CONSOLIDATED ANNUAL REPORT

2018

Transforming for the future

As we are the largest organic dairy producers in the world, and have the second largest milk pool in Europe, we are creating the blueprint for a more sustainable industry. Now we are also transforming Arla for the future we want to see: with fresh thinking and smarter spending, we keep finding new ways to meet and exceed the expectations of our owners, customers and consumers.

Content

Management Review

Consolidated Financial Statements

2018 Performance at a glance

Revenue
BILLION EUR

10.4
2018

10.3
2017

9.6
2016

Target 2018 EUR 10 - 10.5 billion

Performance price
EUR-CENT/KG

36.4

Milk volume

13.9
BILLION KG

2018	13.9
2017	13.9
2016	13.9

Profit share**

2.8%
OF REVENUE

2018	2.8%
2017	2.8%
2016	3.6%

Target 2018 2.8 - 3.2%

Calcium

114
MILLION EUR

2018	114

Target 2018: 30 million

Strategic branded volume driven revenue growth

3.1%

2018	3.1%
2017	3.0%
2016	5.2%

Target 2018 2.5 - 3.5%

Brand share

45.2%

2018	45.2%
2017	44.6%
2016	44.5%

Target 2018 >45%

International share*

19.6%

2018	19.6%
2017	20.2%
2016	19.7%

Target 2018 >20%

Leverage

2.4

2018	2.4
2017	2.6
2016	2.4

Target 2018 2.8 - 3.4

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

MESSAGE FROM THE CHAIRMAN

A year of changes and challenges

2018 was a year of changes, challenges and opportunities – for many of us even more significantly so than anticipated 12 months ago.

MESSAGE FROM THE CHAIRMAN

2018 easily could have been a year characterised by its turbulent start with declining milk and commodity prices, combined with continuing uncertainty from the ongoing Brexit negotiations, which impacted our overall performance. However, we were able to offset these challenges with a strong focus on price and margin management as well as the introduction of our game-changing Calcium transformation programme.

A great effort was put into realising Calcium by both management and employees and the effort resulted in the programme contributing far beyond expectations in its first year, helping us get back on track. With a performance price of 36.4 EUR-cent/kg for 2018, we have now set the direction to further improve our performance.

In July we said goodbye to Åke Hantoft, who crowned his work as chairman and board member by completing our journey towards becoming One Arla. A milestone was marked when British and Central European farmers voted a resounding 'yes' to becoming direct members, thereby paving the way for ONE Arla with equal rights and obligations. Being ONE Arla will make us stronger as a cooperative and as a business. It will give us a consistent and transparent structure across all owner countries and give us the means to act as a truly global company.

A great achievement, and I would like to thank Åke for the effort he put in to this and for all he has contributed to our company during his over thirty years as an elected representative, and seven years as chairman.

For me as newly appointed chairman, it was encouraging that by midterm our remarkably strong balance sheet allowed the board to initiate a proposal to pay out the entire 2018 net profit to our farmer owners. This can be done without adding risks to our investment plan securing our future growth. To be able to make this proposal at a time when the effects of the drought of 2018 are still felt is very empowering.

As a global farmer-owned dairy company, we are measured not only on our products and financial performance, but on how we operate our business. In 2018 sustainability and climate rose even higher up the agenda for us and our customers. The environmental footprint of farming and food production is, quite rightly, becoming increasingly scrutinised and challenged for improvement.

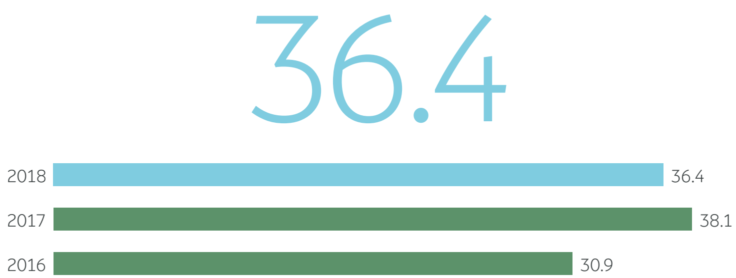
Sustainable dairy starts on farm level. As dairy farmers we have come a long way already, and have every reason to be proud of this. Now we have to go further, find new initiatives to adapt to future demands and at the same time make a reasonable living and develop our farms. We have only seen the beginning of the climate and sustainability discussion, that we in Arla address through our new environmental strategy and by developing a quality assurance programme like Arlagården®.

We know that 2019 will be another volatile year for dairy. Let's embrace the future and take bold decisions to strengthen our business, in part by unfolding the sustainability agenda even more in 2019. It will not be an easy journey, but I'm confident we have set the right course.

Jan Toft Nørgaard
Chairman of the Board of Directors

> "Let's embrace the future and take bold decisions to strengthen our business."

Performance price
EUR-CENT/KG



MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

Decisive action improved our performance after a rough start

While the political and market volatility continued to impact our business, we made significant improvements to our profitability and delivered on our Good Growth 2020 strategy.

MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

After a rough start, we finished the year beating our expectations, reaching our full-year targets for net profit and branded growth. We balanced the effect of a continued weak GBP and unfavourable fat and protein prices with substantial cost reductions and relentless focus on growing our strategic brands.

To strengthen Arla's performance, decisive action was taken by the management team and the Board of Directors to ramp up our transformation programme Calcium. It is already substantially changing the way we work, spend and invest in our business. It is set to deliver EUR 400+ million of sustainable annual savings by the end of 2021 that will be invested in a higher milk price for our farmer owners and in future growth. I'm delighted that the results in the first year have exceeded our expectations, delivering EUR 114 million in savings.

Branded growth and strategic milestones

Despite higher retail prices consumers remained attracted to our strategic brands, Arla® and Puck® and our licensed brand Starbucks™ all of which delivered particularly strong performances.

Retail and food service sales in Europe grew at the top end of our expectations and brands grew faster than anticipated. Specifically our branded milk and yogurt businesses grew against a backdrop of declining dairy consumption trends and adverse currency effects.

Our international markets outside Northern Europe also continued to deliver profitable growth. Our largest region, the Middle East and North Africa, progressed well with strong branded growth in our core categories despite low macroeconomic growth and political uncertainty.

During 2018 important deals were signed that will enable us to fast-forward our Good Growth 2020 strategy. The acquisition of the Yeo Valley organic brand for milk, butter and spreads in the UK will build our position as the world's leading organic dairy. The planned acquisition of Mondeléz' Kraft-branded processed cheese business in the MENA region, including a state-of-the-art production facility in Bahrain, will step up our growth outlook in the region. A 21-year licence agreement with Starbucks™ secures our rights to produce and market their milk-based coffee beverages business for Europe, Middle East and Africa.

2019 outlook and Brexit uncertainties

Another year of political uncertainty and milk price fluctuations is expected for 2019, not least will the outcome of Brexit remain a significant risk. To further strengthen our resilience, we will harvest the benefits of the first year's Calcium programme and continue the transformation with heavy focus on supply chain. We expect to deliver further branded growth in the Europe and international zones.
We will continue to bring innovation into the marketplace and engage with our customers in creating value in their offline and online sales channels.

We will also show strong leadership and action on one of the most important agendas facing us today – climate change. We will present an ambitious strategy, that will accelerate the transition to sustainable dairy in every part of our value chain to maintain trust in dairy's role in a healthy and sustainable diet.

Peder Tuborgh
CEO

> "We finished the year beating our expectations, reaching our full-year targets for net profit and branded growth."

Highlights

2018 showcased the first steps in our transformation journey, new product launches, innovative initiatives and key investments for the future. With exceptional drive and creativity, all segments of our business contributed fresh ideas as we continue to fulfil our Good Growth 2020 strategy.

Starbucks™ extends strategic partnership
After seven years of a successful business partnership, Arla and Starbucks™ signed a 21-year strategic agreement, giving Arla the license to continue to manufacture, distribute and market Starbucks™ premium milk-based, ready-to-drink coffee beverages for the EMEA region. Arla has now launched Starbucks beverages in 38 countries across EMEA and sells over 115 million units per year.

alcium

Transforming Arla through Calcium
The Calcium transformation programme commenced in 2018 to create significant cost and operational efficiencies and reinvestment opportunities in Arla's continued growth. The programme will run over three years and aims to unleash the full potential of our organisation. Calcium exceeded the 2018 target: we saved EUR 114 million with the programme, EUR 84 million more than expected.

Most environmentally friendly carton yet
Arla® Øko (Eco) launched our most eco-friendly milk carton to date, reducing our climate impact by 358 tonnes of CO_2 annually. The new carton is manufactured without whitening processes, consequently we can remove a layer of packaging. In addition, the plastic lid is now also 100 per cent bio. By constantly aiming for the most sustainable solutions, we have reduced emissions by a total of 35 per cent since 2014 compared with the production of the traditional milk carton.

Bold re-launch of Dano in Bangladesh
Arla® re-launched the 56-year-old household name Dano as Dano Power in Bangladesh with a powerful marketing campaign. The main message is that Dano Power is here to make the new generations strong. Thanks to a massive media presence in the local market and the slogan #RaiseThemStrong, Dano Power has already generated over 18 million digital engagements. The commercial impact is also strong with 8 per cent revenue growth and the 2 per cent market share gain in 2018.

Highlights *(continued)*

Two simple ingredients, one new innovation

A growing concern for the level of sugar and additives in products led to a decline in fruit yoghurt consumption. Arla® takes our responsibility to deliver healthier and more natural products very seriously. For this reason, we were the first major company to introduce fruit yoghurts with no additive sugar and no additives. The innovative "Nur" yoghurt was launched in Germany in 2018 and will be expanded to other core European markets in 2019.

Leading the whey

Arla Food Ingredients (AFI), a 100 per cent owned Arla subsidiary and a global leader in whey-based ingredients announced plans to open a new innovation centre in Nr. Vium, Denmark. The investment was approved by the Board of Directors, supporting the company's strategic focus on innovation and AFI's trajectory of high growth. At the centre, scientists, technicians and innovators will use cutting edge research and technology to explore milk and whey to their full potentials as ingredients as nutrition for children, athletes, patients and other consumers. Construction will begin in the fall of 2019, and the centre is expected to open in 2021.

Partnering with Britain's leading organic dairy brand

Arla acquired Yeo Valley Dairies Limited, enabling Arla to use the Yeo Valley brand in the UK market for milk, butter, spreads and cheese under an intellectual property license with Yeo Valley. The investment provides a significant opportunity to strengthen our branded organic business segment in the UK.

Arla to acquire MENA cheese business from Mondeléz International

In December we announced our plans to acquire Mondeléz International's processed cheese business in MENA, currently licensed under the Kraft brand. The acquisition also gives full ownership of a state-of-the-art cheese production site in Bahrain, which provides the company with the opportunity to further expand branded cheese production in the region, which is one of the key regions in our strategy. The deal delivers much-needed capacity growth and gives us a strong regional supply chain footprint that enables us to secure long-term competitiveness through scale and efficiency.

Financial overview

Financial key figures	2018	2017	2016	2015	2014
Performance price (EUR-cent)					
/kg owner milk	36.4	38.1	30.9	33.7	41.7
Income statement (EURm)					
Revenue	10,425	10,338	9,567	10,262	10,614
EBITDA	767	738	839	754	681
EBIT	404	385	505	400	368
Net financials	-62	-64	-107	-63	-30
Profit for the year	301	299	356	295	320
Profit appropriation for the year (EURm)					
Individual capital	0	38	30	31	39
Common capital	0	120	193	141	171
Supplementary payment	290	127	124	113	104
Balance sheet (EURm)					
Total assets	6,635	6,422	6,382	6,736	6,613
Non-current assets	3,697	3,551	3,714	3,903	3,774
Current assets	2,938	2,871	2,668	2,833	2,839
Equity	2,519	2,369	2,192	2,148	1,874
Non-current liabilities	1,694	1,554	1,742	2,084	2,137
Current liabilities	2,422	2,499	2,448	2,504	2,602
Net interest-bearing debt including pension liabilities	1,867	1,913	2,017	2,497	2,547
Net working capital	894	970	831	999	928
Financial ratios					
Profit share	2.8%	2.8%	3.6%	2.8%	3.0%
EBIT margin	3.9%	3.7%	5.3%	3.9%	3.5%
Leverage	2.4	2.6	2.4	3.3	3.7
Interest cover	14.9	12.9	13.3	13.2	8.2
Equity ratio	37%	36%	34%	31%	28%

Financial key figures	2018	2017	2016	2015	2014
Cash flows (EURm)					
Cash flow from operating activities	649	386	806	669	511
Cash flow from investing activities	-425	-286	-167	-402	-416
Free cash flow	217	167	639	267	95
Cash flow from financing activities	-191	-155	-624	-274	-93
Investments in property, plant and equipment	-383	-248	-263	-348	-429
Purchase of enterprises	-51	-7	-	-29	15
Inflow of raw milk (mkg)					
Inflow from owners in Denmark	4,937	4,827	4,728	4,705	4,550
Inflow from owners in the UK	3,196	3,203	3,210	3,320	3,088
Inflow from owners in Sweden	1,826	1,855	1,909	1,995	2,035
Inflow from owners in Germany	1,762	1,759	1,758	1,741	1,526
Inflow from owners in Belgium	517	524	515	531	403
Inflow from owners in Luxembourg	156	151	144	130	119
Inflow from owners in the Netherlands	52	54	56	41	17
Inflow from others	1,457	1,564	1,554	1,729	1,832
Total inflow of raw milk	13,903	13,937	13,874	14,192	13,570
Number of owners					
Owners in Sweden	2,630	2,780	2,972	3,174	3,366
Owners in Denmark	2,593	2,675	2,877	3,027	3,144
Owners in Germany	1,841	2,327	2,461	2,636	2,769
Owners in the UK	2,289	2,395	2,485	2,654	2,854
Owners in Belgium	702	815	852	882	997
Owners in Luxembourg	202	215	218	221	228
Owners in the Netherlands	62	55	57	56	55
Total number of owners	10,319	11,262	11,922	12,650	13,413

For in-depth info please refer to the Consolidated Financial Statements (from page 64).
For calculations click on the highlighted texts.

Essential business priorities for 2018

In 2018 our essential business priorities focused on re-establishing our historical strong performance and maintaining our competitive milk price. The launch of our three year transformation programme, Calcium, and the successful initiatives to increase product prices and margins helped us building a stronger company to face the volatile dairy market.

Improve gross margins

In a continuously volatile commodity market, we maintained a strategic focus on proactive price management to increase prices in our branded retail segments. We worked hard to balance product margins in light of significant changes in fat and protein prices, and increased our Group's underlying profitability compared to 2017.

Create the future of dairy with more innovation

Innovation is at Arla's core to fuel long-term growth and value creation. In the first half of 2018, we rolled out the a new visual identity and eco-friendly packaging for our Arla® Organic product range, while in the second half we launched several highly innovative healthy products. We strengthened our efforts to measure the innovation pipeline, which is expected to deliver over EUR 500 million in the next 3 years in incremental revenue.

Take efficiencies to a new level

With the kickstart of our holistic transformation programme, Calcium, we aim to realise EUR 400 + million net savings to reinvest EUR 100 million into growth areas. We delivered EUR 114 million contribution to date, ahead of our EUR 30 million first year target. The main areas of savings were production, marketing and other indirect costs.

Drive strategic brand growth

Successfully securing a strategic portfolio of higher-margin and consumer-orientated offerings delivered a strong branded growth, increasing our brand share to 45.2 per cent. Growth was driven by our strong innovation game in the European zone, where Starbucks™, Arla® Skyr, and our line of organic products performed strongly, and by our international zone, where Dano and Puck® delivered strong growth.

Drive growth in high-profit areas

We delivered branded growth in high-profit market segments by successfully extending our market-leading Puck® cream cheese range in MENA, expanding Arla® Organic into KSA, and successfully re-launching Dano in Bangladesh. That said, we underperformed expectations in USA and Nigeria. We also signed a 21 year strategic partnership agreement with Starbucks™ , a brand that achieved double digit growth in 2018.

Win with customers

Customer service and strong partnerships is a top priority for Arla. In 2018, we improved delivery services by switching into "hypercare mode" with several key accounts across Europe. Our efforts paid off, as we reached 4.1 per cent branded growth with our top 12 customers. However, our delivery accuracy was below target in Europe. We also made headway with our aim to expand e-commerce activities, growing this valuable platform by 15-20 per cent across markets.

Transform Germany and the UK in light of new realities

We continued our efforts to ensure our voice is heard at the highest levels, as the outcome of Brexit negotiations remains unclear. Purchasing Yeo Valley Dairies Ltd. in the UK showed our long-term commitment to our UK segment. As part of our efforts to transform Germany, we solved capacity utilisation and started building a powder tower at Pronsfeld. Profitability significantly increased in Germany due to strategic price management and strong brands like Skyr.

Arla Foods Ingredients next

In 2018 we kept our position as global leaders in the value added whey product business and to position ourselves for strategic growth, we purchased the remaining shares in whey-business Arla Foods Ingredients S.A, Argentina. Arla Foods Ingredients further advanced their innovation journey as the plans for their new innovation centre in Denmark were approved by the Board of Directors.

● Performance on track ● Trend on track ● Target challenged

OUR STRATEGY

Our strategy, Good Growth 2020 has been our guiding star since 2015. It is vital to our business to constantly review this strategy and align ourselves to new realities. In the following section we present how Arla embraces emerging trends, such as rapidly changing consumer demands, how we respond to risks, such as Brexit, and how we augmented our strategy by introducing our comprehensive transformation programme, Calcium.

Founded in who we are

Arla is the world's oldest cross-border dairy cooperative. We are the fourth largest dairy company in the world, based on milk intake and the world's largest organic dairy producer. Our farmer owners are at the core of our business model, true to our cooperative structure. Our mission is to secure the highest value for our farmers' milk. Our vision is to create the future of dairy, and fulfill the needs of our customers and consumers with our natural and healthy products.

Our business model

Consumers and customers

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

Production and logistics

With 19,190 employees across 105 countries, we work to achieve efficient operations. We treat the milk inflow from our farmer owners as ONE milk pool, processed in our global, integrated supply chain. Our dairy activities are global and earnings are different in individual markets and across product categories. Earnings on all markets contribute positively to the performance price.

ONE milk pool, ONE milk price

We want to create the maximum value for all collected raw milk: ONE milk pool, with the same quality requirements, together with an efficient supply chain, enables Arla to balance the raw milk volumes in the most profitable way. Our farmer owners farm across seven countries and are all paid ONE milk price, The prepaid milk price is set with the ambition to reach the target net profit share of 2.8 to 3.2 per cent.

Innovation

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

Value creation

Our most important goal is to secure a competitive milk price for our farmer owners. In order to achieve this, Arla creates value per kg of milk through the creation of strong brands, the development of innovative products and the expansion into international markets with incremental sales and margin opportunity.

Farmer owner

As the world's oldest cross-border dairy cooperative, our production philosophy dates back to the 1880s when dairy farmers joined forces with one common goal: to produce and provide the best dairy products. Both suppliers and owners, our famers are at the centre of our business. As a cooperative, Arla is obliged to collect ALL of our farmer owners' milk at ONE price, with a commitment to add value to it.

Good Growth 2020

In December 2015, Arla launched our corporate strategy for the next five years called Good Growth 2020. This strategy is our response to the changing world around us, where competition is fierce and we face new demographic realities and fast-changing consumer trends. By excelling in eight categories, focusing on six regions and winning as one Arla we strive to create value for our farmer owners' milk. Three years into Good Growth we believe this strategy is the right one for us, and this year we accelerate it with our transformation programme, Calcium.

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 farmer's milk while creating opportunities for their growth.

Our identity

Good Growth

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

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

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

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

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

Our points of focus

Excel in eight categories
The global dairy industry is developing at high speed and is characterised by a constant evolution of consumer habits and preferences. Matching these trends to our own strengths, we identified eight product categories that are the core focus for our efforts to shape 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. Arla has a strong position in Northern Europe as the preferred dairy company for consumers, and in the Middle East and North Africa where our brands are among the strongest in the food industry. Arla is continually expanding market positions in growth markets such as China, South East Asia and Sub-Saharan Africa, whilst further engaging in opportunities in the US and Russia.

Win as ONE Arla
After significant growth with mergers and acquisitions, and aligning the different companies into ONE, Good Growth 2020 is taking unity to the next level. Arla's ambition is that all our 19,190 employees work from ONE strong common platform. Unity is ever more important as our strategy is accelerated by our transformation programme, Calcium. Arla can't win without addressing the most pressing issues of our times, therefore we have a strategical focus on sustainability and aim to significantly reduce our ecological footprint.

Embracing change

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

Consumers seeking healthy, natural, on-the-go foods

- 58 per cent of global consumers want more all-natural foods[1]
- 33 per cent finds it important to buy organic food, and 33 per cent is willing to pay more for it[2]

Arla is the largest organic dairy producer in the world and a leading producer of lactose-free alternative dairy products. We continuously innovate and expanded our product portfolio to cater to a broad range of health needs and consumption preferences, from high-protein to low sugar and on-the-go alternatives.

Digitalisation is growing rapidly

- 14 per cent of global consumers with internet access regularly buy groceries online, and 30% are planning to do so in the near future[3]
- 58 per cent of average global consumers say they are on the internet constantly[4]
- 90 per cent of average global consumers prioritize experiences over material possessions[5]

Our social media engagement grew 55 per cent compared to 2017, and we launched an array of digital marketing initiatives. We collaborate with all major e-commerce players in our markets, both in the Brick & Click segment, like Tesco or Albert Hein, and also have partnerships with the “pure player” giants like Ocado and Amazon. In 2018 we launched an e-commerce platform in the UK for our Arla Organic Baby & Me products.

