These estimates also reflect expectations about future taxable profits and the group's tax planning. 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) | **2019** | **2018** |
|---|---|---|
| Statutory audit | 1.5 | 1.4 |
| Other assurance engagements | 0.1 | 0.1 |
| Tax assistance | 0.7 | 0.8 |
| Other services | 0.9 | 0.5 |
| **Total fees to auditors** | **3.2** | **2.8** |

# NOTE 5.3 MANAGEMENT REMUNERATION AND TRANSACTIONS

### Remuneration paid to management

The remuneration to the 18 registered members of the Board of Directors (BoD) is assessed and adjusted on a bi-annual basis and approved by the Board of Representatives. The BoD's remuneration was latest adjusted in 2019. Principles applied to the remuneration of the BoD are described on page 44. Members of the Board are paid for milk supplies to Arla Foods amba, in accordance with the terms for the other owners. Similarly, individual capital instruments are issued to the BoD on the same terms as to other owners.

In 2019 the Executive Board was expanded by appointing chief commercial officer, Europe, Peter Giørtz-Carlsen to the board. In 2018, Executive Board compensation reflected remuneration for only chief executive officer (CEO), Peder Tuborgh. Principles applied for the remuneration of the Executive Board are described on page 44.

| **Table 5.3.a Management remuneration** (EURm) | **2019** | **2018** |
|---|---|---|
| **Board of Directors** | | |
| Wages, salaries and remuneration | 1.3 | 1.3 |
| **Total** | **1.3** | **1.3** |
| **Executive Board (only CEO in 2018)** | | |
| Fixed compensation | 2.3 | 1.5 |
| Pension | 0.3 | 0.2 |
| Short-term variable incentives | 0.5 | 0.1 |
| Long-term variable incentives | 0.4 | 0.3 |
| **Total** | **3.5** | **2.1** |

The above table includes amount paid during the respective reporting period. The Executive Board remuneration package includes incentive plans as described on page 44. For 2019 the accrued amount was EUR 3.5 million (EUR 1.9 million last year). The amount was based on reported key figures together with estimates on performance compared to peers and consequently the final future payout may differ.

| **Table 5.3.b Transactions with the Board of Directors** (EURm) | **2019** | **2018** |
|---|---|---|
| Purchase of raw milk | 26.0 | 14.9 |
| Supplementary payment regarding previous years | 2.1 | 0.5 |
| **Total** | **28.1** | **15.4** |
| Unsettled milk deliveries in trade and other payables | 1.5 | 0.7 |
| Individual capital instruments | 2.9 | 1.8 |
| **Total** | **4.4** | **2.5** |

# NOTE 5.4 CONTRACTUAL COMMITMENTS, CONTINGENT ASSETS AND LIABILITIES

### Contractual obligations and commitments

Arla's contractual obligations and commitments amounted to EUR 254 million compared to EUR 345 million last year. The decrease was primarily due to adoption of IFRS 16. Refer to Note 5.6 for further details.

Contractual commitments consisted of IT licenses, short term and low value lease contracts and agreements to purchase property, plant and equipment. Guarantee commitments amounted to EUR 1 million compared to EUR 2 million last year.

As security for mortgage debt based on the Danish Mortgage Act with a nominal value of EUR 966 million, compared to EUR 800 million last year, the group provided security in property.

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

# NOTE 5.5 SUBSEQUENT EVENTS AFTER THE BALANCE SHEET DATE

No 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 18 February 2020 and presented for approval by the Board of Representatives on 26 February 2020.

The consolidated financial statements are prepared as a compilation of the parent company's and the individual subsidiaries' financial statements, in line with 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 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. Some reclassifications have been carried out compared to previously. These, however, have no impact on the net profit or the equity.

### 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.

### Adoption of new or amended IFRS

The group implemented all new standards and interpretations effective in the EU from 2019. The implementation of IFRS 16 had significant impact on the consolidated financial statements as described below. IASB issued a number of new or amended and revised accounting standards and interpretations that have not yet come into effect. Arla will incorporate these new standards when they become mandatory.

### IFRS 16 Leases

IFRS 16 was issued in January 2016 and replaced IAS 17 Leases, IFRIC 4 determining whether an arrangement contains a lease, SIC-15 operating lease-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 the balance sheet, in line with accounting treatment for finance leases under IAS 17. The implementation of IFRS 16 changed the accounting treatment for lease contracts previously treated as operating leases. The group adopted IFRS 16 prospectively from 1 January 2019 and did not restate comparatives for the 2018 reporting period.

The standard requires that each lease contract regardless of type, with some exemptions, needs to be capitalised on the balance sheet as an asset, representing the right to use the underlying asset, with a corresponding lease liability, representing the lease payments.

For leases previously classified as finance leases, the group recognised the carrying amount of the lease asset and lease liability immediately before transition as the carrying amount of the right of use asset and the lease liability at the date of initial application. The measurement principles of IFRS 16 were only applied after that date.

Right of use assets were measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to the lease recognised in the balance sheet as at 31 December 2018.

# NOTE 5.6 GENERAL ACCOUNTING POLICIES (CONTINUED)

In applying IFRS 16 for the first time, the group used the following practical expedients permitted by the standard:

- The use of a single discount rate to a portfolio of leases with reasonably similar characteristics.
- The accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases
- The exclusion of initial direct costs for the measurement of the right of use asset at the date of initial application, and
- The use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

Further, Arla has elected not to apply IFRS 16 to contracts that were not identified as containing a lease under IAS 17 and IFRIC 4 determining whether an arrangement contains a lease. For a description on the applied accounting policies on the right of use assets refer to note 3.2.1

The capitalised right of use assets on the balance sheet at 1 January 2019 amounted to EUR 200 million as specified below.

Contingent liabilities related to lease contracts at 31 December 2018 were discounted by the groups incremental discount rate between 1,75 per cent and 7,50 per cent. Correspondingly net interest-bearing debt increased by EUR 200 million at 1 January 2019.

Consequently, the adoption of IFRS 16 had no effect on equity at 1 January 2019.

The impact on the income statement from adoption of IFRS 16 was a reduction in operating costs of EUR 77 million and a corresponding increase in depreciations of EUR 70 million and interests of EUR 7 million. The impact on EBITDA was an increase of 9 per cent, while EBIT and net profit was virtually unchanged.

Leverage was not significantly affected. The impact on the cash flow statement was an increase in cash flow from operating activities of EUR 66 million and a corresponding change in cash flow from financing activities.

### IFRIC 23 Uncertainty over income tax treatments

IFRIC 23 was issued in May 2017 and clarifies how to apply the recognition and measurement requirements in IAS 12 Income taxes. Arla adhere to the interpretation when assessing disclosures on current and deferred tax positions. The interpretation was effective from 1 January 2019.