Sustainability is increasingly important

- 51 per cent of people globally think that climate change is already harming people[6]
- Partly as a response to environmental concerns, dairy alternatives are predicted to grow by 17 per cent by 2024[7]
- A third of consumers are actively choosing to buy from brands they believe are doing social or environmental good[8]

We have to think about how dairy farming could become more sustainable and still be profitable. Our farmer owners deeply care about the environment, and they show their commitment by regularly and systematically evaluating the well-being of their cows in our enhanced quality assurance framework, Arlagården® Plus. We constantly work on innovative packaging solutions and are part of a project encouraging carbon sequestration on farms. For more information, refer to page 49.

Sources: 1 Nielsen Global Health and Ingredient-Sentiment Survey 2016. More than 30,000 online respondents in 63 countries. 2 Nielsen Global Health and Wellness Survey 2015. 30,000 online respondents in 60 countries. 3 The Nielsen Global Connected Commerce Survey, Q3 2016. 4 Kantar Consulting Global Monitor 2018. 5 See above. 6 Pew Research Center Spring 2015 Global Attitude Survey. 7 Grand View Research: Dairy Alternatives Market Size, Share & Trend Analysis Report. 8 Kantar Consulting Global Monitor 2018

Embracing change *(continued)*

Emerging markets drive global dairy growth

- More than 6 BILLION people consume dairy products worldwide, and the majority of them live in developing countries[9]
- Dairy consumption increased twofold in developing countries in the past 30 years[10]
- Emerging markets generate approximately 85 per cent of dairy growth

We have a wide presence in emerging markets. Our international zone continues to drive solid growth rates and exhibits a positive growth outlook into 2019. The Middle East is a special focus area for us, being our biggest strategic growth market outside Europe. We further strengthened our position in the region in 2018 by the announced acquisition of a processed cheese business from Mondeléz International, including a modern production site in Bahrain that secures our local production capacity.

New volatility characterises Europe

- On 29 March 2019 the United Kingdom is scheduled to leave the European Union
- Politics in Europe remain volatile, with fears of a disintegrating EU
- Significant shifts in fat and protein prices had a negative effect on product margins

As Brexit negotiations progress we continue to deliver strong, evidence-based arguments for the free movement of people and goods to politicians and policy makers hand in hand with our farmer owners and peers in the dairy industry. To read more on Brexit please refer to page 20. To mitigate the effects of shifting in fat and protein prices, as market leader in BSM, we have utilised our strong brand position to manage prices to support higher underlying commodity prices.

Increased risk to do business globally

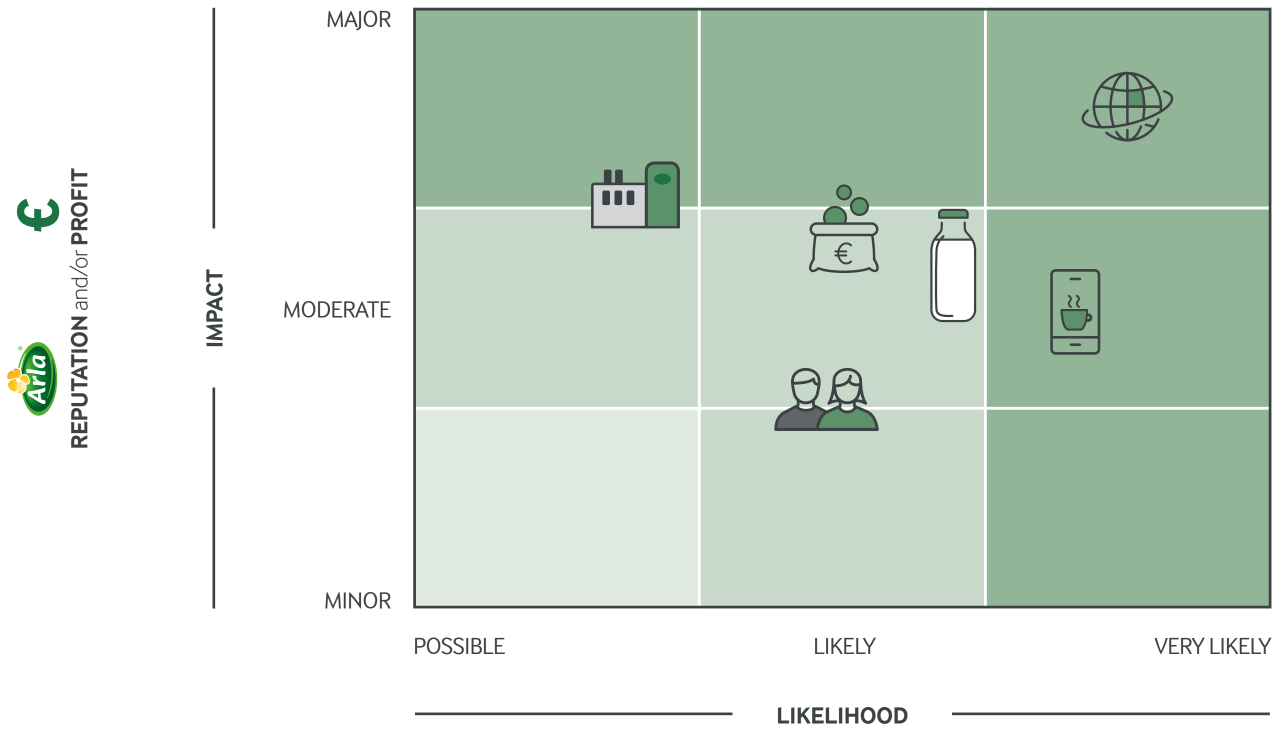
- The future of China-US trade relations is unknown
- EU-Japan agreement steps into force 1 February
- EU in trade negotiations with relevant third countries with market potential for Arla

The future of the global trade system faces more risk and uncertainty than at any time since it was created after. Free trade is under pressure and the future relationships between big traders are unknown. Access to new markets is crucial to Arla's business and the continuous work for improved trade relations and a smooth flow of goods is vital for us. We will utilise our global presence and agility to assure that we take advantage of the possibilities that new agreements give us, just as we will absorb the challenges that the current system presents to us.

Sources: 9 FAO. 10 FAO.

Our risk landscape

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



Market risks and global instability
- Consequences of Brexit
- Other political and macro-risks

Financial and IT risks
- Currency, interest and pension
- Cyber attacks

Milk price and volume volatility
- Milk price and volume volatility

Supply chain
- Product recalls

Changing consumer demands
- Transforming consumer preferences
- Digital disruption

Business ethics, legal and HR risks
- Loss of key personnel
- Non-compliance with regulations

Our risk landscape *(continued)*

Market risks and global instability

Having the majority of our business in Europe means that we are naturally exposed to changes in market positions in these key markets. Such changes are continuously monitored, and mitigating steps are planned. The uncertainty caused by Brexit negotiations and the potential consequences after the UK leaves the EU have been identified as our most critical risk. We undertook extensive analysis to understand the potential implications for our business and further developed our plans to prepare for the possible scenarios, including a no deal. To learn more about our preparation to Brexit please refer to page 20. We are also exposed to macro risks in emerging markets, especially in MENA, and where our business grows the fastest. The US trade deals in China disrupting the trade patterns are also a significant risk.

Risk scenario

Significant change in European market position	→
Consequences of Brexit and further EU exits and protectionism	↗
Major turmoil in emerging markets	→

Financial and IT risks

Arla's main financial risks relate to exchange rates, interest rate changes and pension liability valuations. To manage this risk, the Group hedges expected future cash flows for selected key currencies. Furthermore, we constantly monitor and review worldwide tax matters to ensure our compliance in all locations. Refer to page 46 for more details. We put high attention on IT risks as well. Such risk can materialize in various ways, including unavailability of business-critical data, theft of data, locking of data leading to production shutdown. etc. To minimise IT risks, we continuously review our activities and search for vulnerabilities in our systems. Furthermore, in 2018 we strengthened our data privacy efforts to ensure compliance with GDPR, which commenced on 25 May 2018.

Risk scenario

Currency, interest and pension risks	→
Major cyberattack	↘

Milk price and volume volatility

Continued milk volume and price volatility strongly influence our sales volumes and profit respectively. Arla's Good Growth 2020 strategy focuses on value creation through our strong brands and products, which aim at continually reducing exposure to commodity pricing. To reduce these risks, we have further enhanced our price performance management in 2018.

Risk scenario

Milk price and volume volatility	→

Supply chain

Being in control of the entire value chain from cow to the consumer gives Arla a major foundation to manage our risks well. Guaranteeing food safety is our key priority. Clear and professional crisis management processes and actively applied structured root cause analyses ensure our ability to improve product quality and prevent reoccurring failures. Our quality assurance programme, Arlagården® and our comprehensive quality, health, environment and safety model safeguards the highest quality for all our products. In 2018 we updated and refined our standards for quality and food safety as well as health and safety for our colleagues. Further, we have launched a cornerstone programme to drive change in behavioral safety.

Risk scenario

Major product recall damaging the Arla brand image	→
Production or logistics disruption	→

Changing consumer demands and digital disruption

During 2018 environmental implications of food choices became important for an increasing number of consumers. In particular there's an increasing number of consumers who eat mostly meat free or plant based. War on plastic and waste became a topic for many more consumers in 2018. We have work in our pipeline to respond to these consumer trends. Trust in our brands requires a high focus on digital transparency and dialog with the consumers. Dialog requires an open ear to feedback, but also ready responses if criticism arises. We mitigate by being open in our communication, and increase our digital engagements with our consumers.

Risk scenario

Digital disruption, e-commerce and new channels	↘
Transformation of consumer preferences, incl. growing anti-dairy movement	→

Business ethics, legal and HR risks

Arla Foods has impact on both climate and environment through our activities. This area is well regulated for most issues, but for some, regulation is still in the making. Failure to comply with regulations or expectations may result in restrictions on milk production. In 2018 Arla Foods continued to make good progress towards its environmental ambitions and this is reported in our CSR report. The loss of key personnel in strategic positions and the inability to recruit and retain sufficiently qualified people also pose risks to our business performance. Significant reductions in some support functions due to our transformation programme, Calcium increased this risk in 2018. To mitigate, we strive to create a positive corporate culture and work environment.

Risk scenario

Loss of key personnel in strategic positions and inability to recruit and retain the best talent	↗
Non-compliance with national and EU environmental and climate regulations	↘

Preparing for Brexit

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

It is important for Arla that our products can move freely across the markets in which we operate. 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, and changes to the EU-UK trade relationship may significantly challenge this business.

One of the main risks concerning Brexit relates to Arla's currency exposure, through transaction risk on export business and translation effect on value added by local UK business. If an agreement will be reached between the EU and the UK by the end of March, we expect the GBP to stabilize and potentially strengthen, which will be advantageous for Arla. No agreement could lead to continuing uncertainty on the GBP/EUR relationship with a risk of a negative impact on our performance price relative to our competitors. To mitigate this uncertainty, we have increased hedging of our GBP exposure.

Other risks relate to extra costs in the form of customs duties and customs clearance being imposed on Danish exports affecting demand and increased administrative burdens.

In 2018, we saw effects from a weak GBP. The uncertainty surrounding future implications have been incorporated when assessing asset values, e.g. on goodwill where EUR 459 million is allocated to UK. 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.

The Arla Brexit Task Force has throughout 2018 continued to monitor and assess the various scenarios, considering possible impacts and mitigating actions. Our management team and Board of Directors have been updated frequently and relevant newsletters have been shared with our owners.

At the time of finalising this annual report we are focusing on four possible outcomes

- a Customs Union or Free Trade Agreement (FTA), our preferred scenario without tariffs for dairy products;
- a World Trade Organisation (WTO) relationship with a transition period, under which most-favoured-nation (MFN) tariffs are imposed on dairy products;
- a WTO relationship without a transition period, where EU will impose MFN tariffs and UK grant duty free quota access for EU imports,
- a 'no-deal scenario' with immediate effect, under which dairy would be traded under WTO MFN tariffs with a significant impact on our business as well as the UK Dairy industry.

We want the final trade deal between the UK and EU to be free from tariff and non-tariff barriers in milk and dairy. 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.

Arla in the UK

Revenue, BILLION EUR
2.7

Total assets, BILLION EUR
1.1

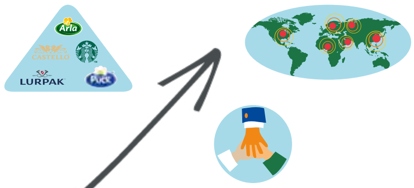
23%
of the total inflow of raw milk

Number of farmers in UK
2,289

Number of employees
3,387

Number of production facilities
11

Key brands
Arla®, Lurpak®, Anchor®, Cravendale®



Calcium accelerates our strategy

Good Growth 2020 is the right strategy for the industry and market trends around us. However, several realities are changing the context of the political, economic and social landscape that we are operating in. Therefore in 2018 we commenced our transformation programme, Calcium which will accelerate our strategy by transforming the way we work, spend and invest. Calcium will strengthen our bones, create efficiencies and release cash to reinvest in our growth.

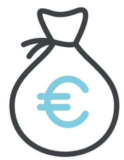
THE WHY

Brexit

The UK contributes 26 per cent of our revenue, which is a much higher exposure than our competitors. The negative impact of GBP currency fluctuations since the announcement of Brexit cost Arla approximately EUR 150 million.

Fat and protein prices

The last two years increase in commodity prices for dairy fat has reduced the relative competitiveness of our branded high-fat products, costing approximately EUR 125 to 175 million in relative performance to our competitors.



Cost consciousness

As a low margin business ongoing cost consciousness is a prerequisite to stay competitive and deliver on our targets to our farmer owners.

THE WHAT

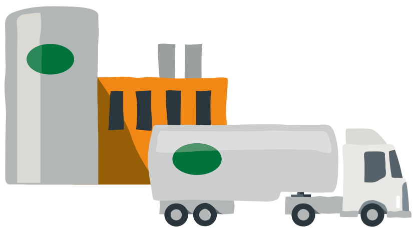
Our ambition is to achieve EUR 400+ million bottom line impact by 2021. With EUR 300+ million we will increase the competitiveness of our milk price, and we plan to reinvest EUR 100+ million into growth areas. We delivered EUR 114 million contribution to date, ahead of our EUR 30 million first year target.

The Calcium transformation is more than just cost savings:

- We are increasing our focus on the frontline of our business, where we are the closest to our customers and consumers. They are at the heart of every decision we make.
- Our decision making is becoming quicker, more data driven, and more transparent throughout the organisation
- We are eliminating waste wherever it doesn't add real value for the customers and consumers
- We are also eliminating complexity where it doesn't add value. We are becoming simpler and more streamlined, both in production and as an organisation.

Calcium transforms nine areas of our business

THE HOW

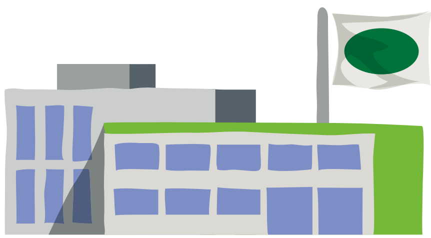


Production
We will create profound change at every site and in every role. We will shift from dairy structure efficiency to individual line efficiency. New transparency in data means our people will benchmark and optimise – line by line, week by week.

Indirect spend
New transparency of data has enabled us to challenge the way we spend money and significantly reduce all spending that is not frontline focused. Going forward our people have better control of costs not related directly to our products – e.g. office equipment, IT, travel, consultants etc.

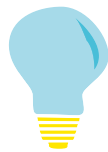
Logistics
New transparency in data will enable us to eliminate waste of finished goods and optimise both the milk pick-up at the farms and the distribution to the customers – route by route – creating value for us and our customers.

Organisation
Our central functions have become smaller, so that we can increase focus on the frontline in our markets.



Procurement
The Procurement function has a stronger mandate to integrate experts and best practice into our buying decisions to secure compliance, maximise the value of goods and services that we buy in Arla and to safeguard responsible sourcing.

Innovation
Our process from idea to market will be simpler and shorter to capture new opportunities faster. We will experiment more in the markets and scale successes quickly.



Range
To reduce complexity in Supply Chain and scale our products' bottom line impact, we will share more products across markets. We will pick from a standard list of ingredients and meet a minimum volume target for new products.

Marketing
We will spend less on developing campaigns and more on reaching consumers. Our content will be developed cheaper, faster and better in new in-house digital studios.

Retail promotions
Better data will enable us to optimise retail promotions for us and our customers empowering Key Account Managers to make informed decisions on the spot.

Calcium delivers strong first year results

Insourcing marketing to make it better

As part of our Calcium efforts to boost our marketing strategy and make it more cost efficient, we are insourcing content development wherever possible. We are setting up an internal creative agency to develop digital content, and insource media buying. Thereby we not only reduce agency fees and ensure higher quality, but by becoming more digital savvy we also empower our own employees to become the best communicators and marketers. We expect to save up to EUR 6.5 million yearly with this solution.

Calcium helped Arla secure a cheese contract worth millions

Calcium can also be a great way of strengthening relations with customers and winning new contracts. Calcium certainly helped when Arla entered into contract negotiations with one of our top 12 retail partners. The retailer's agenda aligns well with Calcium, and during the negotiations we demonstrated our focus on driving operational efficiencies for both businesses. Arla's frontline obsession and customer centric attitude were also important factors in securing the contract with retail sales of EUR 500+ million.

When less is more

When Arla UK wanted to launch a new yoghurt portfolio, instead of developing one themselves they looked across the markets to check what is available, and then launched existing products from Sweden and Denmark. As straightforward as it sounds, in the pre-Calcium times product development was country specific. As a part of the Calcium process, we established a core European yogurt assortment that will be sold across all markets, and achieved a 25 per cent reduction in the number of fruit preparations, which means significant cost reduction.

From 270 supplier to 1

Before Calcium, Arla had over 270 print suppliers. On our Supplier Day in May we invited potential suppliers to our headquarters, and used our print orders from the past as a baseline for an e-auction. One supplier made a bid offering 30 per cent savings without compromising quality. Now when employees need printing, they reach out to this one supplier, which also considers using our own printing capacities. Calcium gave our procurement team a greater mandate to finalize this deal, and their involvement in the commercial negotiations benefitted all involved parties.

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.

Continuous price & margin management while driving volume driven revenue growth

In a volatile, low margin business price management ensures healthy short-to midterm margins. In 2019 we will maintain our focus on volume driven growth across our core categories and markets, while ensuring proactive margin and price management. To secure growth and adapt to changing customer preferences we will take advantage of our increasingly diverse milk pool.

Deliver on Calcium to transform Arla

Our holistic transformation programme, Calcium will embark on its second year in 2019, which will lead to further changes in the way we work, spend and invest. To increase our competitiveness, we aim to create a frontline-obsessed company. Our ambition is to achieve a bottom line impact of more than EUR 75 million in 2019.

Increase innovation output and speed

In 2019 we will review and change our innovation model to significantly increase output speed and decrease product complexity. Our key focus in innovation is the increasingly popular natural and filling dairy products and on-the-go formats, while we also plan to experiment with products for flexitarian consumers. We will leverage existing technologies and competencies – while developing and creating competitive strength and align with external market perspectives.

Drive strong and profitable branded growth agenda

Securing a strategic portfolio of higher-margin and consumer-oriented offerings is key to our future growth. In 2019, we will continue to develop and sharpen the profile of our strategic brands Arla®, Castello®, Lurpak® and Puck® specifically by reviewing our strategy in face of new consumer habits and by expanding into new markets.

Win in focus markets

In 2019, we will strategically focus on delivering branded growth and/or higher-profit in key market segments, such as Bangladesh, Nigeria, China and MENA by strengthening our brand portfolio and entering into new categories and partnerships in these regions. In 2019 we expect a challenging year in Europe, where we have to operationally prepare for the uncertainty following Brexit and secure our UK market.

Take lead on sustainability

Sustainability is high both on our consumers' and on our own agenda. Arla already has many different sustainability initiatives in place, such as our quality assurance and animal welfare programme, Arlagården®. In 2019 we set out to launch our new environmental strategy, and to track both tangible sustainability outputs and consumer perception of our efforts.

Power-up AFI

Further investment in AFI is a top priority for 2019. We will focus on the continued transformation of existing products to higher-value specialties, through new investments and focused research and development efforts. As the demand for our specialised ingredients keeps accelerating we will also strive to grow our raw material pool to secure more whey, enabling us to serve our global customer base.

OUR BRANDS AND COMMERCIAL SEGMENTS

Our brands are at the heart of our business and drive the majority of Arla's profitability. To extend our position as a leading global dairy company we focus our activities on two commercial zones, Europe and international, which represent the regions where we believe Arla has the biggest potential to grow. Our whey business, Arla Foods Ingredients is also a core strategic priority. In the following section we present the growth of our strategic brands, and the successes we achieved in our commercial zones and with AFI and trading.

Arla®: Moving from strength to strength in 2018

The Arla® brand has continued to outperform the market in Europe. We sought to build equity through aligned global positioning and our new 'strength comes from within' campaign, whilst building clear positions with new sub-brands, such as Dano Power, Arla &More and Arla® Organic. 2018 was a success for Arla®'s brand communication as well: we amped up consumer's engagement through accelerating communication on digital channels, and won over 50 marketing awards.

Arla &More is breaking down the breakfast barrier
Our busy lifestyles rarely allow us to consume meals in the traditional way. That's why our new sub-brand, Arla &More developed a range of healthy, natural and filling products such as yoghurts with grains and buckwheat, oat and fruit smoothies and fresh-flavored porridge. These products aim to break down the breakfast barrier dairy has been facing for so long: they were designed to be consumed any time of the day to fuel strength and keep you going. Arla &More is currently available in Finland and Sweden with other European markets being launched across 2019.

Continuing to build digital engagement
Digital engagement for the Arla® brands grew 90 per cent compared to 2017, from 100 million to 190 million engagements. Arla® leveraged data driven marketing principles to drive brand engagement based on audience passion points, shopper missions and buying occasions. With digital investment remaining consistent over the last 12 months, the increase in digital engagement is due to the strong use of first party data to drive engagement across owned media channels with stronger content and optimising our consumer experiences at the ultimate moment of truth, when consumers are searching for an Arla® product.

Animal welfare as our unique selling point
Sommarmjölk® launched in Sweden in 2018 is a unique commercial animal welfare initiative, which compensates conventional (non-organic) Arla farmers who sign-up for 25 per cent extra summer grazing time for their cattle, over and above Swedish grazing legislation requirements. With three out of four conventional Arla farmers participating, Arla has been able to make a difference both for our cows, farmer owners and consumers.

Summer milk generated a market share uplift in all categories and a massive strengthening of key KPI "protecting animal welfare" in consumer perception. The communication campaign was very successful, with an ONS score of 75*.

Revenue, MILLION EUR
3,034
2017: 3,026

Strategic branded volume driven revenue growth
1.8%
2017: 3.4%

Share of branded revenue
64.7%
2017: 65.8%

** Market average ONS result is 50 in the Milward Brown Database.*

Lurpak®: Strength in softness

Lurpak® has been a symbol of Denmark's dairy heritage since 1901. It is now sold and loved in more than 75 countries, from Denmark to the Middle East and beyond. We continue to drive our brand mission: make good food central to the lives of people.

Tough environment

2018 has been a tough environment for butter, as high fat prices were passed onto the customer. It is a testament to the strength of the Lurpak® brand that we are seeing growth in our key markets during this time, with a volume driven revenue growth of 2.7%. Driving our equity is key to encourage consumers to pay more for our brand, and we are seeing results to reflect this.

Innovations based on real consumer insights

In 2018, we launched two new innovations to our biggest markets. Lurpak® Softest was developed from a true consumer insight that, for some, our spreadable was not spreadable straight from the fridge. Launched in the UK in May, it's already a success with a revenue amounting to EUR 8.9 million and above expectations. Lurpak® Mini Blocks was the second big launch for the brand in 2018. 4x50 g blocks in a convenient box was launched in Denmark in March. The revenue from Lurpak® Mini Blocks was EUR 2.6 million in 2018. Both launches were supported with campaigns offline and online, on social media and more, and are making waves to disrupt the BSM category.

Lurpak® Liquid and Spray were re-launched this year in both the MENA region and in Denmark. The aim was to focus more on the occasion and usage of the product to further promote trial. Therefore a new packaging with stronger branding and a clearer understanding of the product alongside a brand new campaign will certainly win with consumers..

Winning digital

Our strong communication throughout 2018 drove the awareness and engagement with the brand beyond the launches. The Game On Cooks campaign was active in many of our markets not only on TV, but across channels from digital to in-store. We delivered another strong digital year with 43 million consumer engagements to year end.

LURPAK

Revenue, MILLION EUR

561

2017: 528

Strategic branded volume driven revenue growth

2.7%

2017: -2.7%

Share of branded revenue

12.0%

2017: 11.5%

Castello®: Indulging sensations

Castello® has a tradition of creative cheese making since 1893. Castello cheeses are developed with a deep understanding of how we perceive flavour and taste, so you can experience an indulgent sensation in every bite. Our speciality cheeses are sold in 87 countries around the world under the Castello brand.

A successful global campaign

Each Castello® cheese brings the consumer a unique and indulgent sensation. Be it the intensity of Castello® yellow cheese, the creaminess of the whites or the sharpness of the blues, each cheese delivers a unique taste experience. These sensations are brought to life in our latest brand campaign "Sensations by Castello®", which has been executed across seven key global markets in 2018.

Strengthening our core assortment

Castello® is the leading blue mould cheese brand in many markets, however blue mould cheese is only part of a larger specialty cheese universe. In 2018 we became even more important to consumers by expanding our core assortment to include yellow cheeses and white mould cheeses. Multiple new product launches in these segments led to an exceptionally good volume driven revenue growth in Finland, the USA and Canada in yellow cheese, and in the UK and Germany on white mould cheese.

Castello achieving growth

Through strong execution across markets to increase awareness of Castello® and drive penetration of a broader Castello® assortment, the brand achieved a strategic branded revenue growth of 3.8 per cent in 2018, with especially strong growth in USA (28 per cent), Finland (8 per cent) and Canada (6 per cent).

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Revenue, MILLION EUR

180

2017: 181

Strategic branded volume driven revenue growth

3.8%

2017: 2.7%

Share of branded revenue

3.8%

2017: 3.9%

Puck®: Innovation is the name of the game

The Puck brand originated as a spreadable cream cheese in Germany and is currently available across the world in over 30 markets, from Syria to Sweden, Kuwait to Kazakhstan. Produced at four of Arla's dairies in Denmark, it is one of the leading dairy brands in the Middle East.

Less fat, more health

As consumers in the Middle East are becoming ever more aware of diet-related health issues such as obesity, the need for healthier products is growing. Our iconic Middle Eastern brand, Puck®, already exploits this trend: by launching a 30 per cent less fat, 25 per cent less salt variant of its flagship cream cheese, Puck beat category decline and added EUR 4 million in net revenue to the business.

Widening horizons

For Puck® to keep its strong position in the Middle East, the health agenda is just one part of the innovation strategy. Venturing into new categories and occasions, and bringing even more variations to the cream cheese brand is also key. In 2018 Puck® launched a wide range of products in the cooking category as well: a range of sauces, an innovative shredded cheese, Cheddarella, and a new spread, Labneh. With our acquisition of a processed cheese business from Mondeléz International in the Middle East, 2019 is bringing new opportunities for expansion.

Snaps about Puck

In 2018 Puck® also challenged category norms by engaging with customers digitally, and embarking on gamification. Through an unprecedented collaboration with Snapchat, Puck® engaged its core audience, mums and kids, in a unique and fun way. The interactive campaign received around 5 million impressions. Other Puck® campaigns were also very successful, the brand won 4 prestigious Effie marketing awards this year.

Revenue, MILLION EUR

352

2017: 339

Strategic branded volume driven revenue growth

8.9%

2017: 4.4%

Share of branded revenue

7.5%

2017: 7.4%

MBB: Tradition and innovation go hand-in-hand

The vision of the milk based beverages (MBB) unit is to build meaningful connections with millennials through better beverage experiences. The portfolio includes strong brands like Cocio®, Matilde®, and the licensed brand, Starbucks™.

Continuous double-digit Starbucks™ growth
Consistently strong year-on-year performances during the last 7 years paved the way for a new 21 year strategic agreement between Arla® and Starbucks™, giving Arla the license to continue to manufacture, distribute and market Starbucks™ premium ready-to-drink coffee beverages for the Europe, the Middle East and Africa region.

Throughout 2018, the Starbucks™ premium ready-to-drink (RTD) coffee beverages yet again achieved double-digit growth, finishing the year with strategic branded growth of 30 per cent. This development is a result of a dedicated focus to expand the distribution across regions by using new channels and reaching new customers on new markets.

Cocio® unlocks a new occasion
Established in 1951, Cocio® has a great heritage and is among the most well-known brands in Denmark. In 2018 Cocio® launched a strategic partnership with HBO®, aiming to make more of the streaming momentum. Free HBO® subscriptions and unique prizes were the main levers in the campaign. The campaign contributed positively to Cocio®'s overall strategic branded growth of 5 per cent in 2018.

Matilde® disrupted the chocolate milk category
The brand essence of Matilde® is the unique Danish 'Hygge' since 1970. During the summer the iconic design changed for 8 weeks and was replaced by colourful illustrations that visualised what Matilde is all about to consumers. By utilising the pack as media, Matilde® created disruption and significant differentiation towards private label. Matilde® achieved strategic branded growth of 16 per cent in 2018.

Total MBB results

Revenue, MILLION EUR
248
2017: 225

Strategic branded volume driven revenue growth
22.7%
2017: 12.3%

Share of branded revenue
4.0%
2017: 3.4%

Europe

The Europe zone, representing 62 per cent of the total revenue, continued its Good Growth journey in 2018 with a year of very strong branded growth. Our core brands performed above expectations, with Skyr growing 22 per cent, Starbucks 24 per cent, our organic line 2 per cent, and our Lactofree products by 4.7 per cent in revenue. In our foodservice business, we grew our branded business by 4.4 per cent, driven by particularly strong performance in the UK, Denmark, Sweden and Finland.

Key brands

Revenue split by country, MILLION EUR

	2018	2017
UK	35%	34%
Sweden	21%	21%
Germany	18%	21%
Denmark	16%	15%
Netherlands, Belgium and France	5%	4%
Finland	5%	5%

Revenue, MILLION EUR

6,507

2017: 6,568

Strategic branded volume driven revenue growth

2.5%

2017: -0.1%

Brand share

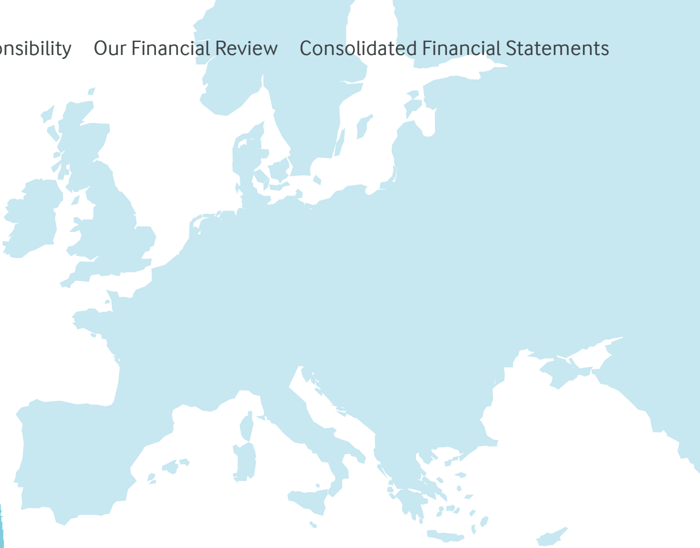
50.4%

2017: 48.3%

> “We had a year of great branded growth of 2.5 per cent. As part of our transformation programme, Calcium, we created a more frontline driven structure within the Europe zone that will enable further acceleration of the innovation and branded growth agenda. We have in 2018 further improved utilising our Europe-wide product portfolio that contributed to our strong branded delivery.”

Peter Giørtz-Carlsen, Vice CEO, Executive Vice President, Europe

Europe *(continued)*



UK

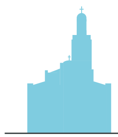
The Arla brand was growing significantly faster than our competitors. Arla® Skyr Fruit & Oats was voted Product of the Year in 2018, following the same recognition given to Organic, BoB and Skyr in previous year. Our famer-owned model and our Calcium transformation were key to win contracts with our top UK retail partners. We continue to develop robust plans to deal with the eventual outcome of the Brexit negotiations. Refer to page 20 for more detail.

Germany

The implementation of our long-term strategy and continued focus on branded growth significantly improved profitability in Germany. The strengthening of the business over the past 2 years is starting to pay off and our branded business grew by 6.5 per cent in 2018. In close collaboration with our customers, we successfully introduced high value-added products, such as our Arla® Bio yoghurt. Arla® Skyr in Germany is amongst the fastest growing areas in Europe.

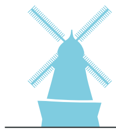
Denmark

We achieved record high branded growth of 4,6 per cent despite declining dairy consumption trends by focusing on existing and new product concepts. Our reputation is also at all-time high, and 2018 was a record year for our organic branded sales. We engaged our consumers in a fruitful conversation about the health value of milk with our Milk-without-Milk campaign.



Sweden

Arla had a year of roughly unchanged turnover, despite a very challenging overall category development and a weakened Swedish currency. Our market shares in Sweden of both cheese and yoghurt reached an all-time high, and the Arla® brand was significantly strengthened during 2018. Arla was ranked amongst the top suppliers across all categories by customers. The campaign "Only milk tastes milk" has slowed down the milk category decline and was awarded as Sweden's best advertising film amongst all categories.

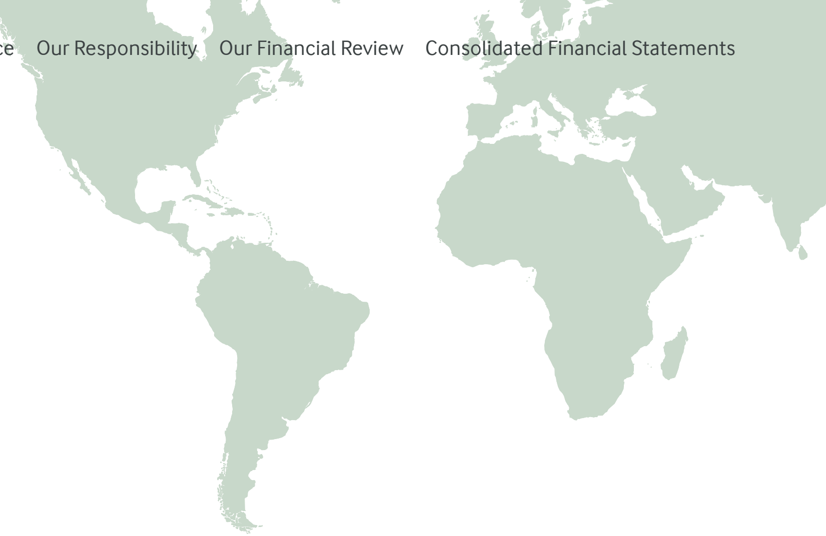


Netherlands, Belgium and France

Our Dutch market share in fresh dairy reached the highest level ever and is now running above 11 per cent. Within fresh dairy, Arla® had the largest growth for two consecutive years now, with Skyr and our organic products driving the double-digit growth. Skyr was successfully introduced in Belgium. Our company is ranked as the number one dairy supplier in Netherlands.

Finland

Despite a long-term trend of decreasing dairy consumption, our key focus brands, Arla® Luonto+ in yoghurt and Lempi in cooking, kept growing. Our Foodservice business also delivered strong growth. To further strengthen our commitment to food safety and transparency, we introduced blockchain technology that enables the consumers to trace back where the milk is from.



International

The international zone, which comprises 15 per cent of total revenue, continued to deliver profitable growth in 2018. We continued to seek new opportunities by launching innovative products and expanding to new markets in South East Asia.

Key brands

Revenue, MILLION EUR

1,576

2017: 1,616

Strategic branded volume driven revenue growth

4.6%

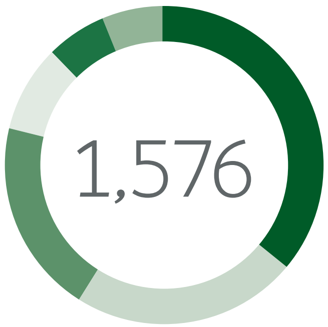
2017: 10.5%

Brand share

85.0%

2017: 83.9%

Revenue split by region, MILLION EUR



	2018	2017
Middle East and North Africa	36%	34%
Russia, SUBs & Distributor Sales	23%	23%
Americas	20%	20%
South East Asia	9%	8%
Sub-Saharan Africa	6%	9%
China	6%	6%

“We had good performance this year in challenging market conditions. Even though our growth was somewhat less than expected, we are on a good track to fully execute our growth strategy in 2019 and beyond with our planned acquisition of a processed cheese business from Mondeléz International in MENA.”

Tim Ørting Jørgensen, Executive President, International

International *(continued)*

Middle East and North Africa

Our strategic agenda in the Middle East and North Africa progressed well in 2018, despite low economic growth and political uncertainty affecting the region. Strong branded growth in our core categories was driven by the Puck® brand. The Arla® Organic brand launch is progressing well in UAE and Saudi Arabia, and the recent launch of Arla® Kids is gaining good traction. Our announced acquisition of a processed cheese portfolio from Mondeléz International in MENA gives us a strong foundation to build on going forward.

Sub-Saharan Africa

We experienced solid market share growth in Nigeria, with Dano emerging as the fastest-growing milk powder brand there. However, on consolidated level Arla Foods' business in Nigeria has been impacted negatively in 2018 driven by challenges in the bulk business with unfortunate timing of import and changes in market prices. In other SSA markets we have seen good traction, e.g. in Senegal, where the Dano brand is now the leading milk powder brand.

China

During 2018, China improved the overall business profitability significantly. Our organic infant milk formula, Baby & Me had an impressive growth in the market. The brand market share is growing faster than the market. The shareholder agreement for the joint venture between Arla and Mengniu was signed in the beginning of 2018; the project to establish the JV is moving on the right track. Despite the good traction, we have experienced delays in some authority approvals impacting the performance negatively. However, we keep a positive outlook for China in 2019.

South East Asia

Arla has made strong progress in SEA delivering growth and profitability. Bangladesh continues to grow the Dano brand market share and household penetration. Japan and Korea delivered very strong branded growth and doubled the business, and we see good traction in the Philippines. Arla® Organic milk has just been launched in Singapore exceeding expectations. To expand Arla's footprint in the region, we are preparing the launch in Indonesia with our newly established Joint Venture Arla/Indofood.

Americas

US and Canada continued to deliver branded growth in 2018. In the US, Arla® Cream Cheese, yellow cheese and Castello have established positive resonance with consumers and customers gaining further market shares – however, the performance did not meet our expectations. Canada's strategic agenda has progressed well, strengthening brand power and delivering strong profit. In the Dominican Republic, Arla's Milex brand continues to lead and grow the milk powder market.

Russia, SUBs & Distributor Sales

We showed growth in our branded business and at same time doubled the net result. A key growth driver were the milk based beverages, particularly Starbucks™ and Arla® Protein. Starbucks™ was successfully launched in more markets and alongside Arla® Protein they grew in both retail and convenience channels. Despite high fat prices, our Lurpak® products continue to grow in Australia and Greece, our strongholds. Russia continued to improve profitability mainly driven by strong sales of Starbucks™ products.

Arla Foods Ingredients

Arla Foods Ingredients (AFI) is a 100 per cent owned subsidiary of Arla and a global leader in whey-based ingredients used in a wide range of categories from bakery, beverages and dairy to clinical, infant and sports nutrition. In addition, we manufacture child nutrition products for third parties.

For more than 20 years, AFI has delivered solid growth. In 2018 we achieved EUR 652 million in revenue, compared to EUR 651 million last year. Our value creation was largely driven by value added ingredients and a strong Child Nutrition Manufacturing (CNM) business.

AFI's customers demand specialised products

Significant changes are underway in the whey industry. In the past, whey was regarded as a simple by-product from cheese production. Today whey is a high-value ingredient in its own right, and in the future, AFI's core markets will need even more product differentiation. Thus, AFI's growth will be based on sale of our unique value-added products like alpha-lactalbumin, whey protein hydrolysates, MFGM and whey protein isolate. We will continue to increase our value-add ratio compared to standard products, delivering advanced and innovative functionalities to our customers.

Our strategy supports the changing industry

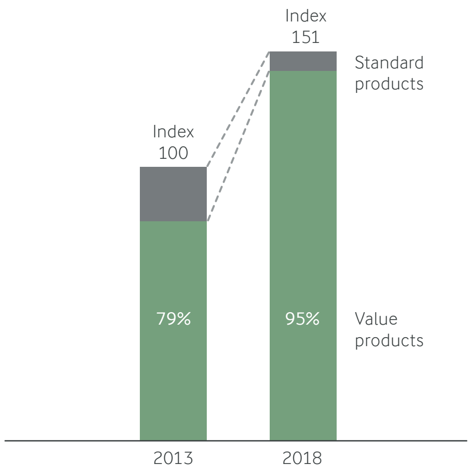
To succeed and to continue to grow our business, AFI focuses on strategic projects and priorities:

- AFI will continue to deliver more value to our customers and our farmer-owners by investing heavily in growing our value-add ingredient business. In 2018, AFI acquired full control of Arla Foods Ingredients S.A. Argentina, taking over 100% of the company shares. Furthermore, we broke ground on a new drying tower at our plant in Denmark.
- We aim to deliver on our ambitious innovation agenda, driven by our customers' motivation to deliver better nutrition and hold a strong pipeline of new products. We will make full use of the available raw material, turning it into specialised and unique products.
- AFI seeks to grow its raw material pool and we are on track with strategic projects securing this. In 2018 we signed a Memorandum of Understanding with the U.S. dairy cooperative Foremost Farms. The MoU formalised the possibility of a future partnership and we hope to reach final agreements in 2019.
- In 2018 our child nutrition business was negatively affected by major changes in Chinese infant formula regulations. Nevertheless, we introduced an ambitious strategy aiming to secure continuous growth of our Child Nutrition products which included investing in significant capacity increases. This will enable us to utilise Arla's position as the global market leader in organic milk to serve strong demand in China for organic Child Nutrition.
- In recent years we have worked hard to address the future demands to Quality & Food Safety in collaboration with our customers. In 2019, we will continue to invest heavily in people and infrastructure to stay at the forefront as a global leader in food safety and product quality.