**Table 5.6.a Impact on balance sheet and contingent liabilities 1 January 2019**
(EURm)

| | |
|---|---|
| Operating lease commitments disclosed as contingent liabilities 31 December 2018 (discounted) | 197 |
| Financial lease liabilities recognised on balance sheet 31 December 2018 | 2 |
| Other adjustments | 1 |
| **Right of use assets on balance sheet 1 January 2019** | **200** |

# NOTE 5.7 GROUP CHART

| | 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 Japan 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 | 100 |
| Arla Foods Ingredients Comércio de Produtos Alimentícios Ltda. | Brazil | BRL | 100 |
| 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 S.P.C. | Bahrain | BHD | 100 |
| Arla Oy | Finland | EUR | 100 |
| Massby Facility & Services Oy | Finland | EUR | 60 |
| Osuuskunta MS tuottajapalvelu ** | Finland | EUR | 37 |
| 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 | 33 |
| 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 |
| Yeo Valley Dairies limited | 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 |

| | Country | Currency | Group Equity interest (%) |
|---|---|---|---|
| **Arla Foods amba** | **Denmark** | **DKK** | |
| Arla Foods UK Property Co. Ltd. | UK | GBP | 100 |
| Arla Foods B.V. | Netherlands | EUR | 100 |
| Arla Foods Comércio, Importacâo e Exportacão de Productos Alimenticios Ltda. | Brazil | BRL | 100 |
| Danya Foods Ltd. | Kingdom of 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 (In 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 | 51 |
| Arla Foods Trading and Procurement Ltd. | Hong Kong | HKD | 100 |
| Aishichenxi Dairy Products Import & Export Co. Ltd. ** | China | CNY | 50 |
| Arla Foods Sdn. Bhd. | Malaysia | MYR | 100 |
| Arla Foods Panama S.A. (In liquidation) | Panama | USD | 100 |

# NOTE 5.7 GROUP CHART (CONTINUED)

| | Country | Currency | Group Equity interest (%) |
|---|---|---|---|
| **Arla Foods amba** | **Denmark** | **DKK** | |
| Arla Foods Corporation | 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 |
| Arla Foods AB | Sweden | SEK | 100 |
| Arla Fastighets AB | Sweden | SEK | 100 |
| Arla Gefleortens AB | Sweden | SEK | 100 |
| Årets Kock | Sweden | SEK | 67 |
| 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 |
| 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 (In liquidation) | Luxembourg | EUR | 100 |
| Arla Foods Agrar Service Belgien AG (In liquidation) | Belgium | EUR | 100 |
| Arla Foods LLC | Russia | RUB | 20 |
| Team-Pack Vertriebs-Gesellschaft für Verpackungen mbH | 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 |

| | Country | Currency | Group Equity interest (%) |
|---|---|---|---|
| **Arla Foods amba** | **Denmark** | **DKK** | |
| 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 |
| Hansa Verwaltungs und Vertriebs GmbH (In liquidation) | 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 Shared Services 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 |
| Marygold Trading K/S ° | Denmark | DKK | 100 |
| Mejeriforeningen | Denmark | DKK | 91 |
| PT. Arla Indofood Makmur Dairy Import PMA. | Indonesia | IDR | 50 |
| PT. Arla Indofood Suksus Dairy Manufactoring PMA. | Indonesia | IDR | 100 |
| COFCO Dairy Holdings Limited ** | British Virgin Irlands | HKD | 30 |
| Svensk Mjölk Ekonomisk förening | Sweden | SEK | 75 |
| Lantbrukarnas Riksförbund upa ** | Sweden | SEK | 24 |
| Jörd International A/S | Denmark | DKK | 100 |

* Joint ventures ** Associates
° According to Danish Act §5 the company does not make a statutory report
The Group also owns a number of entities without material commercial activities.

# STATEMENT BY THE BOARD OF DIRECTORS AND THE EXECUTIVE BOARD

Today, the Board of Directors and the Executive Director discussed and approved the annual report of Arla Foods amba for the financial year 2019. 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, the parent company financial statements and the environmental, social and governance data give a true and fair view of the group's and the parent company's financial position as at 31 December 2019 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 2019.

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, 18 February 2020

Peder Tuborgh
CEO

Peter Giørtz-Carlsen
Executive Board Member

Jan Toft Nørgaard
Chairman

Heléne Gunnarson
Vice Chairman

René Lund Hansen

Jonas Carlgren

Arthur Fearnall

Manfred Graff

Jan-Erik Hansson

Walter Laursen

Bjørn Jepsen

Steen Nørgaard Madsen

Jørn Kjær Madsen

Johnnie Russell

Marcel Goffinet

Simon Simonsen

Inger-Lise Sjöstrom

Håkan Gillström
Employee representative

Ib Bjerglund Nielsen
Employee representative

Harry Shaw
Employee representative

# 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 2019, 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 2019 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 2019 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, 18 February 2020
ERNST & YOUNG
Godkendt Revisionspartnerselskab
CVR no. 30 70 02 28

| | |
|---|---|
| Henrik Kronborg Iversen | Jens Weiersøe Jakobsen |
| State Authorised | State Authorised |
| Public Accountant | Public Accountant |
| MNE no. 24687 | MNE no. 30152 |

# OUR CONSOLIDATED ENVIRONMENTAL, SOCIAL AND GOVERNANCE DATA

**Creating circular systems on farm**

On our way to produce carbon net zero dairy in 2050 our farmers in Sweden are exploring new ways of utilizing cow manure. By turning manure into biogas, farmers in Sweden are now able to power milk trucks. Biogas is also an extra source of income for them, and makes the fertilizer made of manure more nutritious and odourless.

SCIENCE BASED TARGETS

DRIVING AMBITIOUS CORPORATE CLIMATE ACTION

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# CONSOLIDATED ENVIRONMENTAL, SOCIAL AND GOVERNANCE DATA

**Sustainability at Arla**
Sustainability is a cornerstone of Arla's strategy. Arla aims at delivering healthy and nutritional dairy products to consumers globally and the company is committed to do so with a constantly reduced environmental impact. Arla understands that achieving its mission to secure the highest value for the farmer owner's milk while creating opportunities for their growth also requires delivering on its environmental and social performance. Arla's recently launched sustainability strategy ensures this. To signify commitment to the company's sustainability agenda, and to increase accountability towards the goals Arla set, the company in 2019 decided to report on figures describing the Arla's environmental, social and governance performance to the Annual Report.

ESG figures in the following section were chosen according to their materiality, and following the most recent reporting guidelines published by the Danish Finance Society/CFA Society Denmark, FSR – Danish Auditors, and Nasdaq. With the chosen figures Arla aimed at providing a complete picture of the company's impact on the environment, how employees are treated and how the quality of products is safeguarded. Maturity and quality of data was also taken into consideration when selecting the figures presented in this section.

Arla's biggest environmental impact relates to the indirect, scope 3 $CO_2e$ emissions, more precisely to milk production on farm (86 per cent of total $CO_2e$ emissions). Most of the largest companies in the world now account and report on the emissions from their direct operations (scopes 1 and 2), however Arla wanted to take a step further in accountability and started to report on scope 3 emissions in 2005. From 2020 Arla is going to enhance scope 3 reporting by accelerating data collection on farms through the company's new global Climate Check programme. For more information go to page 32.

In 2019 Arla's emissions targets were officially approved by the Science Based Target initiative as aligned with climate science.

*Our science-based targets:*
- Reduce greenhouse gas emissions with 30 per cent for scope 1 and scope 2 in absolute terms from 2015 to 2030
- Reduce greenhouse gas emissions with 30 per cent for scope 3 per kg of raw milk from 2015 to 2030

Beyond the science-based targets, in 2019 Arla also announced the ambition to produce carbon net zero dairy by 2050.

The methodology used for calculating emissions on farm level is constantly evolving. For example currently carbon sequestration on farms is not included in the method and thus the figure presented here is a conservative estimate. Developments in methodology will also be reflected in restatements of baseline.