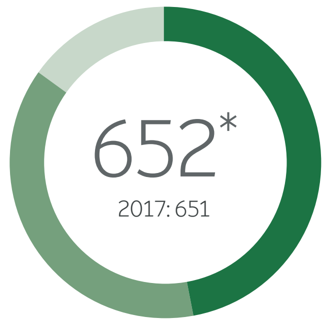
> "Our strategic ambition is to become the leading global supplier of value-added whey and advanced child nutrition products. By combining our mindset with our customers' demands and expectations, we will discover and deliver all the wonders whey can bring to people's lives."

Henrik Andersen, Group Vice President

Sales contribution of standard products and value add products



Revenue split by regions, MILLION EUR



	2018	2017
Europe, the Middle East and Africa	47%	49%
Asia	38%	41%
Americas	15%	10%

* A significant part of Arla Foods Ingredients activities are carried out in joint ventures, which are not fully consolidated in the Financial Statements, Revenue including joint ventures amounts to EUR 695 million.

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 availability in milk intake.

Our strategic decision to increase trading capacities in higher value commodities, such as mozzarella and fat-filled milk powder, coming on line from mid-2019, 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.

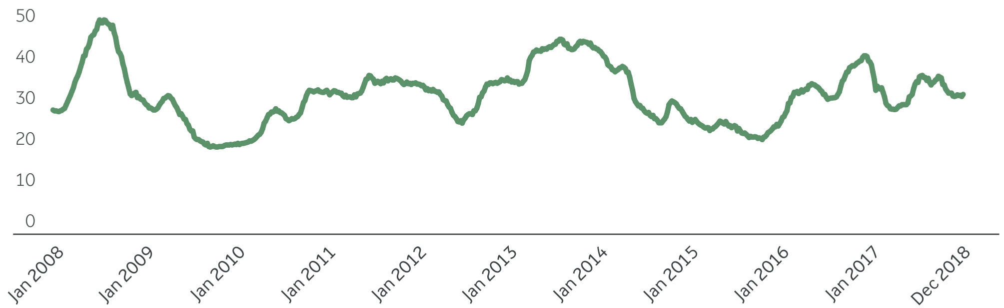
The share of overall milk intake volumes going through the trading business increased to 23.9 per cent from 20.2 per cent last in 2017 as a result of a deliberate shift from private label volumes to better performing trading products and customers.

As a result trading sales increased 12.4 per cent to EUR 1,690 million versus EUR 1,503 million last year, representing 16.6 per cent of total revenue for Arla in 2018.

Alongside the now expected volatility, perhaps the biggest change in the trading portfolio in 2018 was the increased volume in fat based products. This was a result of increased fat prices in reducing consumer demand but driving traders and food manufacturers to secure volumes for own usage.

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

EUR-CENT PER KG



Revenue split by product categories

MILLION EUR

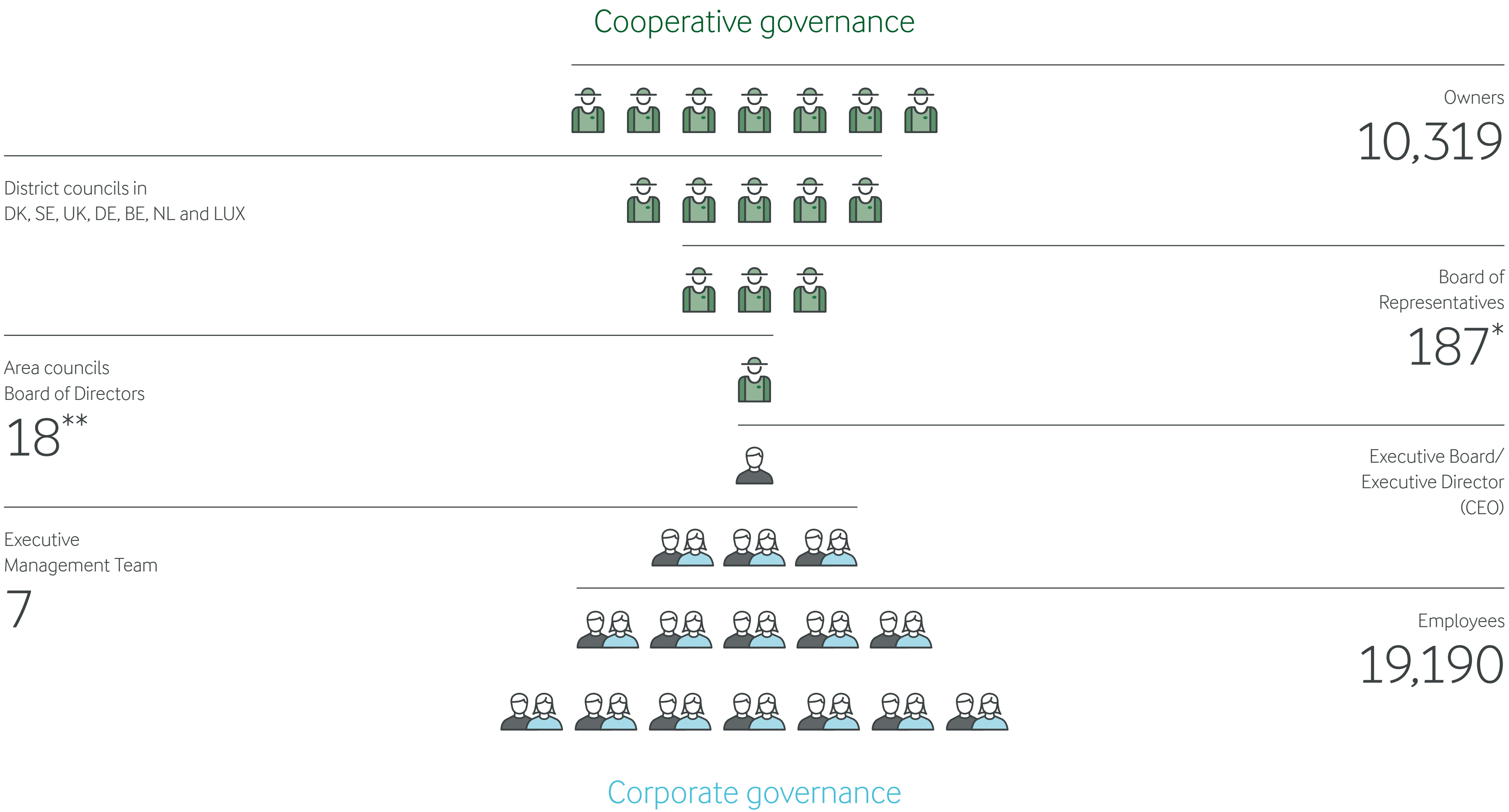
	2018	2017
Raw milk	34%	34%
Powder	32%	36%
Cheese	22%	21%
Butter	7%	3%
Other	5%	6%

OUR GOVERNANCE

Arla is owned by dairy farmers in seven countries. In 2018 we transformed our structure to become ONE Arla, with direct membership for all of our owners. This structure ensures more harmonisation and transparency, preparing Arla as a cooperative for the future. In the following section we present our cooperative and corporate governance and our democratic framework.

Governance framework

For a cooperative like Arla good governance is essential for achieving success and trusting relations with our farmer owners, employees and other key stakeholders. Good governance represents responsible and transparent management and corporate control.



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

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.

Owners
In 2018, 10,319 milk producers in Sweden, Denmark, Germany, the UK, Belgium, Netherlands and Luxemburg were the joint owners of Arla. Last year, the cooperative had 11,262 joint owners. All cooperative owners have the opportunity to influence significant decisions. 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.

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 next election is announced for May 2019. 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 and three employee representatives. The composition of the BoDs 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 / Executive Director
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. In 2018, following the retirement of Povl Krogsgaard, the Executive Board was represented by the Executive Director in solitary. From 1st February 2019, Executive Vice President, Peter Giørtz-Carlsen was appointed to enter the Executive Board as Vice CEO.

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 CEO plus four functional experts and two commercial leaders. The functional experts cover the management areas Finance, IT and Legal (CFO), Marketing and Innovation (CMO), Human Resources (CHRO), and Supply Chain (COO); while the commercial leaders are responsible for the commercial zones Europe and international. The members of the Executive Management Team (EMT) keep each other informed on all significant developments in their business area and align on all cross-functional measures. In 2018, further increasing the diversity of the team, Sami Naffakh, a French national, joined Arla as an Executive Vice President and Head of Supply Chain.

Employees
Arla has 19,190 full time employees (FTE) globally, compared to 18,973 last year. Our employees are represented by three members in the BoD and 12 members in the BoR.

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 zones. With a range of different backgrounds and expertise, the Executive Management Team is responsible for Arla's day-to-day business operations, preparing strategies and planning the future operating structure. The members of the Executive Management Team are also individually responsible for managing their respective business areas.

Executive Management Team *(continued)*

Sami Pascal Naffakh
COO
Exectuive Vice President, Supply Chain

1970
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 Estee Lauder Companies, but he also has thorough knowledge of the dairy industry, as he worked in multiple senior executive positions at Danone Early Life Nutrition. In his free time Sami enjoys chilling out with his friends and family. His favourite product is Arla Unika® Gammel Knas.

Hanne Søndergaard
CMO
Executive Vice President, Marketing and Innovation

1965
Danish

Hanne has been with Arla for 29 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. Hanne is also the member of the board of Arla Fonden and of the Technical University of Denmark. She lives in Aarhus with her partner and enjoys kayaking and cooking. With its Nordic heritage and healthy characteristics, Hanne's favourite product is Skyr.

Tim Ørting Jørgensen
Executive Vice President, International

1964
Danish

Tim joined Arla in 1991 under MD Foods. He has worked in many senior and executive positions across Denmark, Saudi Arabia, Brazil and Germany before becoming the Executive Vice President for International. Tim has been part of the team since 2007. Tim is also the member of the board of Royal Greenland and Mengniu. When he is not working, Tim loves spending time with his wife and four children. When he gets the chance, he enjoys hunting and music. After 27 years in Arla, his favourite product is the staple Danish summer dessert, Koldskål®.

Natalie Knight
CFO
Executive Vice President, Finance, IT and Legal

1970
American

Natalie joined Arla Foods as CFO in 2016, following 17 years at adidas where she held several senior finance positions, including SVP Group Functions Finance, SVP Brand and Commercial Finance, CFO of adidas North America and VP Investor Relations and M&A. After having lived and worked in five countries, Natalie is now based in Aarhus, Denmark with her husband and teenage daughter. She is also a member of the Board at Grundfos and Biomar. Her favourite Danish song is Flying on the wings of love, and her favourite product is Arla® Protein, which she loves as a healthy follow-up to a variety of sport activities.

Peder Tuborgh
CEO
Head of Milk, Members and Trading
Head of Arla Foods Ingredients

1963
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. He is also the Chairman of the Board of Pandora. Above all, he enjoys spending time with his wife, son and four daughters. His favourite product is an Arla classic, Castello®.

Peter Giørtz-Carlsen
Executive Board member, Executive Vice President, Europe

1973
Danish

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

Ola Arvidsson
CHRO
Executive Vice President, HR and Corporate Affairs

1968
Swedish

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

Year of birth
Nationality

** From 1st February 2019, Executive Vice President, Peter Giørtz-Carlsen was appointed to enter the Executive Board*

Board of Directors

Our Board of Directors has a wealth of knowledge, consisting of 15 elected farmer owners and three employee representatives. In 2018 Jan Toft Nørgaard became Chairman, and Heléne Gunnarson was elected as the first female Vice Chairman. Arthur Fearnall and Janne Hansson joined as new members. The Board of Directors' primary responsibility is to ensure that Arla is managed in the best interest of all farmer owners.

1
Jan Toft Nørgaard
Chairman
■ 1960
■ Danish
■ 2000

2
Heléne Gunnarson
Vice Chairman
■ 1969
■ Swedish
■ 2008

3
Manfred Sievers
■ 1955
■ German
■ 2013

4
Inger-Lise Sjöström
■ 1973
■ Swedish
■ 2017

5
Torben Myrup
■ 1956
■ Danish
■ 2006

6
Harry Shaw
■ 1952
■ British
■ 2013
■

7
Janne Hansson
■ 1963
■ Swedish
■ 2018

8
Ib Bjerglund Nielsen
■ 1960
■ Danish
■ 2013
■

9
Manfred Graff
■ 1959
■ German
■ 2012

10
Håkan Gillström
■ 1953
■ Swedish
■ 2015
■

11
Steen Nørgaard Madsen
■ 1956
■ Danish
■ 2005

12
Viggo Ø. Bloch
■ 1955
■ Danish
■ 2003

13
Jonas Carlgren
■ 1968
■ Swedish
■ 2011

14
Bjørn Jepsen
■ 1963
■ Danish
■ 2011

15
Johnnie Russell
■ 1950
■ British
■ 2012

16
Arthur Richard Fearnall
■ 1963
■ British
■ 2018

17
Markus Hübers
■ 1975
■ German
■ 2016

18
Simon Simonsen
■ 1970
■ Danish
■ 2017

■ Year of birth ■ Nationality ■ Member of the board since ■ Employee representative

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 drive strong performance in both short and long-term business results. Our remuneration levels package is 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, social and environmental 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. This ensures that the Board pursues the cooperative's long-term interests without taking into consideration what this may mean in terms of the value of incentive-based remuneration. The Chairman and the Vice Chairman (together: Chairmanship) receive a fee that is three times and two times the base fee respectively, and the remaining members of the Board receive equal compensation. Beyond a minimal travel per diem, no additional compensation is paid for meeting attendance or committee 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 2017. For more details on specific amounts please refer to page 115.

Executive Board/Executive Director (CEO)

The Executive Board is appointed by the BoD and registered as Executive Director at the Danish Business Authority. The Executive Board appoints the members of the Executive Management Team (EMT) and assumes the overall authority and responsibility for planning, directing and controlling the Group's activities. In 2018, following the retirement of Povl Krogsgaard, the Executive Board was represented by the Executive Director in solitary. Remuneration of the Executive Director is based on a fixed salary, short- and long term variable pay, a pension contribution and non-monetary benefits such as company car, telephone etc. The variable pay component consists of both an annual short-term variable incentive (STI) plan and a three-year long-term variable incentive (LTI) plan. The BoD assesses the remuneration paid to the Executive Board annually, based on recommendations from the Chairmanship. For 2018, the fixed pay was maintained on par with last year. For more details on specific amounts please refer to page 115.

Executive Management Team and other senior leaders

In addition to the CEO, four functional experts and two commercial leaders comprise Arla's Executive Management Team (EMT). Other senior leadership is defined as Vice Presidents and above, constituting of 72 people in total.

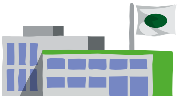
The remuneration package for the Executive Management Team and other senior leaders is based on external benchmarks against European and International FMCG companies, providing a competitive and sustainable mix of fixed and variable pay, as well as a benefit package including a pension contribution. 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 variable incentive (STI) plan and in limited cases a three-year long-term variable incentive (LTI) programme. During 2018, the STI was based on different, area specific measures for senior leaders, and on other individually specified targets for other senior leadership. The LTI was based on strategic branded revenue growth and performance versus a peer group index. For 2018, fixed salary grew on average 2% in line with market-assessed inflation.

OUR RESPONSIBILITY

As a global dairy company, Arla has responsibilities in many areas. Beside the 2018 highlights of our agenda to inspire healthy food habits, preserve and improve the environment and to spread respect for human rights, in the following section we also present our quality assurance programme, Arlagaarden, our Code of Conduct, and our efforts to enhance compliance and our tax affairs.

Our Code of Conduct

The Code of Conduct is the foundation of the high standards we maintain for our products, the environment and the people we employ and do business with. The Code of Conduct applies to all Arla employees and at all our sites worldwide and forms the foundation for how we act and operate.



Responsible company

In Arla profitability and ethical business practices go hand in hand. This is achieved through commitment, know-how, willpower and hard work.

Business principles

We comply with the local laws in all the countries in which we operate.

Operational principles

We manage our business in a responsible and cooperative way that promotes the financial interests of our farmer owners. Our farmer owners' participate in important decisions.

Market conduct

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

Procurement and supplier relations

We expect our suppliers to assume social and environmental responsibility as we do ourselves, so we can purchase goods and services in a sustainable manner.

Confidence in products

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

Food safety

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

Nutrition and health

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

Care for the environment and animal welfare

As a farmer-owned dairy cooperative, we have a natural interest in good environmental and dairy farming practices. We work to reduce our adverse environmental impact, and maintain high animal welfare standards.

Environment and climate

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

Dairy farming

Sustainable dairy farming is a priority for Arla. Together with our farmer owners, we formed and regularly update our quality assurance programme Arlagården® which covers aspects such as animal welfare, milk quality and the environment.

Responsible relations

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

Workplace

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

Human rights

At Arla it's our top priority to create a culture that upholds internationally recognised human rights.

Society and community relations

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

Our compliance activities

In Arla, it is a given that profitability and ethical business practices go hand in hand. Knowing right from wrong goes beyond laws and regulations. For us a responsible business conduct also comes from living our company values, following our Code of Conduct, through our culture of openness and transparency.

Through our compliance framework we drive continued adherence to our Code of Conduct and corporate policies by ensuring that adequate policies, processes and guidelines are established, embedded and enforced throughout the business.

All white-collar employees are trained in our Code of Conduct by policy awareness e-learnings as well as in other high-risk compliance areas such as IT Security and third party relations.

Our Risk, Controls & Compliance team continuously monitor high-risk areas through internal compliance reviews, self-assessments and internal controls. Furthermore, all employees are encouraged to speak up and voice any concerns or violations to the Code of Conduct through our external whistle-blower service.

Examples of compliance activities

Safeguarding of assets

Arla continuously works to develop a robust internal controls environment by strengthening and automating existing controls and establishing new controls to mitigate identified risk in order to safeguard Arla's assets. These could be financial, physical or reputational assets. Our internal controls framework provides a transparent overview of financial and operational risks and highlights areas of weakness which are addressed with mitigating activities.

This year, special attention has been given to GDPR effective from May 25th, 2018, where new controls have been designed to mitigate potential risks associated to this area.

New policy site

We want to let our employees know that we have corporate policies governing our behaviour as stated in the Code of Conduct in all aspects of the company, embedding a responsible culture. Therefore in 2018 we restructured our internal policy site to show employees how each policy is linked to our Code of Conduct representing all areas of our value chain.

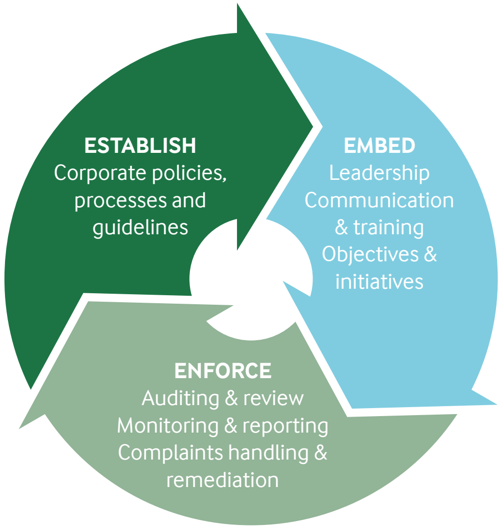
IT security

Arla continuously assesses the increasing threats from the online world to ensure that we have proper IT Security policies and internal controls in place. Our employees are the first line of defence and we prioritise education in cyber-security for all Arla employees.

In 2018 Arla has completed a major system access rights project resulting in improved risk monitoring as well as more thorough access allocation process.

Fraud and Bribery

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



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) 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 pay taxes legally due and to ensure compliance with legislative requirements in all jurisdictions in which the business operates
- We do not use tax havens to reduce the group's tax liabilities
- We do not set up tax structures intended for tax avoidance which have no commercial substance and do not meet the spirit of the law
- 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 build on 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 on improving 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.

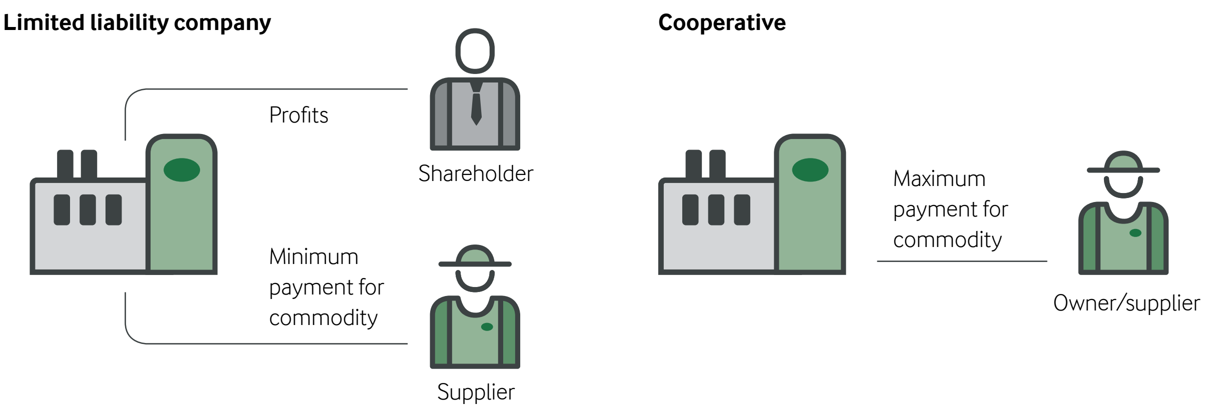
Operating under a cooperative tax scheme

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 generally pay income tax on the amount received for their milk. Danish cooperative tax rules reflect the fact that the cooperative acts as its members' extended arm, and as such, Arla 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 cooperative and a listed company



Leading the sustainability agenda

We operate our business in a sustainable and responsible manner, based on our Code of Conduct. At Arla, we believe sustainability and profitability go hand in hand, and that our dedication to being responsible will benefit our business. The core of our sustainability strategy is our respect for human rights, and we focus our efforts on the areas where we have the biggest impact: access to nutritious dairy products, inspiring good food habits and improving the environment. With our sustainability efforts, we contribute to the UN's Sustainable Development Goals (SDGs).