Arla also annually publishes a CSR report, where the company presents in-depth analyses on the progress towards environmental, social and governance targets. A sub-set of the figures presented in this report can be also found there. Find the CSR report and further information about Arla's sustainability efforts on the company's webpage.

| Five-year ESG overview | ESG note | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|---|
| **Environmental data** | | | | | | |
| $CO_2e$ scope 1 (Mio. kg) | | 470 | 497 | 498 | 483 | 535 |
| $CO_2e$ scope 2 (Mio. kg) | | 275 | 263 | 313 | 334 | 342 |
| $CO_2e$ scope 3 (Mio. kg) | | 17,758 | 18,073 | 18,217 | 18,292 | 19,802 |
| **Total $CO_2e$ (Mio. kg)** | 1.1 | **18,503** | **18,834** | **19,028** | **19,110** | **20,679** |
| Progress towards 2030 $CO_2e$ reduction target (scope 1 and scope 2) | | -15% | -13% | -8% | -7% | - |
| Progress towards 2030 $CO_2e$ reduction target (scope 3 per kg milk and whey) | | -7% | -7% | -6% | -6% | - |
| Renewable energy share (%) | 1.2 | 33% | 27% | 24% | 21% | 19% |
| Solid waste in production (Tonnes) | 1.3 | 33,713 | 34,600 | 32,608 | 32,192 | 33,106 |
| **Social data** | | | | | | |
| Full time equivalents (average) | 2.1 | 19,174 | 19,190 | 18,973 | 18,765 | 19,025 |
| Gender diversity for all employees (% of females) | 2.2 | 27% | 27% | 26% | 26% | 27% |
| Gender diversity in management (% of females) | 2.2 | 26% | 23% | 22% | 22% | 21% |
| Gender diversity in top management (% of females) | 2.3 | 29% | 29% | 29% | 29% | 13% |
| Gender pay ratio, white collar (male to female) | 2.3 | 1.05 | 1.06 | - | - | - |
| Employee turnover (%) | 2.4 | 12% | 12% | 11% | 14% | - |
| Food safety - Number of recalls | 2.5 | 4 | 2 | 10 | 6 | 7 |
| Accident frequency (Per 1 Mio. working hours) | 2.6 | 6 | 8 | 10 | 11 | 14 |
| **Governance data** | | | | | | |
| Gender diversity Board of Directors (%)* | 3.1 | 13% | 13% | 12% | 7% | 7% |
| Board meeting attendance (%) | 3.2 | 96% | 99% | 99% | 98% | 97% |

**Including all board members, those elected by the general assembly, employee representatives and external advisors, the share of females was 20 per cent as of 31 December 2019*

# ESG NOTE 1 ENVIRONMENTAL FIGURES

## ESG Note 1.1 Greenhouse gas emissions ($CO_2e$)

### Total $CO_2e$ emissions decreased

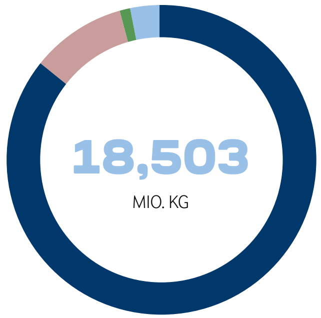
To follow up on Arla's contribution to climate change, and the progress towards the company's emissions targets, the total greenhouse gas emissions (expressed as $CO_2$ equivalents, $CO_2e$) are calculated annually. $CO_2e$ are categorized into three scopes, according to the methodology of the Greenhouse Gas Protocol. The three scopes cover nearly all of the company's activities.

Total $CO_2e$ emissions decreased to 18,503 million kilos compared to 18,834 million kilos last year. The decrease is explained by multiple factors. Arla farmers are becoming more and efficient, the overall milk intake decreased, as well as increased use of biogas in the production of Arla Food Ingredients all contributed to the improvement.

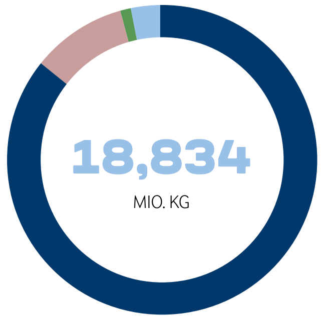
Since 2015 scope 1 and scope 2 CO2e emissions decreased by 15 per cent, which means that in 2019 we are already halfway to reach our 2030 science-based target to reduce emissions by 30 per cent.

Scope 3 emisssions per kilo of milk were reduced by 7 per cent since 2015 due to several progressive activities on Arla farms, and more specific methods to measure and estimate farm level emissions. This means that Arla is well on its way to achieve the 2030 target to reduce scope 3 emissions per kilo of milk by 30 per cent.

**$CO_2e$ emmision 2019**
(Mio. kg)




**$CO_2e$ emmision 2018**
(Mio. kg)




**ESG Table 1.1 Greenhouse gas emmissions*** (Mio. kg)

| | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|
| **$CO_2e$ scope 1** | | | | | |
| Production | 373 | 407 | 414 | 394 | 422 |
| Transport | 97 | 90 | 84 | 89 | 113 |
| **Total $CO_2e$ scope 1** | **470** | **497** | **498** | **483** | **535** |
| **Total $CO_2e$ scope 2** | **275** | **263** | **313** | **334** | **342** |
| **$CO_2e$ scope 3** | | | | | |
| *Emissions from farms:* | | | | | |
| Emissions related to milk production and operations on farm | 15,949 | 16,119 | 16,393 | 16,289 | 17,865 |
| *Emissions from purchased goods and services:* | | | | | |
| Whey | 1,032 | 1,162 | 1,002 | 1,117 | 1,119 |
| Packaging | 375 | 371 | 372 | 418 | 390 |
| Transport | 294 | 308 | 325 | 338 | 302 |
| Operations | 108 | 113 | 125 | 130 | 126 |
| **Total $CO_2e$ scope 3** | 17,758 | 18,073 | 18,217 | 18,292 | 19,802 |
| **Total $CO_2e$** | **18,503** | **18,834** | **19,028** | **19,110** | **20,679** |

### Accounting policies

Greenhouse gas emissions are measured in $CO_2$ equivalents and are categorized into three scopes.

*Calculating $CO_2$ equivalents*
Greenhouses gases are gases that contribute to the warming of the climate by absorbing infrared radiation. Besides the widely-known carbon dioxide ($CO_2$), there are two other major greenhouse gases associated with dairy production: nitrous oxide ($N_2O$) and methane ($CH_4$). In order to calculate the total greenhouse gas emissions (the carbon footprint) of the company, different greenhouse gas emissions are converted into carbon dioxide equivalents ($CO_2e$). The conversion of different gases reflect their global warming potential. The potency of the different gases are taken into consideration according to the following calculations (based on IPCC* Fifth Assessment Report, Climate Change 2013):

1 kg carbon dioxide ($CO_2$ )= 1 kg $CO_2e$
1 kg methane ($CH_4$) = 28 kg $CO_2e$
1 kg nitrous oxide ($N_2O$) = 265 kg $CO_2e$

The majority of Arla's emissions are methane (e.g.: created from the digestion of cows) and nitrous oxide (e.g.: from fertilizer use on farms, or manure storage).

Greenhouse gas emissions are categorized into three scopes according to where do they appear across the value chain, and what control the company has over them.

** The IPCC (Intergovernmental Panel on Climate Change) is the United Nations body for assessing the science related to climate change.*
*** Following the methodology of the Greenhouse Gas Protocol, historical numbers for greenhouse gas emissions are restated each year due to acquisitions and divestments. Restatement has only immaterial effect on the figures.*

# ESG NOTE 1 ENVIRONMENTAL FIGURES (CONTINUED)

## Accounting policies (continued)

*Scope 1 – All direct emissions*
Scope 1 emissions relate to the activities under the group's control. This includes transport with Arla's vehicles, and direct emissions from Arla's production facilities. Scope 1 emissions are calculated in accordance with the methodology set out in the Greenhouse Gas Protocol Corporate Standard, by applying global warming potentials and emissions factors to Arla specific activity data.

*Scope 2 – Indirect emissions*
Scope 2 emissions relate to the indirect emissions caused by energy Arla purchases, i.e.: electricity or heating. Scope 2 emissions are calculated in accordance with the methodology set out in the Greenhouse Gas Protocol Corporate Standard, by applying global warming potentials and emissions factors to the company specific activity data. The method used for scope 2 reporting is location-based reporting, which reflects emissions due to electricity consumption from a conventional power grid, using an average emissions factor of the country's energy mix.

*Scope 3 – All other indirect emissions*
Scope 3 emissions relate to emissions from sources that Arla does not directly own or control. It covers emissions from purchased goods and services (e.g.: raw milk purchased from farmer owners packaging and, transportation purchased from suppliers), but also end-of-life processing waste (e.g.: recycling or incinerating).

Scope 3 emissions for raw milk are calculated in accordance with the International Dairy Federation's guideline for carbon footprint of dairy products (IDF 2015). Emissions related to raw milk include, amongst numerous factors, emissions related to the production and transportation of feed, fertilizer usage, the cow's digestion, and manure management. On farm calculations are made by external emission experts using Arla's carbon assessment tool. Scope 3 emissions from waste at sites, packaging, third party transportation and extraction of fuels are calculated by applying global warming potential and emissions factors to Arla specific-activity data.

According to the latest quantification of Arla's total climate impact, scope 1 and 2 emissions accounted for 3 and 1 per cent of total emissions, respectively. Scope 3 emissions accounted for 96 per cent of Arla's total climate impact. Milk production on farm (including, amongst many factors, methane emitted by cows, and emissions related to feed and transportation of feed) accounted for 90 per cent of the scope 3 emissions. For transportation, operations and packaging emission factors are obtained from Sphera, an industry-leading consultancy firm. Farm level emission factors are obtained from 2.0 LCA Consultants, a Danish consultancy firm formed from academics.

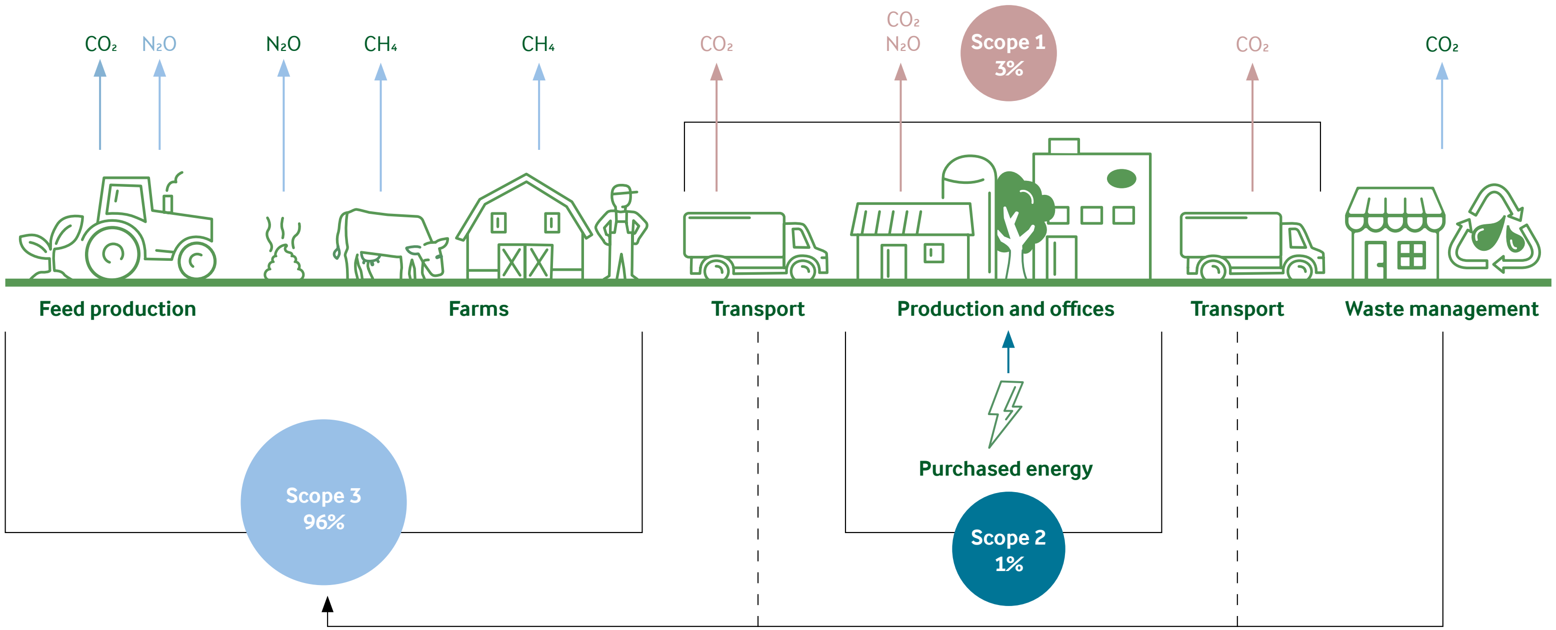
## Uncertainties and estimates

Currently total farm level emissions disclosed in ESG table 1.1 are estimated based on over 5000 voluntary climate checks, conducted since 2010. Farmers have been provided the opportunity to have the greenhouse gas emission of their farms assessed by independent third-party climate experts at no charge, and received recommendations on how to decrease emissions. In an effort to significantly increase the number of farms assessed, farmers from 2020 will be offered an incentive of 1 eurocent per kg of milk to have climate checks on their farms.

Methodology to measure emissions on farm is developing over time. Currently, factors that potentially lower total emissions, such as carbon sequestration of farm are not included. Changes in methodology will be also reflected the restatement of the baseline.

Another uncertainty relates to data collection regarding packaging and transportation from our suppliers. Each year, we send our suppliers detailed requests to provide the necessary data, accompanied with a manual on how to complete the related documentation. A rigorous two-step internal validation process is in place to minimize the chance of reporting incorrectly.

### Where do our emission come from?



# ESG NOTE 1 ENVIRONMENTAL FIGURES (CONTINUED)

### ESG Note 1.2 Renewable energy share

**Share of renewable energy increased**

The use of energy - inclduing heating and electricity - at Arla's sites contributes to climate change, depletion of non-renewable resources and pollution. As a result shifting from fossil to renewable energy is an important lever to fulfil Arla's climate ambition and decrease carbon footprint from scope 2 emmissions.

In 2019 the share of renewable energy increased to 33 per cent compared to 27 per cent last year, primarily due to the increased use of biogas in Arla Food Ingredient's production.

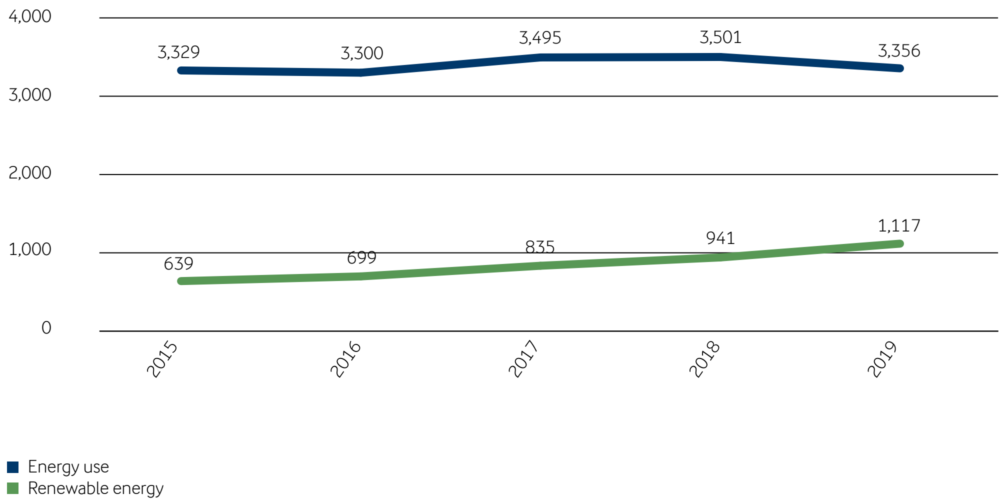
In 2010 Arla announced a target to increase the use of renewable energy to 50 per cent by 2020.