Sustainable dairy farming

Animal welfare

Working with animals is a key reason why dairy farmers choose their line of work. The well-being of animals is key for their success and is at the very heart of the dairy farm. In 2018 84 per cent of farmer owners engaged in quarterly, systematic evaluations of their individual cows from an animal welfare perspective (see page 51 for more information). We are developing an animal welfare index in cooperation with Copenhagen University, to create a common ground for discussion and further improvement of animal welfare.

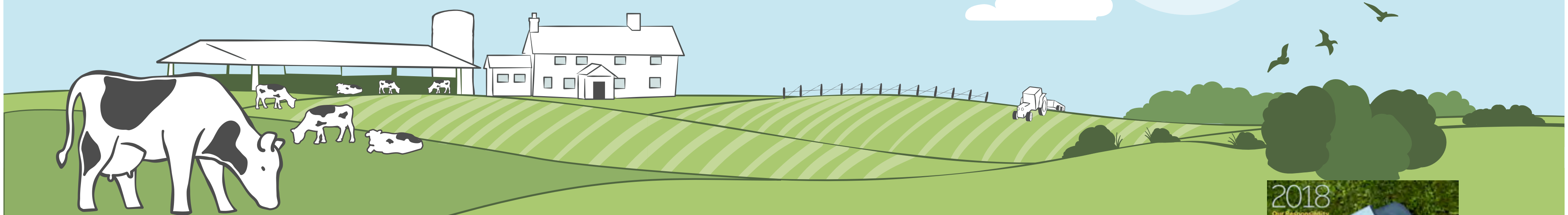
Emissions reduction

Our goal is to reduce the emission of greenhouse gases from farms by 30 per cent per kilo of milk, from 1990 to 2020. We provide carbon assessments performed by external experts to our farmers to help them further reduce emissions. By the end of 2018, Arla farm level emissions had been reduced by 24 per cent per kg of milk. Many Arla farmers produce renewable electricity based on solar, wind or biogas. The amount produced is comparable to 61% of the annual use on farm. From January 2019, our organic farmers in Denmark will cover their net electricity requirements not generated on farm with the purchase of renewable electricity certificates. This is already the case for organic farmers in Sweden.

Nr of carbon assessments*
5,062

Nr of sustainability workshops for farmers**
693

Reduction of greenhouse gas emissions per kg of milk***
24%



Serving the ecosystem

One important ecosystem service Arla farms deliver is the uptake of carbon in grasslands, hedges and pasture lands, which mitigates climate change. To develop a method for estimating carbon sequestration on farm, we have initiated a project together with other large companies within the food industry. The goal is to have a method that will support and encourage farmers to implement activities and practices that promote carbon sequestration.

Read more about our commitments and achievements for 2018 in Arla's Corporate Responsibility Report in accordance with section 99a in the Danish Financial Statements Act.

** Since the start of the programme in 2010. ** Since the start of the programme in 2010. *** Compared to 1990*

2018 sustainability highlights

"At Arla, we are committed to accelerate the transition to sustainable dairy production and build confidence in dairy as part of a healthy and sustainable diet."
Peder Tuborgh, CEO

Health

Increasing access to healthy dairy nutrition

- In 2018 we further increased affordability and enhanced compliance with the Arla® Nutrition Criteria. Currently 93 per cent of Arla® branded products comply with the criteria.
- First and foremost, we want to ensure that eating or drinking our products is always safe. The number of product recalls was reduced by 80 per cent in 2018.
- We continuously explore how we can help people eat more healthily. We have launched a range of on-the-go products for health-conscious consumers, for example, a highly innovative product, Arla Bio that contains only yoghurt and fruit.

Inspiration

Actively inspiring good food habits and choices

- In 2018 Danish, Swedish and German farms hosted more than 140,000 children to educate them about the life on a farm and origins of their food.
- In 2018, Arla Sweden began labelling fresh dairy products including milk, cream and yoghurt 'Best before, often good after'. This was done to discourage unnecessary food wastage, since many products can safely be consumed beyond the best before date, if they have been stored at the correct temperature.
- Arla co-hosted seminars with over 1,000 participants and several workshops to improve the skills and knowledge of Chinese farmers and farm workers, in an effort to enhance animal welfare and milk quality.

Natural

Making a positive contribution to a more sustainable future

- Small step-by-step packaging improvements can have a large aggregated impact in a company such as Arla. Some products that were previously packaged in white HDPE-plastic, are now available in clear PET with PET sleeves. In addition to improving recyclability, the bottle weight has been reduced by approximately 20 per cent.
- Our ambition is to use as much renewable energy as possible at Arla sites; with an aim of at least 50 per cent by 2020. In 2018, we continued to work across sites with projects to improve energy efficiency, increase share of renewable energy and reduce climate impact.

Human rights

Respecting human rights across the globe

- As part of a continuous partnership, we held a stakeholder workshop in Nigeria to identify human rights risks within the project's dairy value chain.
- In the Middle East, we employ many migrant colleagues and we acknowledge our particular responsibility to respect their human rights. One focus point is to provide them with decent housing. In 2018 improvements were made in this respect in Saudi Arabia, Qatar, Oman and United Arab Emirates.

Arlagården®, our quality assurance and animal welfare programme

Food safety and animal welfare enable Arla to create growth for our products and brands and thereby growth for our farmer owners. As a cooperative in control of the entire value chain, our quality assurance programme, Arlagården®, ensures high quality milk produced responsibly. Arlagården® Plus, our farm documentation center gives us a competitive advantage, as we are the only large dairy company to have regularly updated, comprehensive data regarding the wellbeing of our farmers' herds.

What is Arlagården®?
High quality is an important part of our strategy and key to creating the future of dairy. As high quality in our products starts on the farm, all of our 10,319 farmer owners are governed by our farm assurance programme, Arlagården®.

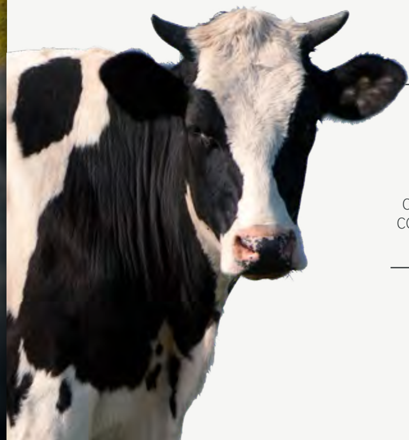
Arlagården® covers all the good work our farmers are doing every day to ensure superior raw milk quality, and welfare for both animals and the environment. Our farmers are proud of how they farm and for Arla, it is a strength that our owners are committed to shared principles and standards. Arlagården®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

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

Arlagården® Plus for the benefit of consumers and owners
It is increasingly important to share the story about all the good we do on the farms as consumers and customers are increasingly interested in the origin of our products, what farmers feed their cows and how they look after them. Arlagården® Plus enables that as it contains a wide range of regularly updated facts about the cows, from their feed and health plan to their daily routine, but also other important facts about farm, like the state of facilities and land use. To have these facts is unique in the dairy industry, and thus it gives a competitive edge to our brands and strengthens our position with consumers and customers.

Furthermore, Arlagården® Plus serves as a benchmarking tool, enabling the individual farmer to benchmark his or her own development in terms of animal welfare against groups of other Arla farmer owners.

Farm facts from Arlagården® Plus*



1,344,285
NUMBER OF COWS

96%
OF THE MILK POOL COVERED BY ARLAGÅRDEN® PLUS

83%
COWS INVOLVED IN A HEALTH PLAN IN COLLABORATION WITH A VETERINARIAN

183
DAYS/YEAR OF GRAZING ON AVERAGE FOR ORGANIC COWS

8.3 m²
AVERAGE SPACE/COW INDOORS

120**
DAYS/YEAR OF GRAZING ON AVERAGE FOR CONVENTIONAL COWS

** The facts below are based on the data submitted to Arlagården® Plus. To date, 84 per cent of our owners submitted data to the system.*
***This average pertains to the conventional cows who graze. The majority of conventional cows don't graze.*

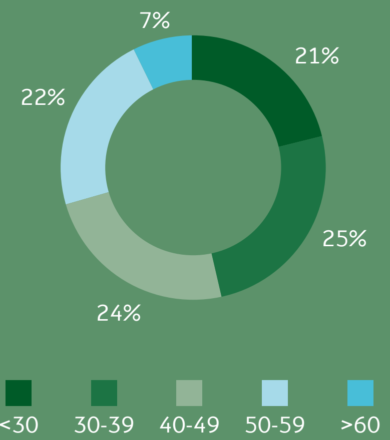
Diversity and inclusion

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

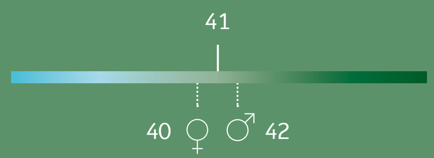
Our employees come from a total of 105 countries and represent multiple generations and genders with a broad range of experiences, backgrounds and skills. We highly value age diversity as it creates an environment where each generation brings different skills and talents to the table. Our aim is that all teams have a representation of a minimum of 30 per cent and no more than 70 per cent of the same gender, nationality and age group. This is necessary to secure diversity of thought in all teams and an environment of creativity, engagement and performance across Arla. Diversity statistics are calculated monthly and shared with HR Business Partners and the business.

In our recruitment processes we apply a competency-based approach when assessing candidates to ensure decisions are data-based, thereby removing any bias in the selection process. All recruiters are continuously trained in securing unbiased processes and working closely with our hiring managers is also a way of making sure that we hire based on sound arguments.

Age distribution



Average age at Arla



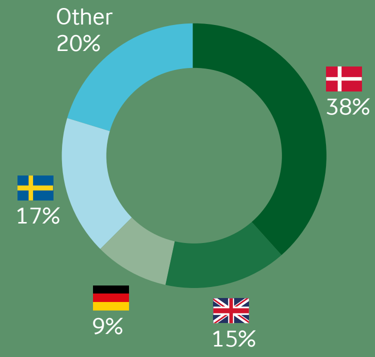
Gender distribution*

Female 44%
2017: 42%

Male 56%
2017: 58%

	2018	2017	2018	2017
EMT	29%	29%	71%	71%
BoD**	13%	13%	87%	87%
BoR	13%	8%	87%	92%

Nationalities



Nationalities in the EMT

*This is the gender ratio in the white collar workforce. Gender ratio in blue collar workforce: female: 20%; male: 80%; and in Arla in total: female: 28%; male: 72%. ** The ratio pertains to the general assembly members of the BoD (excluding employee representatives). In accordance with section 99b of the Danish Financial Statements Act, in 2018 Arla has set a 4-year target to achieve a female representation in the Board of Directors of at least 20 per cent, to be reviewed going forward. In 2018 we didn't achieve the target as there was no election.

OUR FINANCIAL REVIEW

We measure our performance by the value we add to each kilo of milk supplied by our owners. We call it our performance price and it is our key financial indicator. In the following section we present key financial developments in 2018 and give an outlook for 2019.

Market Overview

Volatile milk markets continued into 2018, with European and global milk prices drifting apart. However, healthy farmer milk prices characterised most of 2018. Worldwide milk production grew at a slow pace and farmers in Europe were impacted by a severe drought and high feed prices. The macroeconomic development was clouded by political uncertainty around Brexit and free trade; GDP growth slowed down in both developed and emerging markets, and major currencies relevant to Arla were under pressure.

Challenging macroeconomic environment

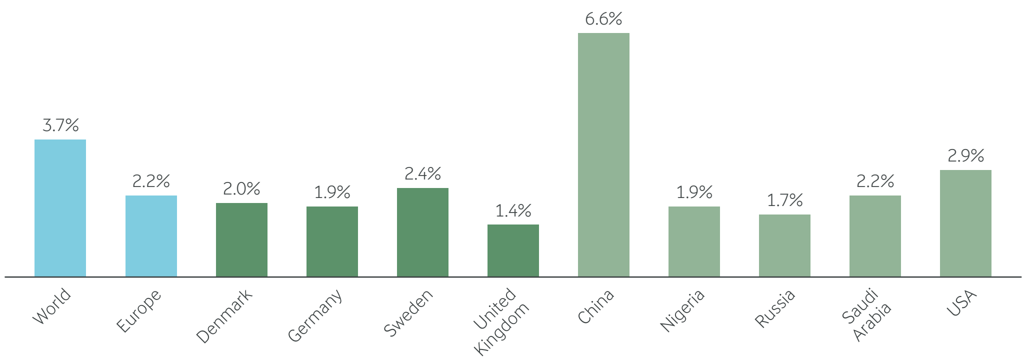
After a strong start in 2018 global economic development decelerated and GDP growth in Europe and key emerging markets slowed significantly. Increasing political uncertainty caused by ongoing Brexit negotiations, the trade conflict between the US and China as well as discussions regarding a renegotiation of NAFTA also contributed to a challenging and unpredictable business environment. This impacted GBP, USD and SEK exchange rates, which are the most relevant currencies to Arla. The GBP decreased on average 1.0 per cent versus already very low 2017 values, mainly due to instability around Brexit, while the SEK depreciated by 6.1 per cent due to low interest rates and political uncertainty. The USD appreciated during most of 2018, but remained on average 4.4 per cent below 2017 levels. While Arla was not significantly affected by macroeconomic challenges in 2018, the developments have generally been unfavourable for globally-oriented companies relying on free trade and open markets.

Milk prices and volumes relatively stable

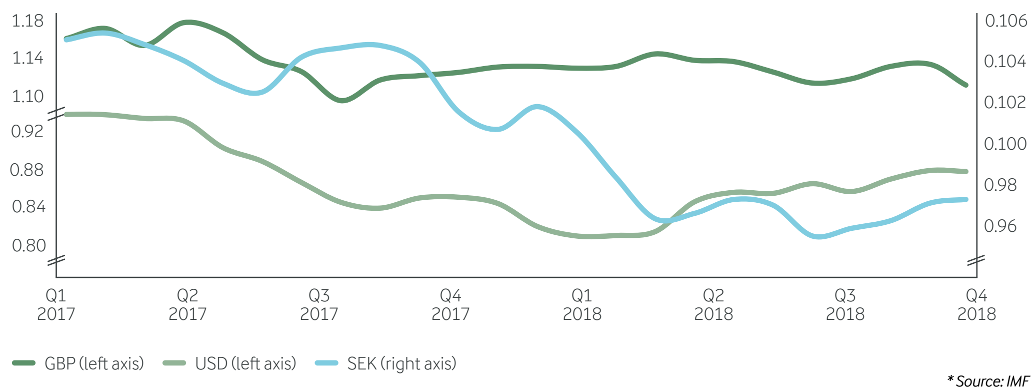
After a very volatile last year, farmer milk prices decreased early in 2018, but recovered in Q3, remaining stable for the rest of the year. Fat continued to be more valuable than protein, following the trend seen in the second half of 2017 – however, the price gap started to close slightly toward the end of the year. European cheese prices recovered in mid-2018 from the low level at the end of 2017, remaining stable for the rest of the year. Global Dairy Trade auction prices fell moderately over the course of 2018. Butter prices, though remaining firm, fell back from the high levels of 2017. The EU intervention scheme was effectively closed for the year, resulting in very low skim milk powder prices while substantial stocks remained. However, towards the end of the year, significant volumes were sold.

Milk production growth in the world's main exporting regions slowed down throughout 2018 and stalled at the end of the year. Large parts of Europe, including Arla's main member areas, were affected by a severe drought, which started to impact milk production in Q4, mainly due to the reduced stocks and resulting increasing cost of feed

Gross Domestic Product* (expressed in purchasing power parity)
GROWTH YEAR-ON-YEAR



GBP, SEK, USD exchange rate development**
GROWTH YEAR-ON-YEAR



*Source: IMF
** Source: Bloomberg

This brought farm economies under pressure, with herd sizes shrinking, and the development is expected to continue into the first half of 2019. The EU market is still finding its footing after the removal of milk quotas and the launch of new phosphate regulations in the Netherlands, which both further limited supply growth in 2018. Overall, EU volumes grew by 1.0 per cent versus 2017, with this increase being weighted towards those areas not impacted by the drought. Production in Arla's core countries remained, in aggregate, largely flat.

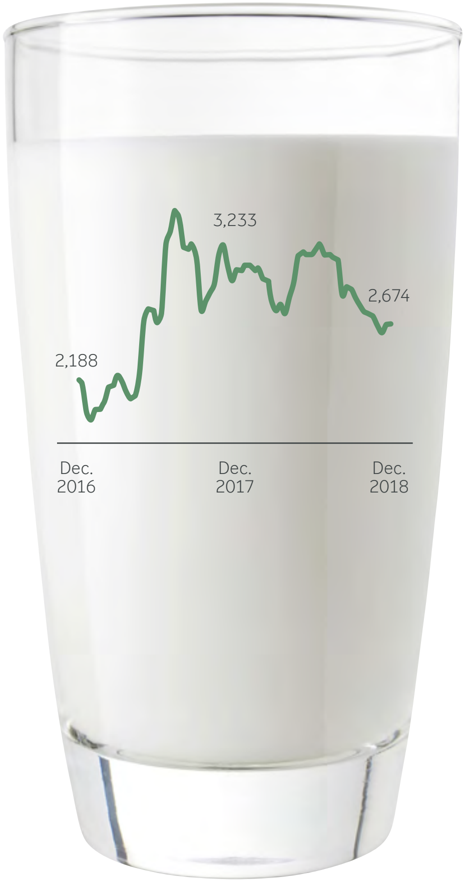
Demand and consumption growth strongest in emerging markets

The latest available global consumption numbers from 2017 show that per capita consumption of dairy grew faster in developing markets at 4.4 per cent year on year versus developed markets, where consumption increased by 2.5 per cent. In absolute numbers, approximately 85 per cent of dairy consumption growth was driven by emerging markets.

At retail, market volumes for most dairy categories in our European core markets were in decline, with the exception of milk in Denmark, yellow cheese in Germany, and yoghurt in Denmark and Sweden. Volumes for ready-to-drink coffee grew significantly across markets. With changes in world market commodity prices for dairy products settling into consumer products, category value increased substantially across categories in 2018.

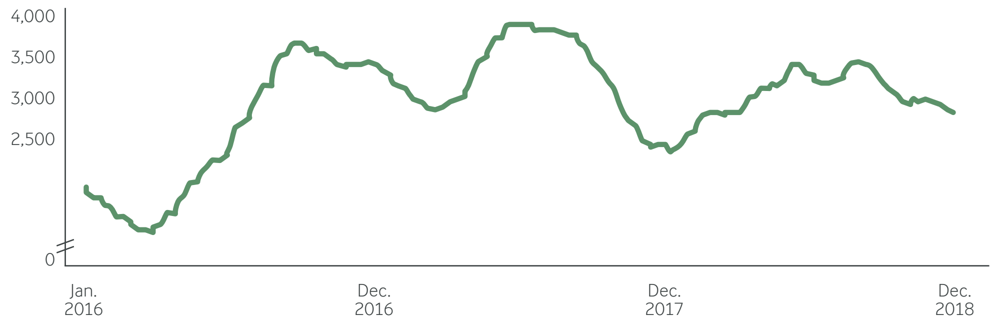
Global Dairy Trade prices, average, Whole Milk Powder

USD/TONNE



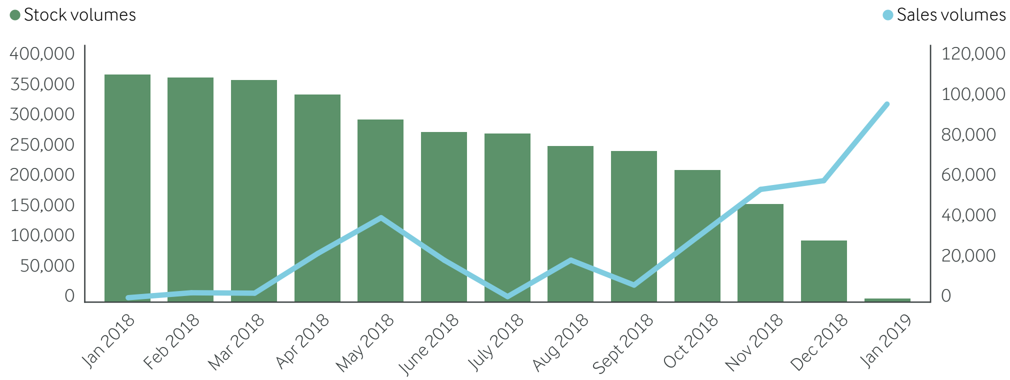
European Cheese* prices,average

EUR/TONNE



EU intervention stock development**

SMP, TON



*Cheddar, Gouda, Mozzarella, Emmental – EXW prices. Source: Trigona Dairy Trade. **Source: EU Milk Market Observatory

Financial performance

In 2018, Arla improved its milk price performance relative to competition– in absolute terms the milk price delivered to farmer owners decreased by 4.5 per cent due to lower market prices, resulting in a still strong performance price of 36.4 EUR-cent/kg. This was mainly driven by a successful first year of Calcium and solid branded growth in EU. Our strong balance sheet gave the Board of Directors (BoD) confidence to propose a one-time pay-out of the full profit for the year to our farmer owners in response to the extraordinary drought situation.