Arla no longer expects to achieve this goal by 2020 due to the company's capacity increase and expansion in the international segment, where renewable energy sources are less accessible .In line with our long-term environmental startegy, new targets and initiatives are being developed to change the future energy mix.

| **ESG Table 1.2 Energy use*** (Thousand MWh) | **2019** | **2018** | **2017** | **2016** | **2015** |
|---|---|---|---|---|---|
| Heating oil | 138 | 123 | 117 | 114 | 129 |
| Natural gas | 1,632 | 1,942 | 1,975 | 1,868 | 1,959 |
| Grid electricity | 927 | 944 | 950 | 965 | 962 |
| Renewable energy sources** | 654 | 449 | 410 | 312 | 238 |
| District heating | 6 | 43 | 43 | 41 | 41 |
| **Total** | **3,356** | **3,501** | **3,495** | **3,300** | **3,329** |
| *Of which renewable energy relate to:* | | | | | |
| Biogas | 434 | 234 | 201 | 111 | 44 |
| Biomass | 127 | 121 | 120 | 119 | 142 |
| District heating based on renewable sources | 92 | 94 | 89 | 82 | 52 |
| Renewable electricity | 463 | 492 | 425 | 387 | 401 |
| **Total** | **1,117** | **941** | **835** | **699** | **639** |
| **Renewable energy share** | **33%** | **27%** | **24%** | **21%** | **19%** |

** Historical numbers for energy use are restated each year due to acquisitions and divestments. Restatement has only immaterial effect on the figures. ** Renewable energy sources refer to energy from biogas, biomass and district heating based on renewable sources.*

**Energy consumption**
(Thousand Mwh)




**Accounting policies**

Energy usage at sites consist of renewable and fossil-based fuels and electricity. Renewable energy is energy based on renewable resources, which can be naturally replenished, such as sun, wind, water, biomass, and geothermal heat. Electricity, on the other hand, is a mix of both electricity from renewable and non-renewable sources. The renewable electricity purchased from national sources is assessed annually using methodology from Sphera, an industry-leading consultancy collecting, assessing and analysing emissions data based on the latest scientific evidence. To calculate the share of renewables the total renewable energy use is divided by the group's total energy use

**Uncertainties and estimates**

The data presented in ESG table 1.2 is collected annually from our sites and offices. Data for energy consumption is based on meter readings at each site, and therefore there is very little uncertainty attached to these figures.

In relation to the specification of renewable energy, there are some cases where it is not possible to discover how district heating is produced and therefore what relates to renewable and non-renewable sources. Using conservative assumptions, when the split is not possible, the heating is reported as conventional.

# ESG NOTE 1 ENVIRONMENTAL FIGURES (CONTINUED)

## ESG Note 1.3 Solid waste

### Solid waste decreased

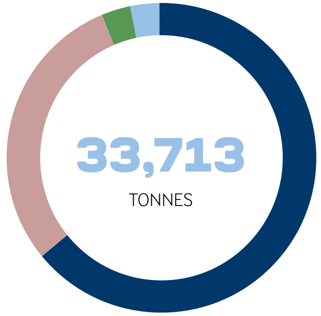
Waste that cannot be recovered by recycling, reusing or composting puts a burden on the environment. Arla's goal is to generate zero waste that needs to be depositied at a waste disposal site (landfill) by 2020. To achieve this goal, Arla is increasing production efficiency at sites, reducing waste throughout the manufacturing and transportaion process, as well as collaborating with waste management suppliers to reduce waste and improve waste handling.

In 2019 solid waste decreased to 33,713 tonnes compared to 34,600 tonnes last year, the first decrease since 2016. Waste to landfill increased to 988 tonnes compared to 933 tonnes last year, due to expansions into international markets and capacity increase related to these expansions.

| ESG Table 1.3 Solid waste* (Tonnes) | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|
| Recyled waste | 21,651 | 20,233 | 19,699 | 18,997 | 20,283 |
| Waste for incineration with energy recovery | 10,011 | 12,546 | 11,088 | 11,264 | 10,833 |
| Waste for landfilling | 988 | 933 | 897 | 1,015 | 991 |
| Hazardous waste | 1,063 | 888 | 924 | 916 | 999 |
| **Total** | **33,713** | **34,600** | **32,608** | **32,192** | **33,106** |

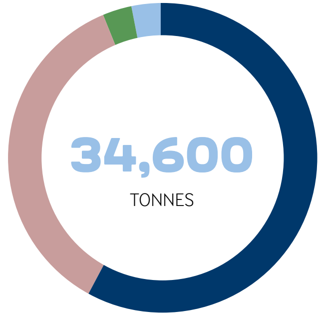
*Historical numbers for solid waste are restated each year due to acquisitions and divestments. Restatement has only immaterial effect on the figures.*

**Solid waste, 2019**




- Recyclable waste 64%
- Waste for incineration 30%
- Waste for landfilling 3%
- Hazardous waste 3%

**Solid waste, 2018**




- Recyclable waste 58%
- Waste for incineration 36%
- Waste for landfilling 3%
- Hazardous waste 3%

### Accounting policies

Solid waste includes materials no longer intended for their original use that are required to be recovered (e.g.: recycled, reused, composted) or not recovered (e.g.: landfilled) – this includes packaging waste, hazardous and other non-hazardous waste. To follow up on the goal of zero waste to landfill Arla collects data annually from all sites where we have control.

### Uncertainties and estimates

Currently Arla discloses only solid waste in ESG table 1.3, due to lack in methodology on how to account for food waste and measure milk solids content in product losses. Solid waste is only a small part of Arla's total waste. Other waste types are product waste and waste water. Arla plans to report total waste figures from 2020. Our ambition is to reduce our total waste by 50 per cent by 2030.

# ESG NOTE 2 SOCIAL FIGURES

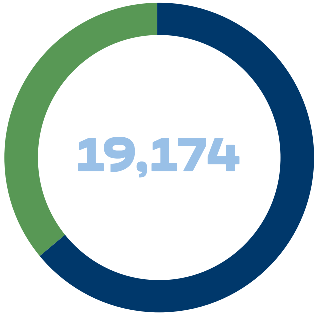
## ESG Note 2.1 Full time equivalents

**FTEs decreased despite expansion and acquisitions in international markets and Arla Foods Ingredients**

People are the most important asset to Arla, thus it's imperative to know how the company deploys these resources across geographies and time. Number of employees is measured in full time equivalents (FTE). The total number of FTEs decreased slightly compared to last year despite further expansion in international markets including the acquisition of the cheese business in the Middle East from Mondeléz International, contributing an additional 70 FTEs. Expansion in Arla Foods Ingredients explains the increase in FTEs in Denmark, while the insourcing of several IT services to the global shared service centre in Gdansk increased FTEs in Poland by 48. Insourcing, however, reduced the overall cost related to IT services. These increases were offset by a reduction in FTEs in most core markets including Germany, Finland and Sweden.

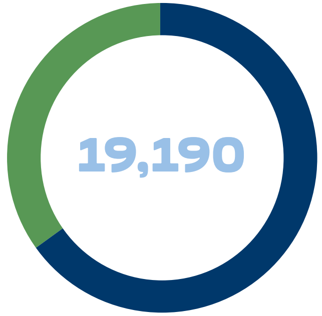
Over the last five years the FTE level has been relatively stable, but shows a shift of FTEs from core European countries to international markets, especially to MENA, supporting Arla's strategic plan to expand the share of business outside Europe, where the prespective for growth is more promising.

**Full time equivalent split by employee type, 2019**




- Blue collar employees 64%
- White collar employees 36%

**Full time equivalent split by employee type, 2018**




- Blue collar employees 65%
- White collar employees 35%

| ESG Table 2.1 Full time equivalents | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|
| Denmark | 7,258 | 7,264 | 7,069 | 6,956 | 7,086 |
| UK | 3,407 | 3,387 | 3,477 | 3,532 | 3,593 |
| Sweden | 2,977 | 3,001 | 3,029 | 3,175 | 3,305 |
| Germany | 1,681 | 1,759 | 1,809 | 1,780 | 1,828 |
| Saudi Arabia | 952 | 965 | 1,009 | 895 | 863 |
| North America | 477 | 502 | 496 | 477 | 476 |
| Poland | 511 | 463 | 433 | 425 | 429 |
| Netherlands | 339 | 327 | 320 | 313 | 317 |
| Finland | 319 | 325 | 325 | 321 | 323 |
| Other countries | 1,253 | 1,197 | 1,006 | 891 | 805 |
| **Full time equivalents** | **19,174** | **19,190** | **18,973** | **18,765** | **19,025** |

### Accounting policies

FTEs are defined as the contractual working hours for an employee compared to a full time contract in the same position and country. The full time equivalent figure is used to measure the active workforce counted in full time positions. An FTE of 1.0 is equivalent to a full-time worker, while an of FTE of 0.5 equals half of the full workload.

The average FTE figure reported in Note 1.2 in the consolidated financial statements, and in the ESG note 2.1 is calculated as the average number for each legal entity during the year based on quarterly measurements taken at the end of each quarter.

All employees are included in the FTE figure, including both people who are on permanent and temporary contracts. People on long term leave eg. maternity leave or long term sick leave are excluded.

The majority of employees in production and logistics are classified as blue collar employees, while employees within sales and administrative functions are classified as white collar employees. The ratio between white and blue collar employees is calculated based on FTEs at 31 December.

### Uncertainties and estimates

Employee data are handled centrally, in accordance with GDPR. The FTE figure is reported internally on a monthly basis. To improve data quality, data is validated by each legal entity on a quarterly basis through the financial consolidation system.

# ESG NOTE 2 SOCIAL FIGURES (CONTINUED)

## ESG Note 2.2 Gender diversity and inclusion

### Share of females in management increased

At Arla, we believe gender diversity is key to the success of the business. Arla's policies do not differentiate between men and women when it comes to promotion opportunities or remuneration, however women are underrepresented in the blue collar workforce of Arla, and to a lesser extent in the white collar workforce as well.

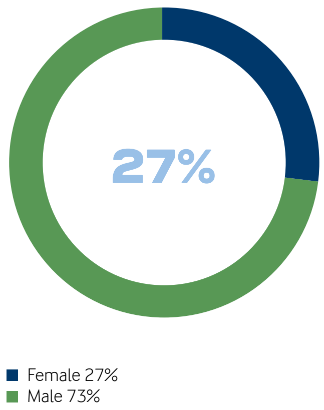
Arla strives to create a workplace with a diverse workforce, characterised by mutual respect and trust, promoting equal opportunities and allowing colleagues to live up to their full potential. Policies on diversity, inclusion and anti-harassment are in place to handle related issues in a structured manner. Work councils, at both local and global levels, also help secure that workplace decisions are made in the best interests of all colleagues and Arla. Gender diversity for the Board of Directors is disclosed in ESG note 3.1.

*Gender diversity (all employees)*
In 2019 the female share of FTEs was 27 per cent, unchanged from last year. Read more about how we work with diversity on page 37.

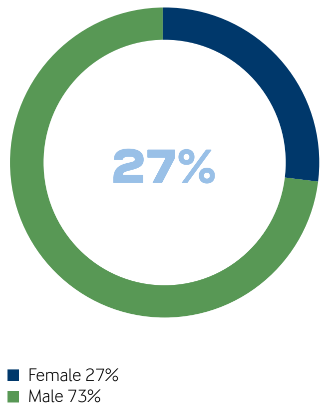
*Gender diversity (management)*
In 2019 26 per cent of director and above positions were held by women, compared to 23 per cent in 2018.

*Gender diversity (management)*
In 2019 29 per cent of the executive management team members were women. The gender composition is unchanged since 2016.

**Gender diversity for all employees, 2019**




**Gender diversity for all employees, 2018**




| **ESG Table 2.2.a Gender diversity for all employees** (all employees) | **2019** | **2018** | **2017** | **2016** | **2015** |
|---|---|---|---|---|---|
| Total share of female | 27% | 27% | 26% | 26% | 27% |

| **ESG Table 2.2.b Gender diversity in management** (diversity in management) | **2019** | **2018** | **2017** | **2016** | **2015** |
|---|---|---|---|---|---|
| Share of female at director level or above | 26% | 23% | 22% | 22% | 21% |

| **ESG Table 2.2.c Gender diversity in top management** | **2019** | **2018** | **2017** | **2016** | **2015** |
|---|---|---|---|---|---|
| Share of female in executive management team (EMT) | 29% | 29% | 29% | 29% | 13% |

### Accounting policies

*Gender diversity (all employees)*
Gender diversity is defined as the share of female FTEs compared to total FTEs. Gender diversity is not based on average FTEs, described in ESG note 2.1, but FTEs at 31 December 2019. It covers all white and blue collar employees.

*Gender diversity (in management)*
Arla gender diversity in management is defined as the share of female FTEs in director positions and above compared to total FTEs positions at director level and above.

*Gender diversity (in top management)*
Gender diversity in top management is defined as the share of females represented within the executive management team (EMT).

### Uncertainties and estimates

Gender diversity in management has previously been reported externally. The number, however, was based on number of employees and not FTEs. In accordance with the ESG reporting guidelines of the Danish Finance Society (FSR) and Nasdaq, the figures presented here are based on FTEs. Comparison figures related to 2015-2018 have been restated to reflect the changed calculation method and therefore are not comparable with numbers in prior publications.

# ESG NOTE 2 SOCIAL FIGURES (CONTINUED)

## ESG Note 2.3 Gender pay ratio

### Gap between male and female salary decreased

Paying equal salaries for the same job regardless of gender is a basic requirement for an ethical and responsbile company. At Arla men and women doing the same or equivalent jobs are paid the same salary level. This is secured through well-defined and fixed salary bands across all job categories.

The primary aim of the gender pay ratio is to ensure equitable treatment between genders and show where women are represented in the company hierarchy. In Arla, in 2019 the median male salary was 5 per cent higher than the median female salary, compared to 6 per cent last year. The improvement is primarily explained by increased number of women in senior leadership position (director and above).

| ESG Table 2.3 Gender pay ratio | 2019 | 2018 |
|---|---|---|
| Gender pay ratio | 1.05 | 1.06 |

### Accounting policies

The gender pay ratio is defined as median male salary divided by median female salary. The salary used in the calculation includes contractual base salaries while pension and other benefits are not included.

### Ucertainties and estimates

In ESG reporting guidelines by the Danish Financial Association and Nasdaq, it is recommended to include the total workforce into the equation. However, due to data limitations we only disclose gender pay ratio in the white collar workforce. It is estimated that including blue collar employees would make the gap smaller, as males are overrepresented in the blue collar workforce.

## ESG Note 2.4 Employee turnover

### Employee turnover was stable

Attracting and retaining the right people are imperative to the success of Arla's business. Employee turnover shows the fluctuation in the workforce. Turnover is broken down to voluntary (i.e: employee quits the company) and involuntary (i.e: employee is dismissed). With such differentiation, turnover is an indicator for talent retainment in Arla and also signals the effciency of operations.

Employee turnover in 2019 was 12 per cent, unchanged from last year. It is considered to be a normalized level. Voluntary turnover remained very stable in recent years, despite signficant organizational changes. It acccounted for 8 per cent of turnover in 2019.

| ESG Table 2.4 Employee turnover | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|
| Voluntary turnover | 8% | 8% | 8% | 9% | - |
| Involuntary turnover | 4% | 4% | 3% | 5% | - |
| **Total turnover** | **12%** | **12%** | **11%** | **14%** | **-** |

### Accounting policies

Employee turnover is calculated as the ratio between total employees leaving compared to the total number of employees in the same period. The number refers to number of employees and not to FTE.

Turnover is calculated for all employees on a permanent contract and includes several reasons for leaving such as retirements, dismissals and resignations. The leaving is only included in the calculation from the month where remuneration is no longer paid (e.g: for some tenured employees renumeration may be paid for a few months after they have been dismissed).

### Uncertainties and estimates

From 2016 turnover data was registered according to standard methodologies and in a central system. To ensure comparable and high quality data, only 2016-2019 turnover figures are disclosed.