Owner milk price decreases slightly in line with lower commodity market milk prices
Arla's mission is to secure the highest value for our farmers' milk while creating opportunities for their continued growth. Our commitment to maximise both short- and long-term value for our owners requires strong commercial execution on all levels of the business through active price management, delivering favourable branded growth as well as firm cost control. In 2018 we were able to enhance the shape of our business and deliver a continued strong milk price for our farmer owners.

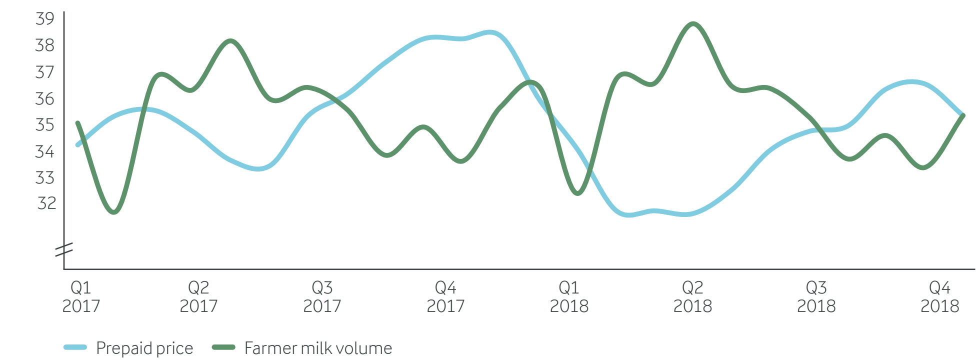
Performance price is the most important KPI for Arla, measuring the value Arla creates per kilogram of owner milk. In 2018, the performance price decreased by 4.5 per cent to 36.4 EUR-cent/kg, compared to 38.1 EUR-cent/kg last year. This decrease was largely driven by lower commodity market prices, impacting our milk price particularly in Q1. This impact was largely offset by branded growth and deliveries of our transformation programme, Calcium, as well as strong price management towards retailers. For more information on the performance price please refer to Note 1.4.

The largest component of performance price is the prepaid milk price, which represents the on-account payment farmer owners receive per kilogram of milk delivered during the settlement period. Coming from a low level at the end of the first quarter, we succeeded in increasing our prepaid price significantly, leading to an improvement in our relative performance and a milk price that outperformed competitors throughout the last three quarters of 2018. For the full year 2018 our prepaid price nevertheless decreased by 5.0 per cent to 34.1 EUR-cent/kg versus 35.9 EUR-cent/kg last year, reflecting overall lower market prices.

Arla owner milk intake in 2018 grew only 0.6 per cent compared to last year's levels, impacted by the slightly lower milk price environment as well as the drought. This year-on-year stability masks modest seasonality in milk intake throughout the year. During the first and second quarter of 2018, milk intake expanded by 1.7 and 1.1 per cent year-on-year respectively. During the third and fourth quarter, the impact of the year's severe drought became visible, leading to a milk intake reduction of -0.4 and -0.7 per cent year-on-year.

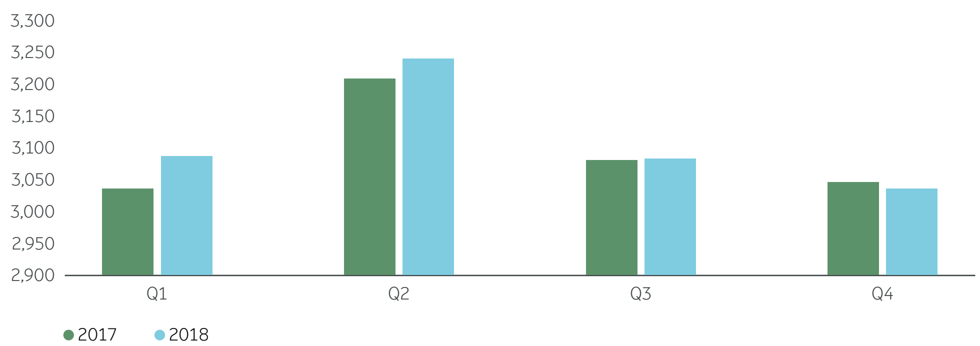
Prepaid milk price and owner milk volumes

EURC/KG; TONNES



Quarterly milk intake from our owners

MKG



Revenues grow, driven by higher sales volumes and improving product mix

In 2018, revenue increased by 0.8 per cent to EUR 10.4 billion, compared to EUR 10.3 billion last year, which is in the higher end of our expected range. At Arla, there are four components of revenue development: sales prices, volumes and product mix, exchange rates, as well as changes due to acquisitions and/or divestments. Branded volumes and product mix, and to a lesser extent acquisitions, were the drivers of sales growth in 2018. The development of exchange rates impacted revenues negatively. Underlying revenue development, excluding foreign exchange effects and acquisitions, was 2.0 per cent.

After strong sales price increases last year, price levels were relatively stable in 2018, with a small negative impact of 0.5 per cent for the full year.

Improving product mix through continued strategic branded volume growth of 3.1 per cent was the main driver of revenue growth. Private label volume-driven revenue growth was negative at -6.3 per cent based on a strategic decision to step out of unprofitable contracts in Germany and the UK. As a result, the share of branded business, which represents our most important quality of business indicator, reached 45.2 per cent, which exceeded our Good Growth 2020 long-term ambition of 45 per cent two years ahead of schedule.

Due to our European operations in non-Euro currencies and our increasingly international business, Arla is significantly exposed to currency fluctuations. In 2018, these negatively impacted our sales by EUR 210 million, primarily due to the weaker SEK and USD.

Sales were positively impacted with EUR 89 million by the acquisition of Yeo Valley in the UK and Gefleortens in Sweden as well as by the purchase of the remaining shares in Arla Foods Ingredients S.A. in Argentina. For more details on revenue development please refer to Note 1.1.

Branded growth and continued innovation signal improving quality of business

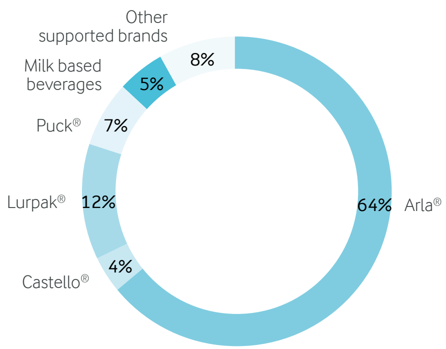
Our brands are at the heart of our business and drive about two thirds of Arla's profitability. Increasing branded sales is critical for us to achieve stronger relative profitability on a medium- and long-term basis. We also know that branded revenue and profitability is less volatile and drives a fundamentally 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 2018, strategic branded volume grew 3.1 per cent, following a 3.0 per cent increase last year. This strong result is at the top end of our target range, despite significant reductions in marketing spend compared to last year, thanks to Calcium-in-spired initiatives that led us to increase marketing spend efficiency.

In absolute terms, most of our branded growth in 2018 was driven by our core brands in Europe, supported by strong innovation and brand execution. Brand growth in our international zone was limited by challenges in China and Nigeria. Nevertheless, core brands Puck® and Lurpak® performed strongly in international markets. From a brand and category perspective, milk based beverages (including Starbucks™) was our fastest-growing segment in 2018 followed by Puck®, Castello®, Lurpak® and the Arla® brand. For more details on our brands refer to pages 26 to 30.

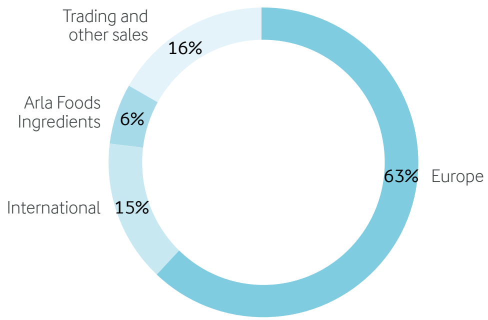
Branded revenue, split by brands

PER CENT



Revenue split by commercial segment

PER CENT



3.1%

In 2018, strategic branded volume grew 3.1 per cent, in line with our target of 1-3.5% growth. Increasing branded sales is critical for us to achieve stronger relative profitability on a medium- and long-term basis.

Our brands

Arla®

The Arla® brand is central to our global business, and the key driver of our branded growth. In 2018, Arla® brand sales grew 0.2 per cent to EUR 3,034 million. Arla® strategic branded volume growth (SB VDRG) amounted to 1.8 per cent, primarily as a result of successful sub-brand launches in both European and international markets. Price-driven revenue growth (PDRG) excluding exchange rate effects, which were negative, was 0.8 per cent. For definitions on SB VDRG and PDRG please refer to the glossary.

Lurpak®

Revenue for our leading brand in the butter and spreads category increased 6.1 per cent to EUR 561 million in 2018 driven mainly by sales prices with a PDRG effect of 5.4 per cent, which was a necessary response to rising market prices for milk fat. Despite these higher price levels, SB VDRG also reached 2.7 per cent – as a result, Lurpak® once again remains the biggest global butter brand.

Castello®

Sales of our Castello® specialty cheese brand declined 1.0 per cent to EUR 180 million mainly due to exchange rates – PDRG excluding exchange rate effects had a minor impact of -1.3 per cent. Nevertheless, the brand reached a SB VDRG of 3.8 per cent, which is a very good result that reflects an improving product mix. This was enabled by an expanded portfolio with big bets in white mould and yellow cheese, supported by the strong and globally executed "Sensations by Castello" campaign.

Milk based beverages incl. Starbucks™

Our milk based beverages segment includes strong brands such as Cocio, Matilde, and most importantly, the licensed StarbucksTM brand. In 2018 branded sales in the MBB segment grew by 10.1 per cent to EUR 248 million, driven by a very strong SB VDRG of 22.7 per cent, while sales prices had a minor negative PDRG impact of 1.0 per cent. Our licensed Starbucks™ brand achieved an SB VDRG of 29.7 per cent driven by significantly expanded distribution, while our Matilde brand reached an SB VDRG of 15.7 per cent thanks to improved differentiation. Cocio SB VDRG amounted to 5.1 per cent driven by a new collaboration with HBO and strong communication.

Puck®

Our region MENA's leading brand continued to perform strongly for Arla in 2018. Puck® revenues grew 3.7 per cent to EUR 352 million driven by an SB VDRG of 8.9 per cent, which is over twice the 2017 rate. Prices excluding exchange rate effects had a negative PDRG effect of 1.6 per cent due to strong growth in lower price point markets.

Our commercial zones and segments

Europe

Sales in Europe declined 0.9 per cent to EUR 6,507 million compared to EUR 6,568 million last year. Positive price effects, higher branded sales volumes as well as additional revenue from our acquisitions were more than offset by negative currency effects of EUR 108 million. Lower volumes in our private label business, resulting from our strategic decision to step out of unprofitable contracts, also had a small negative impact on European sales. Revenue growth excluding currency effects was 0.7 per cent.

Europe's strategic branded volume-driven revenue growth of 2.5 per cent reflects the solidity of our European core branded business. Main drivers were our central European markets Germany (+6.5 per cent) and Netherlands/Belgium/France (+12.9 per cent), while Denmark (+4.6 per cent) and UK (+4.1 per cent) also performed strongly. Branded sales declined by 0.8 per cent in Sweden, impacted by the increasing trend towards private label products and dairy alternatives. For further details on the development of each of our strategic European markets, please refer to page 31.

International

International sales declined by 2.5 per cent to EUR 1,576 million, compared to EUR 1,616 million last year, bringing our International share of retail and foodservice revenues to 19.6 per cent vs. 20.2 per cent last year and thus below our target of 20 per cent. This reflects a negative currency effect of EUR 67 million. Revenues excluding currency effects increased by 1.7 per cent.

In this high-margin segment, SB VDRG amounted to 4.6 per cent. Our largest international commercial region MENA exceeded SB VDRG expectations at 7.9 per cent despite challenging market dynamics. SB VDRG in the SEA region reached 25.9 per cent, mainly driven by Dano's success in Bangladesh and strong growth in Japan and Korea. In North America, we achieved an SB VDRG of 3.2 per cent driven by very good results in Canada across all categories, partially offset by only modest growth in the US despite a major marketing offensive. In China, an SB VDRG of -8.0 per cent was driven by lower sales of infant milk powder following new regulations as well as lower UHT milk volumes based on a profitability-driven reprioritisation of our product portfolio. In Nigeria, SB VDRG was also negative at -15.2 per cent due to lower volumes of foodservice milk powder, while retail sales performed well. For more details on our performance in International, please refer to page 33.

Arla Foods Ingredients

In 2018, sales grew by 0.1 per cent to EUR 652 million compared to EUR 651 million last year. The full consolidation of Arla Foods Ingredients S.A. Argentina had a positive impact on sales of EUR 45 million following its acquisition in the first quarter as explained in Note 3.5. Revenue in our core whey business was stable, driven by positive impacts from the product mix improving towards more specialised products and a volume-driven upside on lactose, as well as a negative price development in relation to standard products. Revenues in our third-party manufacturing business for infant milk formula in China also decreased temporarily, caused by new regulation limiting the number of customers for which a specific site can produce – in 2019 and onwards we expect no negative impacts from this. Refer to page 35 for more information on our AFI journey.

Trading

Sales of trading products and commodity liquid milk increased 12.4 per cent to EUR 1,690 million versus EUR 1,503 million last year. This higher revenue is the direct result of the improved quality of our trading portfolio, with less focus on commodity liquid milk. We expect to continue selling higher-value trading products into 2019 thanks to our substantial capacity investments as well as higher retail and foodservice milk consumption in Europe and International, leading to less milk available for sale of lower-value commodity liquid milk. The trading share of overall milk intake volumes, however, increased to 23.9 per cent compared to 20.2 per cent last year as a result of our intentional shift away from private label volumes to more profitable short-term trading opportunities. To read more about our trading segment, refer to page 36.

Calcium savings exceed first year expectations

Early 2018 we launched our comprehensive transformation programme, Calcium, as our response to challenging external developments, such as the decline of the GBP and SEK, as well as the historic shift in value between milk fat and protein, and to optimise our internal cost structure. Calcium delivered strong first year savings of EUR 114 million, which significantly exceeded our initial target of EUR 30 million. This number excludes reinvestments and one-time investments as well as non-Calcium related cost. The primary cost categories driving these savings included sales and administrative costs, marketing, and supply chain costs. For more details on Calcium, please refer to page 21.

From a profit and loss perspective, these significant Calcium contributions are not directly visible on all cost lines due to inventory revaluation, volume-mix effects in supply chain driven primarily by a positive brand mix development, as well as additional logistics costs to optimise our trading sales. Reported cost levels also include negative one-time impacts, such as supply chain and Calcium restructuring costs. For more details on our cost development, please refer to Note 1.2.

Net profit in target range and proposed to be paid out fully to member farmers for 2018

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 on an ongoing basis 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. In 2018, we again prioritised prepaid milk prices throughout the year and achieved a profit share of 2.8 per cent (2017: 2.8 per cent). Although there were positive and negative one-offs in 2018, they had no material net effect on profit.

On the basis of our very strong balance sheet and hence leverage, the Board of Directors made an exceptional proposal in August 2018 to pay out the full net profit for the year as a supplementary payment to support our farmer owners.

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

Working Capital reduced further

Inventory values on our balance sheet declined 4.6 per cent to EUR 1,074 million versus EUR 1,126 million last year, driven by price levels and our continued efforts to optimise stock. Receivables increased 5.0 per cent to EUR 989 million versus EUR 942 million last year, after we decided to not fully utilise our customer financing agreements to reduce cost, enabled by our strong cash position. Payables increased by 6.5 per cent to EUR 1,169 million compared to EUR 1,098 million last year, thanks to the utilisation of Supply Chain Financing programmes with our suppliers – please see Note 2 for details. As a result, total net working capital (NWC) excluding owner milk was reduced by 6.1 per cent from 1,175 million last year to EUR 1,103 million in 2018 – a reduction equivalent to 3.8 days measured on a trailing 3-month basis. Compared to 2014 levels, we have been able to reduce NWC by nearly 10 days.

Leverage decreases to historically low level, driven by lower debt and higher earnings

Financial leverage is calculated as the ratio of net interest-bearing debt 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 2018 leverage was reduced to 2.4 compared to 2.6 last year, which significantly outperformed our target range. Net interest-bearing debt including pension liabilities decreased to EUR 1,867 million compared to EUR 1,913 million last year. EBITDA was EUR 767 million versus EUR 738 million last year.

These further improvements in working capital and leverage have made our balance sheet stronger than ever.

114

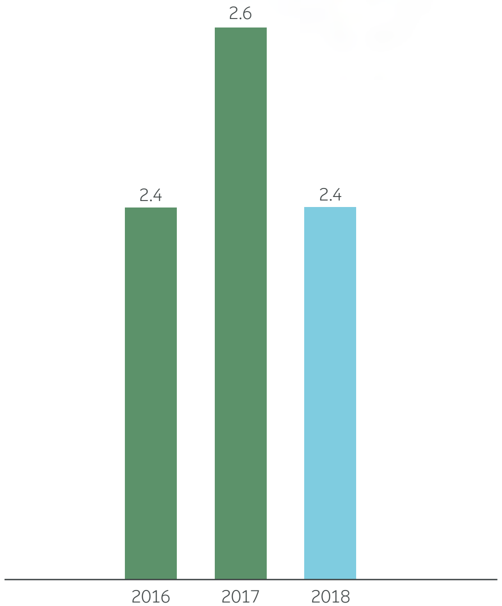
MILLION EUR

Our transformation programme, Calcium delivered exceptionally good first year results of EUR 114 million savings, ahead of our EUR 30 million target. Calcium is our response to challenging external developments.

Leverage*

2.4

Target 2018 2.8 - 3.4



Strong cash flow despite significantly higher investments

Cash flow from operating activities increased to EUR 658 million compared to EUR 386 million last year due to a higher EBITDA and strong improvements in working capital. At the same time, we increased CAPEX investments by 47 per cent from EUR 298 million (including intangible assets) last year to EUR 438 million in 2018, leading to a free operating cash flow of EUR 224 million vs. EUR 100 million last year. Our M&A activity in 2018 led to a net investment compared to a net income from divestments last year.

Strong investment activity in CAPEX and M&A

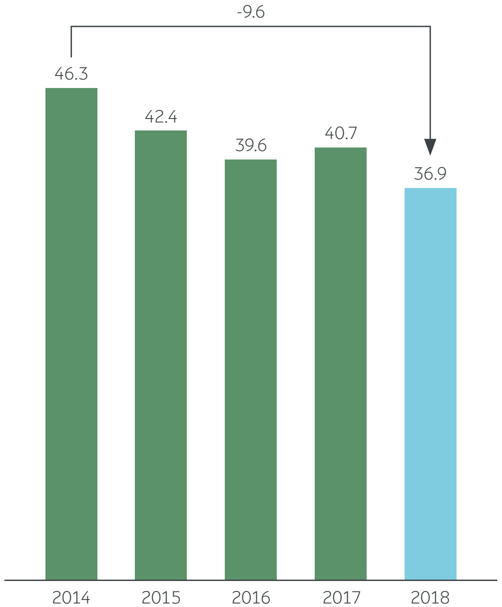
Approved capital expenditure, also referred to as CAPEX, for 2018 was EUR 527 million, increasing by 57.3 per cent from EUR 335 million last year. Actual CAPEX spend of EUR 438 million was incurred in 2018 primarily due to the timing of payments and strategic reprioritisation. Major focus areas included new production methods, new whey processing technology in AFI, capacity expansion, for example within child nutrition and milk powder, as well as structural optimisation of our fermented dairy production footprint.

In February 2018 we acquired the remaining 50 per cent share in our joint venture Arla Foods Ingredients S.A. Argentina from our partner SanCor to secure the whey necessary for supporting AFI's growth ambition. In June we acquired Yeo Valley Dairies Ltd. in the UK, a subsidiary of Yeo Valley Group. This gives us the right to use the Yeo Valley brand in the UK market for milk, butter, spreads, and cheese, which supports our high ambitions for organic dairy. In combination, these acquisitions had an investment cash flow impact of EUR 51 million in 2018.

Group Net Working Capital

DSO, DIO, DPO (DAYS)

36.9



*NIBD incl. pensions/EBITDA

Financial outlook

In 2019, we will continue our Calcium transformation journey as well as our branded growth focus, and we are committing significant investments to deliver our strategy, Good Growth 2020. The macroeconomic outlook is challenging, and the dairy industry remains volatile – market signals are mixed. Our recent acquisitions will support us on our journey as we leverage our global strategic brands to create the future of dairy.