# ESG NOTE 2 SOCIAL FIGURES (CONTINUED)

## ESG note 2.5 Food safety - Number of product recalls

### Number of product recalls increased, but still on a very low level

As a global food company, food safety is key to Arla. A core responsibility for Arla is to ensure that products are safe for consumers to eat and drink, and that the content of the product is clearly and appropriately labelled on the packaging. Food safety is also one of our most important indicators towards consumers, singaling that Arla's products are produced and labelled according to the highest quality standards.

in 2019 the number for prodcut recalls increased to 4 compared to 2 last year. Arla is dedicated to ensure that products are safe to consume and works continously across the value chain, including at farm level, to reduce the number of recalls to as close to zero as possible. All product incidents must be dealt with in a timely manner to ensure the safety of our consumers as well as legality, quality of product and brand protection (Arla or private label). The handling of all public recall incidents follows a detailed and standardized process. An annual test of product incident management is also conducted.

| ESG Table 2.5 Recalls | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|
| Number of recalls | 4 | 2 | 10 | 6 | 7 |

### Accounting policies

In accordance with ESG reporting standards, product recalls are defined as public recalls. A public recall is the action taken when products pose a material food safety, legal or brand integrity risk. Public recall is only relevant if products are available for the consumers in the marketplace. Public recall covers two types of recalls, that are trigerred when a public recall occurs, and are used and reported internally: delivery stop (prior to market release) and withdrawal.

Public recalls are reported as soon as they happen, and an incident report has to be completed about each incident within two week days from the first notice of the problem. The total number of public recalls is reported externally on a yearly basis.

## ESG Note 2.6 Accidents

### Accidents decreased

The company has a complex and long value chain and offers a large variety of jobs across geographies. Colleagues are key to the success of Arla, and it is our ambition to provide all colleagues with safe and healthy working conditions. Arla is committed to preventing accidents, injuries and work-related illnesses. A systematic approach to target-setting and tracking is applied to mitigate risks and reduce problems, in an ongoing close collaboration with employees across the organization.

Accidents resulting in injuries can be lost time accidents (LTA) as well as non-lost time accidents (minor). The number of LTA per 1 million working hours is reported below.

| ESG Table 2.6 Accidents (per 1 Mio. working hours) | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|
| Accident frequency | 6 | 8 | 10 | 11 | 14 |

### Accounting policies

Accidents are defined as any sudden and unplanned event that results in personal injury, ill health, or damage to or loss of property, plant, materials or the environment, or a loss of business opportunity.

An LTA is a work place injury sustained by an employee whilst completing work activities that results in the loss of 1 or more days from work on scheduled working days /shifts. An accident is considered a lost time accident only when the employee is unable to perform the regular duties of the job, takes time off for recovery, or is assigned modified work duties for the recovery period.

All colleagues sustaining injury or illness related to the work place are required to report to their team leader/ manager as soon as reasonably practical, regardless of severity. Workers at all sites have access to a mobile application where they can quickly and easily report any accidents. Notification must be done prior to the injured party leaving work. Accidents reported after the end of the individuals working day may not be accepted as a workplace accident. However, there could be accidents not reported. The number of accidents is reported to the board of directors and executive management team monthly.

### Ucertainties and estimates

In 2019 Arla offered extensive training for employees to ensure they report accidents in a correct and timely manner, as an effort to significantly increase work safety. As a result, we experienced an increase in reported accidents, which enabled the company to better understand the factors potentially leading to accidents and to make proactive efforts to prevent such situations.

# ESG NOTE 3 GOVERNANCE DATA

## ESG Note 3.1 Gender diversity - Board of Directors

### Share of females unchanged from last year

Gender diversity in the board is important, on the one hand to secure representation of both genders at a high level, and on the other hand to bring a variety of perspectives to the business. Ensuring gender diversity in the Board is also a legal requirement in Denmark. The current Board of Directors consist of fifteen farmer owners, three employee representatives and two external advisors, where only owner representatives are elected at the general assembly by the Board of Representatives. Four of these 20 board members are female, reflecting a ratio of 20 per cent female and 80 per cent male. This constitues an improvement of 7 percentage points compared to last year and has been postively impacted by the inclusion of two independent external advisors. In accordance with section 99b of the Danish Financial Statements Act, we also disclose board composition data only for members elected by the Board of Representatives. In 2019 two of 15 farmer owners within the board were female which equates to a composition of 13 per cent female and 87 per cent male, unchanged compared to last year. In 2019 Arla set a 4-year target to achieve a female representation in the Board of Directors of at least 13 per cent.

| ESG Table 3.1 Gender diversity Board of Directors | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|
| Share of female among Board of Directors | 13% | 13% | 12% | 7% | 7% |

### Accounting policies

The gender diversity ratio is calculated based on the general assembly members of the board of directors and excludes employee representatives and advisors to the board.

## ESG Note 3.2 Board meeting attendance

### Steady meeting attendance

Attendance of the board meetings by the members of the board ensures that all of Arla's owners and employees are represented when important strategic decisions are made. The board members in Arla are highly engaged, and in general all board members attend all meetings unless they are prevented due to health reasons.

In 2019 board attendance decreased to 96 per cent from 99 per cent last year, but is still at an exceptionally high level.Information on board members are included on page 39 to 41.

| ESG Table 3.2 BoD meeting attendance | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|
| Number of meetings | 10 | 13 | 9 | 9 | 10 |
| Attendance | 96% | 99% | 99% | 98% | 97% |

### Accounting policies

The board meeting attendance ratio is calculated as the sum of board meetings attended per board member and the total possible attendance.

The current Board of Directors consists of three employee representatives, two external advisors and fifteen owners. When calculating board meeting attendance, all twenty board members are included.

# ESG NOTE 3 GOVERNANCE DATA (CONTINUED)

## ESG note 3.5

**Basis for preparation**
The consolidated environmental, social and governance (ESG) data are based on ongoing monthly and annual reporting procedures. The consolidated data comply with the same consolidation principles as the consolidated financial statements unless described separately in the definition section of each ESG note. All reported data follow the same reporting period as the consolidated financial statements.

**Materiality and reporting scope**
When presenting the consolidated ESG data, management focuses on presenting information that is considered of material importance for stakeholders, or which is recommended to be reported by relevant professional groups or authorities.

To establish what is material for this report, an analysis was conducted in 2017, involving consumers, customers, owners, non-profit organisations and financial institutions in Denmark, Sweden, the UK and Germany. All stakeholder groups received a survey and were asked to prioritise 22 defined areas of interest. Moreover, a group of non-profit organisations was interviewed to get a deeper understanding of their views and opinions. In addition to prioritising the group's activities, these results were used to improve communication processes and widen the reporting scope. Based on results from the materiality analysis and constant tracking of consumer preferences; climate, food safety and animal care were identified as focus areas. Recycling and waste, transparent and accountable business, and diversity were also ranked as highly important to Arla's stakeholders.

The figures disclosed in the consolidated ESG data section were chosen based on the materiality analysis, but also consider the maturity of data to ensure high data quality on each KPI. In some cases it was concluded that current data tracking or collection capabilities do not provide sufficient data quality to satisfy disclosure to the highest standards, despite the fact that the figures could be of material importance to stakeholders. In these cases the necessary steps to improve data tracking and collection have been intiated and the plan is to extend the ESG reporting in 2020
and beyond.

This section was inspired by the principles and recommendations of the The Danish Finance Society/CFA Society Denmark, FSR – Danish Auditors, and Nasdaq, published in the ESG reporting guidelines booklet in 2019. Where maturity and availability of data allowed, recommended ESG figures were added to this section. In the coming years plans are to widen the scope of reporting to fully comply with best practice in ESG reporting.

The above priorities are reflected throughout the annual report: natural products (pages 20, 21 and 33), farming practices (page 32), governance principles (page 35) and diversity policies (page 38) are reported at length in the management review, while in this section definitions, data and accounting policies related to Arla's greenhouse gas emissions (Note 1.1) food safety (Note 2.5), waste and recycling (Note 1.3), and diversity (Note 2.2 and 2.3) are presented, making Arla's business more transparent and accountable.

**Comparison figures**
In line with ESG reporting guidelines, environmental data are presented in absolute figures to ensure comparability. Where relevant, a measure for progress towards Arla's previously communicated internal targets are included. In case of new mergers and acquisitions, the baseline has been adjusted to better reflect the changed business.

# INDEPENDENT AUDITOR'S LIMITED ASSURANCE REPORT

### To the stakeholders of Arla Foods Amba

Arla Foods Amba engaged us to provide limited assurance on the data described below and set out in the consolidated environmental, social and governance (ESG) statements in the Annual Report on pages 122-132 for the period 1 January 2019 to 31 December 2019.

We are to conclude on whether the ESG statements have been prepared in accordance with the reporting approach and criteria described on pages 122-132. The degree of assurance expressed in the conclusion is limited.

### Limited assurance conclusion

Based on the procedures performed and the evidence obtained, nothing has come to our attention that causes us to believe that Arla's ESG statements in the annual report for the period 1 January 2019 to 31 December 2019 have not been prepared, in all material respects, in accordance with the reporting approach and criteria described on pages 122-132.

### Management's responsibility

Arla's Management is responsible for the preparation of the ESG statements in accordance with the reporting approach and criteria described on pages 122-132. Arla's Management is also responsible for such internal control, as the Management considers necessary to enable the preparation of the ESG statements that are free from material misstatement, whether due to fraud or error.

### Auditor's responsibility

Our responsibility is to express a conclusion on Arla's ESG statements in the Annual Report based on our procedures. We performed our procedures in accordance with ISAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information" and additional requirements under Danish audit legislation to obtain limited assurance for our conclusion.

Ernst & Young Godkendt Revisionspartnerselskab is subject to the International Standard on Quality Control (ISQC) 1 and thus uses a comprehensive quality control system, documented policies and procedures regarding compliance with ethical requirements, professional standards, applicable requirements in Danish law and other regulations.

We complied with independence requirements and other ethical standards under FSR - Danish Auditors' Code of Ethics for Professional Accountants, which rely on general principles regarding integrity, objectivity, professional competence and due care, confidentiality and professional conduct.

### As part of our examination, we performed the below procedures:

- Interviews of relevant company professionals responsible for sustainability strategy, management and reporting, located at Arla's headquarters in Viby
- Assessment of whether data have been collected, assessed and quality-reviewed as prescribed in Arla's manual for collection of ESG data
- Analytical reviews, including trend analyses, of data supplied by Arla
- Evaluation of the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management
- On a sample basis, tested if data is supported by sufficient evidence

We believe that our procedures provide a reasonable basis for our conclusion. The procedures performed in connection with our examination are less than those performed in connection with a reasonable assurance engagement. Consequently, the degree of assurance for our conclusion is substantially less than the assurance, which would be obtained, had we performed a reasonable assurance engagement.

Viby, 18 February 2020
ERNST & YOUNG
Godkendt Revisionspartnerselskab
CVR-nr. 30 70 02 28

Henrik Kronborg Iversen
State Authorised Public Accountant
MNE no. 24687

Carina Ohm
Associate Partner

# GLOSSARY

**Arlagarden®** is the name of our quality assurance programme.

**BEPS** is an acronym referring to base erosion and profit shifting. These are tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations.

**Biogas** is the mixture of gases produced by the breakdown of organic matter in the absence of oxygen, primarily consisting of methane and carbon dioxide. At Arla biogas is primarily produced from cow manure.

**Biomass** is plant or animal material used for energy production. It can be purposely grown energy crops, wood or forest residues, waste from food crops, horticulture, food processing, animal farming, or human waste from sewage plants.

**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.

**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.

**Carbon sequestration** refers to a natural or artificial process by which carbon dioxide is removed from the atmosphere and held in solid or liquid form.

**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.

**Digital reach** is defined as engagement with Arla's digitial content, i.e: spending more than 2 minutes on our website, watching our videos to the end on YouTube, and liking or commenting on content on our social media platforms.

**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.

**EMEA** is an acronym referring to Europe, Middle-East and Africa.

**Equity ratio** is the ratio between equity excluding minority interests and total assets, and is a measure of the financial strength of Arla.

**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.

**FTE** is an acronym for full time equivalents. FTEs are defined as the contractual working hours for an employee compared to a full time contract in the same position and country. The FTE figure is used to measure the active workforce counted in full time positions. An FTE of 1.0 is equivalent to a full-time worker, while an of FTE of 0.5 equals half of the full workload.

**GDPR** is an acronym for the General Data Protection Regulation, which regulates data protection and privacy in the European Union (EU) and the European Economic Area (EEA). It also addresses the transfer of personal data outside the EU and EEA areas. The GDPR aims primarily to give control to individuals over their personal data and to simplify the regulatory environment for international business by unifying the regulation within the EU.

**The Greenhouse Gas Protocol** (GHGP) provides accounting and reporting standards, sector guidance, calculation tools to account for greenhouse gas emissions. It establishes a comprehensive, global, standardized framework for measuring and managing emissions from private and public sector operations, value chains, products, cities, and policies.

**Incoterms** refer to International Commercial Terms. These are a series of pre-defined commercial terms published by the International Chamber of Commerce (ICC) relating to international commercial law. They are widely used in international commercial transactions or procurement processes and their use is encouraged by trade councils, courts and international lawyers.

**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.

**Lactalbumin,** also known as "whey protein", is the albumin contained in milk and obtained from whey.

**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.

**Meal kits** are a subscription service-foodservice business model where a company sends customers pre-portioned and sometimes partially-prepared food ingredients and recipes to prepare homecooked meals.

**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.

# GLOSSARY (CONTINUED)

**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.

**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.

**Non-GMO** means non-genetically modified organisms, for example non-genetically modified feed crops for cows.

**OCI** is an acronym for other comprehensive income. OCI includes revenues, expenses, gains, and losses that have yet to be realized.

**OECD** refers to the Organisation for Economic Cooperation and Development.

**On-the-go** refers to food consumed while on the go, and also to packaging solutions supporting this trend of food consumption.

**Other supported brands** are brands other than Arla®, Lurpak®, Puck®, Castello® and milk based branded beverages, that contribute to strategic branded volume driven revenue growth.

**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 margin** is a measure of profitability. It is the amount by which revenue from sales exceeds costs in a business.

**Profit share** is defined as the ratio between profit for the period allocated to owners of Arla Foods, and total revenue.

**QEHS** stand for Quality, Environmental, Health, and Safety. It is a department within Arla's supply chain safeguarding the quality and safety of production.

**SEA** is an acronym referring to South-East Asia.

**SMP** is an abbreviation of skimmed milk powder.

**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. It is also referred to in the report as branded volume growth.

**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.

**USD related currencies** are currencies which move the same direction as the USD (i.e: when the USD depreciates versus the EUR, they also depreciate vs the EUR). Currencies in the MENA region and the Chinese yen are typical examples.

**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.

**Volume driven revenue growth** is defined as revenue growth associated with growth in volumes while keeping prices constant.

**Whey protein hydrolysate** is a concentrate or isolate in which some of the amino bonds have been broken by exposure of the proteins to heat, acids or enzymes. This pre-digestion makes hydrolysed proteins more rapidly absorbed in the gut than either whey concentrates or isolates.

**WMP** is an abbreviation referring to whole milk powder.

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**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.*

# CORPORATE CALENDAR 2020

Financial reports and major events

## 27 FEBRUARY

Publication of the consolidated annual report for 2019

## 7-8 OCTOBER

Board of Representatives meeting

## 26-27 FEBRUARY

Board of Representatives meeting

## 29 AUGUST

Publication of the consolidated half-year results for 2020

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