Macroeconomic environment clouded by slowing growth and heightened risks

We enter 2019 with the expectation of lower GDP growth in most markets compared to 2018 on the back of moderating investments and increasing trade tensions, impacting both developed and emerging markets. While the outlook for dairy prices is stable, expectations for many other commodities and export in general are subdued. Financial market pressure and interest rates are rising in most markets. The political environment remains unstable, with developments regarding Brexit being the most impactful macroeconomic topic to watch for Arla. US actions on trade could also impact our business both positively and negatively through higher barriers and potential tariffs. We therefore expect a challenging year in terms of the economic and political environment. While we do not currently expect significant changes in global consumption trends or big shifts in global trade patterns during 2019, continuous monitoring and ensuring our ability to react and adapt quickly will be imperative in the year ahead, and beyond.

Stable market milk price and production outlook

The outlook on market milk prices is firm as we enter 2019. The lingering effects of the drought in our production areas on the one hand, combined with relatively stable price levels on the other, lead us to expect our milk supply to be stable into 2019 with growth returning later in the year. As a result, we anticipate stable to slightly increasing prices in the first half of the year with increasing volatility later. This will depend on a myriad of variables, including weather and the relationship between milk price and feed prices.

Mixed demand signals, with China picking up again

Demand signals for dairy products are stable in the US as well as the EU, where intervention stocks were effectively emptied by the start of 2019, and positive from China due to low stock levels and slowing local production. Limited GDP growth and weakening currencies in emerging markets, which have supported the underlying demand growth in recent years, may impact buying power and thereby dairy sales and prices.

The main consumer trends we expect to impact dairy sales in 2019 include living healthy and conscious lives in times of increasingly busy and fragmented schedules, combined with a higher demand for transparency and accountability.

Continued focus on branded growth

In 2019, we will continue to expand the value of our business by accelerating and sharpening the profile of our strategic brands Arla®, Castello®, Lurpak® and Puck®, leveraging also our fast-growing brands in milk-based beverages, e.g. Starbucks™. We will introduce new additions to our broad product portfolio and continue to invest to increase the share of branded sales, thereby ensuring our future growth and profitability. We are targeting an SB VDRG of 1.5 to 3.5 per cent as we continue to pursue our Good Growth 2020 strategy with significantly higher growth rates in International compared to Europe.

500
MILLION EUR

In 2018 we strengthened our efforts to measure our innovation pipeline, which is expected to deliver over EUR 500 million in the next three years in incremental revenue.

Cost improvements driven by Calcium

We expect to further strengthen Arla's competitiveness, driven by Calcium where our ambition for 2019 is to achieve savings of EUR 75-100 million. In 2018 we significantly overdelivered on our Calcium ambition, and solid plans are in place to progress towards our 2021 target of EUR 400+ million run-rate savings, of which EUR 100 million will be reinvested.

M&A focus on integrating acquisitions in the UK and Bahrain

In 2018 we announced our intention to acquire Mondelez' cheese business and production plant in Bahrain. Pending regulatory approval, the deal is scheduled to be finalised end of May 2019, after which our focus will be on integrating and leveraging the acquisition – we expect this acquisition to have top- and bottom-line impact from June 2019. Furthermore, after the acquisition of Yeo Valley Dairies Ltd. in the UK in June 2018 we expect to absorb the full run-rate effect in 2019 and achieve solid commercial traction.

Net profit of at least 2.8% 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 2019 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 2019 are expected to be below the annual target range due to seasonality in our profit creation.

Significant investments planned

In terms of capital expenditure, we expect 2019 to be another big investment year, with a CAPEX outlook of EUR 458 million driven by structural investments and Calcium efficiency initiatives. Our main projects include a new powder tower in Pronsfeld, Germany, the consolidation of our footprint for fermented products in northern Europe, as well as large investments in AFI. Our strong balance sheet allows us to increasingly invest in the capacities and technologies required to succeed in the future, with a 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 despite 2018 profit pay-out to farmer owners

The availability of sufficient financial manoeuvring room is a priority to Arla Foods, as it enables us to strategically position ourselves for future growth. Based on our ambitious investment plans for 2019 as well as the extraordinary pay-out of 2018 profits to our farmer owners, we expect 2019 leverage to increase versus the 2018 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.

The implementation of IFRS 16 leases as of 1 January 2019 is expected to have very limited effect on the reported leverage. Refer to note 5.6 for more details.

Expectations for 2019

Revenue
10.2-10.6
BILLION EUR

Profit share
2.8-3.2%
OF REVENUE

Strategic branded volume driven revenue growth
1.5-3.5%

Brand share
≥46.0%
BILLION EUR

International share
≥20.0%

Calcium
75-100
MILLION EUR

Leverage
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 developmentsin 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 18).

OUR CONSOLIDATED FINANCIAL STATEMENTS

Our financial reporting follows best practise standards and we aim at producing a reader-friendly report. We have grouped the consolidated financial statement into sections to increase understanding of each accounting area. The consolidated financial statements consist of the primary statements and related notes. The notes include our financial figures and financial comments in addition to our accounting policies and areas where significant management judgement has been applied.

Content

Income statement

(EURm)	Note	2018	2017	Develop-ment
Revenue	1.1	10,425	10,338	*1%*
Production costs	1.2	-8,163	-8,063	*1%*
Gross profit		**2,262**	**2,275**	*-1%*
Sales and distribution costs	1.2	-1,540	-1,584	*-3%*
Administration costs	1.2	-422	-419	*1%*
Other operating income	1.3	118	71	*66%*
Other operating costs	1.3	-43	-39	*10%*
Gain from sale of enterprise	3.5	-	44	*-100%*
Share of results after tax in associates and joint ventures	3.4	29	37	*-22%*
Earnings before interest and tax (EBIT)		**404**	**385**	*5%*
Specification:				
EBITDA excluding gain from sale of enterprise		767	694	*11%*
Gain from sale of enterprise	3.5	-	44	*-100%*
Depreciation, amortisation and impairment losses	1.2	-363	-353	*3%*
Earnings before interest and tax (EBIT)		**404**	**385**	*6%*
Financial income	4.1	2	13	*-85%*
Financial costs	4.1	-64	-77	*-17%*
Profit before tax		**342**	**321**	*5%*
Tax	5.1	-41	-22	*86%*
Profit for the year		**301**	**299**	*1%*
Minority interests		-11	-14	*21%*
Arla Foods amba's share of profit for the year		**290**	**285**	*2%*

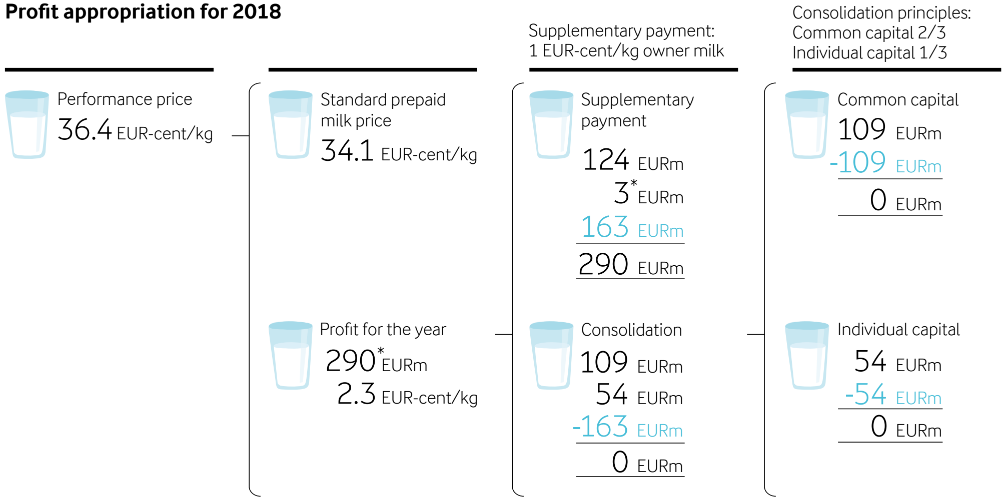
Comprehensive income

(EURm)	Note	2018	2017
Profit for the year		**301**	**299**
Other comprehensive income			
Items that will not be reclassified to the income statement:			
Re-measurements of defined benefit schemes	4.7	25	58
Income tax on actuarial gains and losses on defined benefit plans		-6	-10
Items that may be reclassified subsequently to the incomestatement:			
Value adjustments of hedging instruments	4.4	3	48
Fair value adjustment of certain financial assets		-3	14
Foreign currency translation		-10	-77
Income tax on items that may be reclassified to profit or loss		-1	-1
Other comprehensive income, net of tax		**8**	**32**
Total comprehensive income		**309**	**331**
Allocated as follows:			
Owners of Arla Foods amba		297	321
Minority interests		12	10
Total		**309**	**331**

Profit appropriation

(EURm)	2018	2017
Profit for the year	301	299
Minority interests	-11	-14
Arla Foods amba's share of net profit for the year	**290**	**285**
Profit appropriation:		
Supplementary payment for milk	287	124
Interest on contributed individual capital	3	3
Total supplementary payment	**290**	**127**
Transferred to equity:		
Reserve for special purposes	-	120
Contributed individual capital	-	38
Total transferred to equity	**-**	**158**
Appropriated profit	**290**	**285**

Profit appropriation for 2018



** Based on profit allocated to owners of Arla Foods amba*
Numbers in blue reflect extraordinary one-time decision to deviate from Arla's consolidation policy

Profit appropriation

The Board of Representatives made an extraordinary one-time proposal to pay out the full profit for the year, EUR 290 million, as supplementary payment corresponding to 2.3 EUR-cent/kg owner milk. Interest on the carrying value of contributed individual capital amounts to EUR 3 million. Contributed individual capital carried an interest of 1.53 per cent in 2018.

If the consolidation policy had been applied Arla would have paid out EUR 127 million as supplementary payment while EUR 163 million would have been consolidated and split into 1/3 to individual capital (contributed individual capital), amounting to EUR 54 million, and 2/3 to common capital (reserve for special purposes), amounting to EUR 109 million.

Balance sheet

(EURm)	Note	2018	2017	Development
Assets				
Non-current assets				
Intangible assets	3.1	887	811	*9%*
Property, plant and equipment	3.2	2,308	2,212	*4%*
Investments in associates and joint ventures	3.3	439	454	*-3%*
Deferred tax	5.1	30	43	*-30%*
Pension assets	4.7	4	-	*100%*
Other non-current assets		29	31	*-6%*
Total non-current assets		**3,697**	**3,551**	*4%*
Current assets				
Inventory	2.1	1,074	1,126	*-5%*
Trade receivables	2.1	989	942	*5%*
Derivatives	4.5	37	19	*95%*
Other receivables	2.1	254	182	*40%*
Securities		465	511	*-9%*
Cash and cash equivalents		119	91	*31%*
Total current assets		**2,938**	**2,871**	*2%*
Total assets		**6,635**	**6,422**	*3%*

(EURm)	Note	2018	2017	Development
Equity and liabilities				
Equity				
Common capital		1814	1,781	*1%*
Individual capital		456	502	*-9%*
Other equity accounts		-89	-77	*3%*
Proposed supplementary payment to owners		290	127	*128%*
Equity attributable to the owners of Arla Foods amba		**2,471**	**2,333**	*6%*
Minority interests		48	36	*33%*
Total equity		**2,519**	**2,369**	*6%*
Liabilities				
Non-current liabilities				
Pension liabilities	4.7	224	277	*-19%*
Provisions	3.4	17	12	*42%*
Deferred tax	5.1	84	59	*42%*
Loans	4.2	1,369	1,206	*14%*
Total non-current liabilities		**1,694**	**1,554**	*9%*
Current liabilities				
Loans	4.2	860	1,013	*-15%*
Trade and other payables	2.1	1,169	1,098	*6%*
Provisions	3.4	11	11	*0%*
Derivatives	4.5	85	87	*-2%*
Current tax		5	11	*-55%*
Other current liabilities	2.1	292	279	*5%*
Total current liabilities		**2,422**	**2,499**	*-3%*
Total liabilities		**4,116**	**4,053**	*2%*
Total equity and liabilities		**6,635**	**6,422**	*3%*

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	Proposed supplementary payment	Reserve for value adjustment of hedging instruments	Reserve for fair value through OCI	Reserve for foreign exchange adjustments	Total	Minority interests	Total Equity
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
Minority 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 minority shareholders	-	-	-	-	-	-	-	-	-	-	-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 at 1 January 2017	**829**	**766**	**223**	**87**	**193**	**124**	**-122**	**3**	**54**	**2,157**	**35**	**2,192**
Supplementary payment for milk	-	-	-	-	-	124	-	-	-	124	-	124
Interest on contributed individual capital	-	-	-	-	-	3	-	-	-	3	-	3
Reserve for special purposes	-	120	-	-	-	-	-	-	-	120	-	120
Contributed individual capital	-	-	38	-	-	-	-	-	-	38	-	38
Minority interests	-	-	-	-	-	-	-	-	-	-	14	14
Profit for the year	**-**	**120**	**38**	**-**	**-**	**127**	**-**	**-**	**-**	**285**	**14**	**299**
Other comprehensive income	48	-	-	-	-	-	47	14	-73	36	-4	32
Total comprehensive income	**48**	**120**	**38**	**-**	**-**	**127**	**47**	**14**	**-73**	**321**	**10**	**331**
Capital issued to new owners	3	-	-	-	-	-	-	-	-	3	-	3
Payments to owners	-	-	-12	-7	-9	-	-	-	-	-28	-	-28
Dividend to minority shareholders	-	-	-	-	-	-	-	-	-	-	-9	-9
Supplementary payment related to 2016	-	-	-	-	-	-120	-	-	-	-120	-	-120
Foreign exchange adjustments	15	-	-6	-1	-4	-4	-	-	-	-	-	-
Total transactions with owners	**18**	**-**	**-18**	**-8**	**-13**	**-124**	**-**	**-**	**-**	**-145**	**-9**	**-154**
Equity at 31 December 2017	**895**	**886**	**243**	**79**	**180**	**127**	**-75**	**17**	**-19**	**2,333**	**36**	**2,369**

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 in detail:

Common capital

Common capital is by nature undivided and consists of the capital account and the reserve for special purposes. The capital account represents a strong foundation for the cooperative's equity, as the non-impairment clause, described on page 71, ensures that the account cannot be used for payment to owners. The reserve for special purposes is an account that in extraordinary situations can be used to compensate owners for losses or impairments affecting the profit for appropriation. Amounts transferred from the annual profit appropriation to common capital are booked to this account.

Individual capital

Individual capital is capital allocated to each owner based on their delivered milk volume. Individual capital consists of contributed individual capital, delivery-based owner certificates and injected 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. Also characterised as individual capital is the account for proposed supplementary payment that will be paid out following the approval of the annual report.

Other equity accounts

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

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

Equity improved

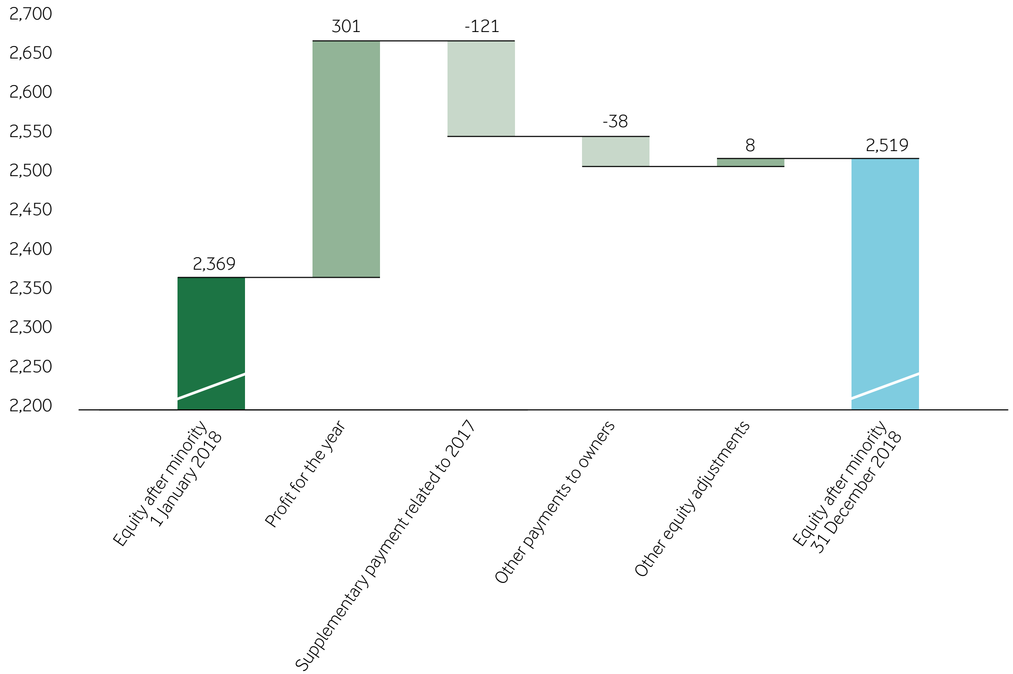
During 2018, equity increased by EUR 150 million compared to last year.

Other comprehensive income explained
Other comprehensive income includes revenue, expenses, gains and losses that are excluded from the income statement, typically, they have not yet been realised. Other comprehensive income amounting to a net income of EUR 8 million attributable to actuarial gains on pension liabilities, negative value adjustments on hedging instruments and net assets measured in foreign currencies.

Payments to and from owners
A supplementary payment relating to 2017 totalling EUR 121 million was paid out in March 2018. Additionally, EUR 38 million was paid out to owners resigning or retiring from the cooperative. In connection with farmers in the UK and Central European becoming direct members, 131 members from Central Europe decided to leave Arla, representing 79 million kg of milk and resulting in extraordinary repayment of individual capital of EUR 3 million.

The Board of Directors proposes to payout EUR 290 million in March 2019 as supplementary payment for the year. Furthermore it is expected that EUR 23 million will be paid out in 2019 to owners resigning or retiring. Read more about owner development 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 movements on actuarial gains or losses on defined benefit pension schemes, effects from disposal and acquisitions of non-controlling interests in subsidiaries and exchange rate differences in the owners' equity instruments. Furthermore, the common capital account is impacted by agreed contributions from new members of the cooperative.

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

Balances on Delivery-based owner certificates and Injected individual capital carry no interest.

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

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

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 and 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 and measured 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 that hedge 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 basis of the most recent annual report presented under IFRS. Individual capital accounts and reserve for special purposes are not covered by the non-impairment clause.

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

On initial recognition, minority interests are measured at either the fair value of the equity interest or the proportional share of the fair value of the acquired companies identified assets, liabilities and contingent liabilities. The measurement of minority interests is selected on a transactional basis, and disclosure is made in note 3.5 pertaining to business combinations.

Cash flow

(EURm)	Note	2018	2017
EBITDA		767	738
Reversal of gain from sale of enterprise	3.5	-	-44
EBITDA excluding gain from sale of enterprise		767	694
Reversal of share of results in joint ventures and associates	3.3	-29	-37
Change in net working capital	2.1	90	-200
Change in other receivables and other current liabilities		-73	8
Reversal of other operating items without cash impact		-43	-10
Dividends received, joint ventures and associates		11	7
Interest paid		-46	-52
Interest received		1	5
Taxes paid	5.1	-29	-29
Cash flow from operating activities		**649**	**386**
Investment in intangible fixed assets	3.1	-55	-50
Investment in property, plant and equipment	3.2	-383	-248
Sale of property, plant and equipment	3.2	13	12
Operating investing activities		-425	-286
Free operating cash flow		*224*	*100*
Sale of financial assets		44	-
Acquisition of enterprises	3.5	-51	-7
Sale of enterprises	3.5	-	74
Financial investing activities		-7	67
Cash flow from investing activities		**-432**	**-219**
Free cash flow		*217*	*167*

(EURm)	Note	2018	2017
Financing			
Supplementary payment regarding the previous financial year		-121	-120
Paid out from equity regarding terminated membership contracts		-38	-28
Loans obtained, net	4.2.c	5	32
Payment to pension liabilities		-37	-39
Cash flow from financing activities		**-191**	**-155**
Net cash flow		**26**	**12**
Cash and cash equivalents at 1 January		91	84
Exchange rate adjustment of cash funds		2	-5
Cash and cash equivalents at 31 December		**119**	**91**

Free operating cash flow	**2018**	**2017**
Specification		
Cash flow from operating activities	649	386
Operating investing activities	-425	-286
Free operating cash flow	**224**	**100**

Free cash flow	**2018**	**2017**
Cash flow from operating activities	649	386
Cash flow from investing activities	-432	-219
Free cash flow	**217**	**167**

Cash flow *(continued)*

Strong operational cash flow and increased investments

Cash flow from operating activities improved by 68 per cent to EUR 649 million compared with EUR 386 million last year. Net working capital contributed with a positive net cash release of EUR 90 million compared to last year, where we saw an adverse development of EUR 200 million. Net position of other working capital items increased mainly due to the repayment of a previously held VAT loan. Non-cash items were mainly affected by the revaluation gain from step-up acquisitions of Arla Foods Ingredients S.A. and Svensk Mjölk Ekonomisk förening.

After operating investments of EUR 425 million, explained by higher CAPEX investments, compared with EUR 286 million last year, the free operating cash flow ended at EUR 224 million. Free operating cash flow is a measure of the amount of cash generated by normal business operations.

As a result of our investing activities, primarily related to the purchase of Yeo Valley Dairies Ltd in UK and the acquisition of the remaining shares of Arla Foods Ingredients S.A. in Argentina, the free cash flow amounts to EUR 217 million. Free cash flow is a measure of the amount of cash generated after investing activities.

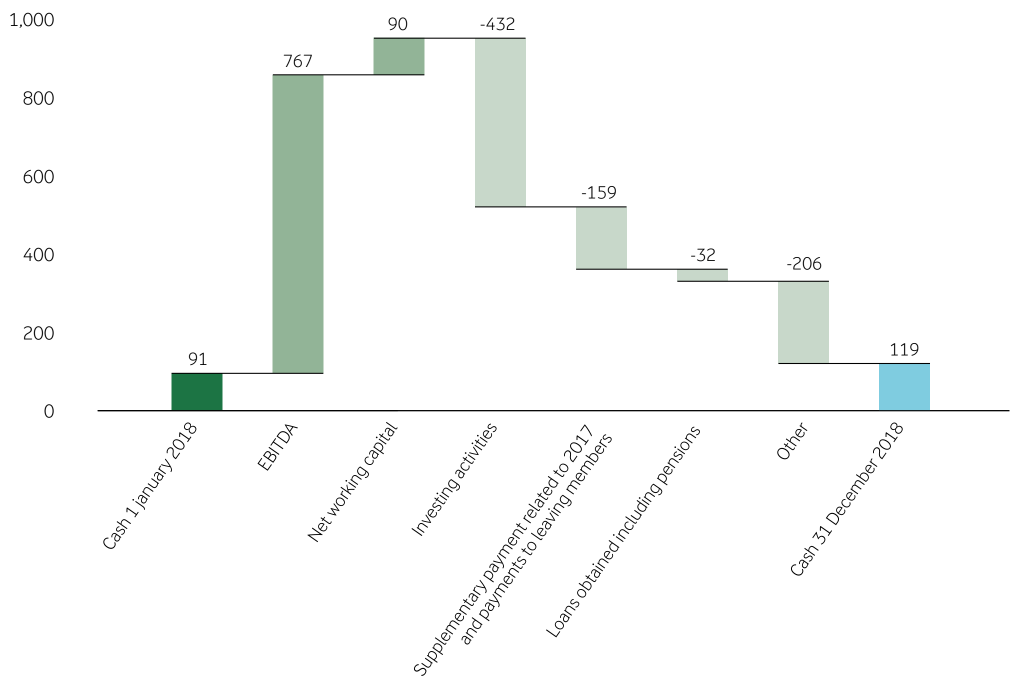
Cash flow from financing activities are changed with EUR 36 million from 2017 to 2018. A supplementary payment of EUR 121 million was made in relation to the 2017 profit allocation and further payments, representing EUR 38 million in individual capital, were paid out to owners who resigned or retired.

Combined cash and cash equivalents as at 31 December 2018 were EUR 119 million, compared to EUR 91 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 for more detail.

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 Financial Review pages 53-63, Note 1.4 and the Glossary page 123-124 for more details on performance price and other alternative performance measures.

Applying materiality

When preparing the annual report, management focuses 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 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 performed estimates and judgements are based on historical experience and other factors. By nature, these are associated with uncertainty and unpredictability, which can have a significant effect on the amounts recognised in the consolidated financial statements. The most significant accounting estimates relate to:

Measurement of revenue and rebates

Revenue, net of rebates, is recognised when goods are transferred to customers. Estimates are applied when measuring the accruals for rebates and other sales incentives. The majority of rebates are calculated using terms agreed with the customer. For some customer relationships, the final settlement of the rebate depends on future volumes, prices and other incentives. Thus, there is to some degree an element of uncertainty relating to the exact value. 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 our goodwill is allocated to activities in the UK. Following Brexit, expected cash flows supporting the carrying value of goodwill will be inherently more uncertain. Refer to Note 3.1.1 for more detail.

Assessing the level of influence and classification of investments

Following the acquisition of Gefleortens last year Arla was in 2018 allocated the majority of voting rights in Svensk Mjölk, Sweden. Based on this, management has concluded that the investment in the association should be reclassified from an associated company to a subsidiary. Furthermore management has assessed that representatives from the Group have significant influence in COFCO Dairy Holdings Limited and Lantbrukarnas Riksförbund. Based on this the investments have been classified as associated companies. Refer to Note 3.3 and 3.5 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 liabilities

Judgements are performed when setting actuarial assumptions such as discount rate, expected future salary increases, inflation and mortality. The actuarial assumptions vary from country to country, based on national economic and social conditions. They are set using available market data and compared with benchmarks to ensure that they are set consistently from year to year and in compliance with best practice. Refer to Note 4.7 for more detail.

Note 1.1 Revenue

Stronger sales mix and improved brand positions

Revenue increased by 0.8 per cent to EUR 10,425 million, compared to EUR 10,338 million last year. The underlying development in revenue, excluding currency effects and M&A activities, represents an increase of 2.0 per cent compared to last year. Improved product mix was the key driver for sales growth. Milk intake was 13.9 billion kg, which was virtually unchanged compared to the milk intake of 13.9 billion kg last year.

Revenue pertaining to strategic branded volume grew by 3.1 per cent, compared to 3.0 per cent last year. After a strong increase in sales prices last year, price levels decreased by 0.5 per cent for the full year.

Europe is Arla's largest commercial segment, comprising 62.4 per cent of total revenue, which represents a minor decrease of 0.9 per cent compared to last year. The revenue in Europe decreased by EUR 61 million, primarily driven by the negative impact from currencies of EUR 108 million, which was partially offset by the acquisitions of Yeo Valley Dairies Ltd (UK) and Gefleortens AB (Sweden). The strategic branded share in Europe comprised 50.4 per cent of revenue which is 2.1 percentage points higher compared to last year.

The international segment accounted for 15.1 per cent of total revenue, compared to 15.6 per cent last year. The international share of retail and foodservice revenue was 19.6 per cent compared to 20.2 per cent last year. The strategic branded revenue in International represented 85.0 per cent. The share of revenue for International was negatively affected by currency effects, primarily due to the development in the USD. Excluding currency, International's revenue increased by 1.7 per cent.

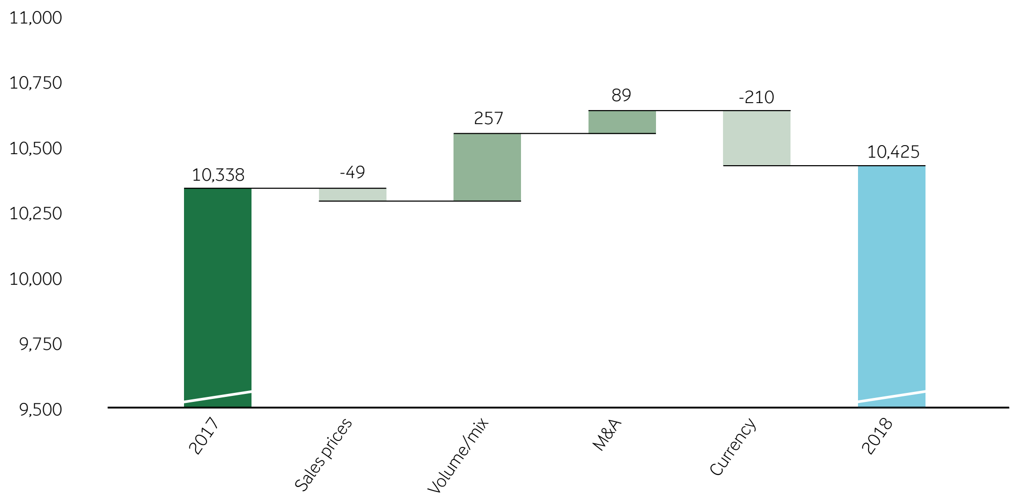
Arla Foods Ingredients comprised 6.3 per cent of the total revenue, which is unchanged compared with last year. Revenue increased due to more sales of value added products and the full consolidation of Arla Foods Ingredients S.A., our joint venture in Argentina. The increase was offset by a reduction in our third-party manufacturing business in China.

The trading and other segment represented 16.2 per cent of the total revenue and increased by 12.4 per cent to EUR 1.690 million versus EUR 1,503 million last year. This was a direct result of a strategic decision to increase trading activities in high margin commodities, and with less focus on milk trade.

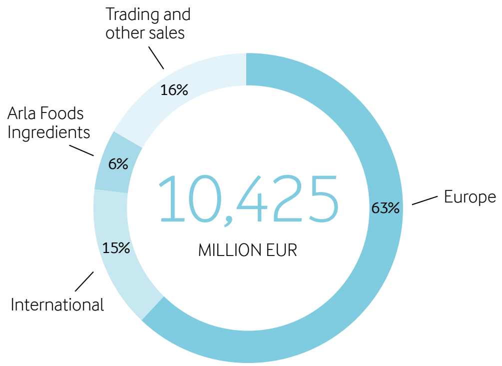
The purchase of Yeo Valley Dairies Ltd (UK) and the acquisition of the remaining shares in Arla Foods Ingredients S.A. (Argentina) combined with the full year revenue of Gefleortens AB (Sweden) purchased last year, contributed to a revenue increase of EUR 89 million.

Arla revenues were negatively impacted by exchange rate developments of EUR 210 million, driven primarily by the devaluation of the SEK, USD and GBP.

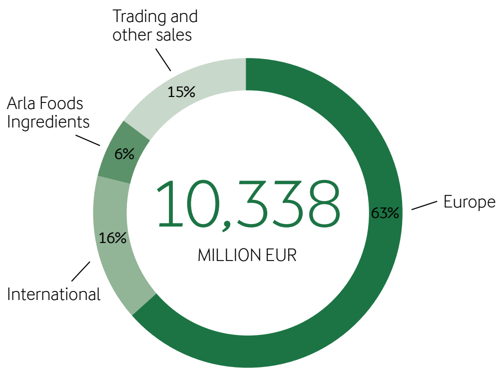
Development in revenue
(EURm)



Revenue split by commercial segment, 2018



Revenue split by commercial segment, 2017



Note 1.1 Revenue *(continued)*

Table 1.1.a Revenue split by country (EURm)	**2018**	**2017**	**Share of revenue in 2018**
United Kingdom	2,725	2,614	26%
Sweden	1,481	1,522	14%
Germany	1,447	1,525	14%
Denmark	1,094	1,031	10%
Netherlands	507	460	5%
Finland	320	304	3%
China	276	302	3%
Saudi Arabia	244	261	2%
Belgium	240	215	2%
USA	171	179	2%
Other*	1,920	1,923	19%
Total	**10,425**	**10,338**	

**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 30 to 35.

Table 1.1.b Revenue split by brand (EURm)	**2018**	**2017**
Arla®	3,034	3,026
Castello®	180	182
Lurpak®	561	528
Puck®	352	339
Milk based beverages	248	225
Other supported brands	375	367
Arla Foods Ingredients	652	651
Non-strategic brands and other	5,023	5,020
Total	**10,425**	**10,338**

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 the 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 significant reversal in the amount of revenue will not occur. This is commonly 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 the 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 sales volumes and prices, as well as other incentives. Thus, there is an element of uncertainty in estimating accruals and rebates.

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

Based on current milk price, Arla has contractually secured approximately EUR 230 million revenue related to raw milk sales for 2019 and approximately EUR 700 million for 2020 and later.

Note 1.2 Operational costs

Tight cost control challenged by higher production complexity

Operational costs increased 0.6 per cent to EUR 10,125 million compared to EUR 10,066 million last year.

Cost of production increased 1.2 per cent to EUR 8,163 million from EUR 8,063 million last year. Excluding costs relating to raw milk, production costs increased to EUR 3,356 million compared to EUR 3,015 million last year. Despite Calcium initiatives that led to savings across all functions, production costs increased. An increased focus on sales of branded products, handling of additional milk types and additional logistics costs to optimize our trading sales led to higher costs of EUR 274 million. Production cost levels were also impacted by higher market prices for energy and transportation. Due to decreasing milk prices, inventory reevaluation increased costs by EUR 77 million compared to last year. Finally, cost increased by EUR 73 million as a result of the acquisitions of new entities.

Sales and distribution costs decreased by 2.8 per cent, mainly due to currency effects and lower marketing spend. Research and development spend incurred amounted to EUR 47 million, compared to EUR 37 million last year. Additionally, EUR 20 million related to development activities was capitalised. Sales and distribution costs from newly acquired entities was EUR 10 million.

Administration costs increased by EUR 3 million, primarily due to redundancy costs and other expenses related to the transformation programme, Calcium. Refer to pages 21-23 for more on Calcium.

Cost of raw milk
The cost of raw milk decreased 4.8 per cent to EUR 4,807 million compared to EUR 5,048 million. This was primarily driven by lower commodity prices impacting our milk price.

Owner milk
Costs related to owner milk decreased by EUR 192 million, representing a decrease of 4.3 per cent. Higher volumes contributed to an increase of EUR 26 million while a lower average prepaid milk price decreased the costs by EUR 218 million.

Other milk
Costs of other milk decreased by EUR 49 million, equivalent to 8.6 per cent, due to lower volumes and lower market prices. Other milk consists of speciality milk and other contract milk acquired to meet local market demands.

Staff costs and FTE
Staff costs increased 2.3 per cent to EUR 1,246 million compared to EUR 1,218 million last year. Staff costs increased due to additional FTE's from the acquisition of new entities and due to inflation. Furthermore, staff costs increased by EUR 8 million because of a general court decision about Guaranteed Minimum Pensions equalisation in the UK where Arla had to recognise a onetime past service costs related to defined benefit plans. The development was partially offset by currency development.

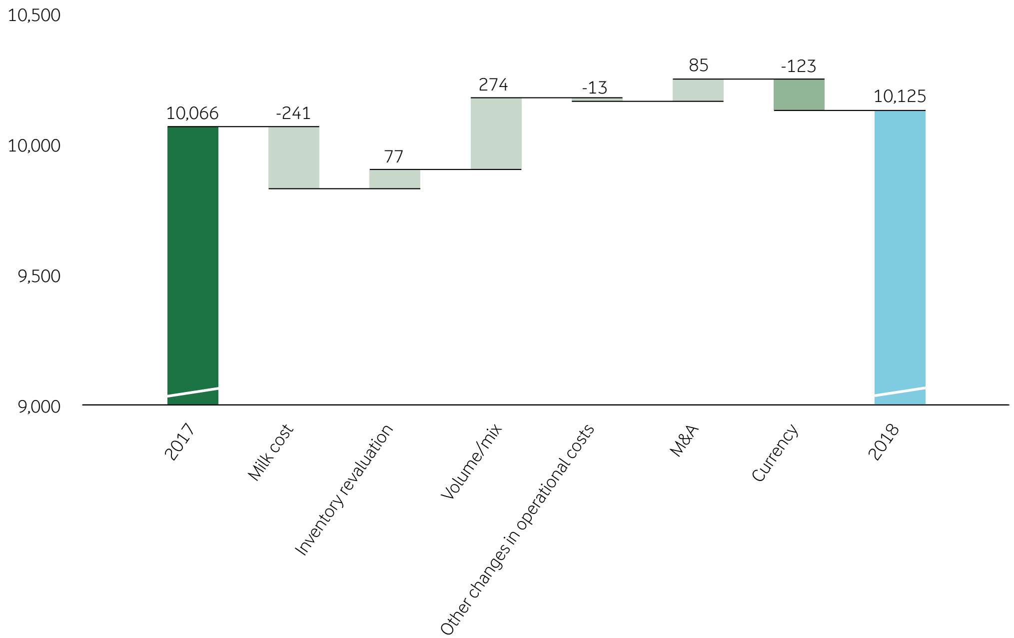
Within sales and distribution, as well as administration, staff costs increased 3.0 per cent. Staff cost related to production increased 1.7 per cent.

The total number of FTE's increased by 217 as a result of expansion in International and Arla Foods Ingredients. The increase was partially offset by reductions in most other markets as a result of Calcium.

Marketing spend
Marketing spend decreased 12.3 per cent to EUR 263 million compared to EUR 300 million last year. Improved efficiency including insourcing of key marketing activities, enabled by the Calcium transformation programme, allowed us to reduce spend. Major marketing investments included vitalising the Arla b rand through "inner strength" campaigns, the launch of Lurpak softest® in the UK and fueling digital customer engagement in the Middle East. Refer to page 23 for more detail.

Depreciation, amortisation and impairment
Depreciation, amortisation and impairment increased 2.8 per cent to EUR 363 million compared to EUR 353 million last year. This was due to higher investments.

Development in operational costs
(EURm)

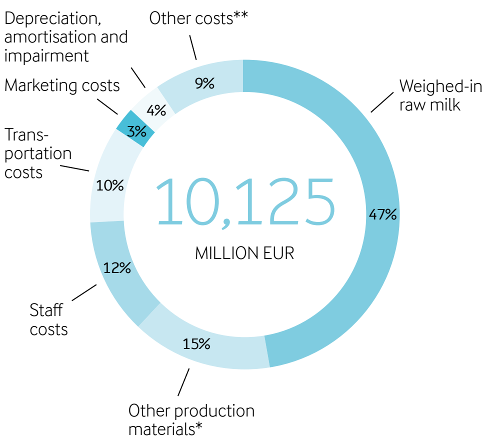


Note 1.2 Operational costs *(continued)*

Table 1.2.a Operational costs split by functions (EURm)	**2018**	**2017**
Production costs	8,163	8,063
Sales and distribution costs	1,540	1,584
Administration costs	422	419
Total	**10,125**	**10,066**
Specification:		
Weighed-in raw milk	4,807	5,048
Other production materials*	1,468	1,231
Staff costs	1,246	1,218
Transportation costs	1,037	1,002
Marketing costs	263	300
Depreciation, amortisation and impairment	363	353
Other costs**	941	914
Total	**10,125**	**10,066**

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

Cost split by type, 2018



Cost split by type, 2017

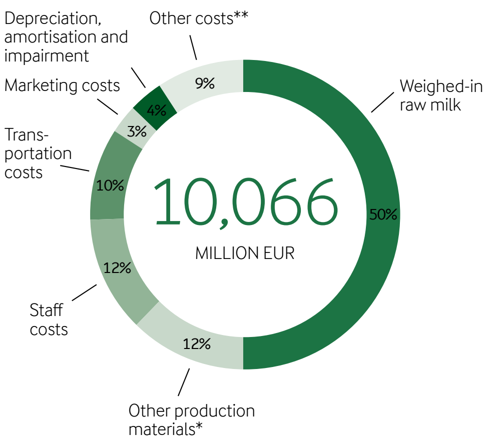


Table 1.2.b Weighed-in raw milk	**2018** Weighed in mio. kg	**2018** EURm	**2017** Weighed in mio. kg	**2017** EURm
Owner milk	12,446	4,286	12,373	4,478
Other milk	1,457	521	1,564	570
Total	**13,903**	**4,807**	**13,937**	**5,048**

Table 1.2.c Staff costs (EURm)	**2018**	**2017**
Wages, salaries and remuneration	1,055	1,034
Pensions - defined contribution plans	74	72
Pensions - defined benefit plans	11	4
Other social security costs	106	108
Total staff costs	**1,246**	**1,218**
Staff costs relate to:		
Production costs	703	691
Sales and distribution costs	331	336
Administration costs	212	191
Total staff costs	**1,246**	**1,218**
Average number of full-time employees	19,190	18,973

Table 1.2.d Depreciation, amortisation and impairment (EURm)	**2018**	**2017**
Intangible assets, amortisation	57	54
Property, plant and equipment, depreciation	306	299
Total depreciation, amortisation and impairment	**363**	**353**
Depreciation, amortisation and impairment relate to:		
Production costs	277	280
Sales and distribution costs	40	36
Administration costs	46	37
Total depreciation, amortisation and impairment	**363**	**353**

Note 1.2 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 reevaluation. 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 losses.

Note 1.3 Other operating income and costs

Positive impact from non-recurring items

Net other operating income amounted to EUR 75 million, compared to EUR 32 million last year. The increase is attributable to the settlement of disputes, revaluation gain from step acquisition of entities (see note 3.5) and negative effect from hedging activities. 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 settlement of disputes, revaluation gains from step acquisition of entities (see note 3.5), the net result from financial hedging activities and the net result from 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)	**2018**	**2017**
Other operating income	118	71
Other operating costs	-43	-39
	75	32
Specification:		
Income from settlement of disputes	47	-
Revaluation gain from step acquisition of entities	29	-
Effect from hedging activities, net	-5	29
Other items, net	4	3
Total other operating income, net	**75**	**32**

Note 1.4 Performance price

Lower market prices, partly countered by positive volume/mix and cost development, have led to slightly lower performance price

A key measure expressing Arla's overall performance is the performance price. This measures the value added to each kg of milk supplied by our farmer owners. The performance price is calculated as the standardised prepaid milk price, included in production costs, plus Arla Foods amba's share of profit for the year, divided by the milk volume weighed in 2018. The performance price was 36.4 EUR-cent/kg owner milk, compared to 38.1 EUR-cent/kg owner milk last year. Refer to page 56 for more detail.

Table 1.4 Performance price	**2018**			**2017**		
	EURm	Volume in mio. kg	EUR-cent/kg	EURm	Volume in mio. kg	EUR-cent/kg
Owner milk	4,286	12,446	34.4	4,478	12,373	36.2
Adjustment to standard milk (4.2% fat, 3.4% protein)			-0.3			-0.4
Profit for the year	290		2.3	285		2.3
Total		**12,446**	**36.4**		**12,373**	**38.1**

Note 2.1 Net working capital, other receivables and other current liabilities

Strong focus on inventories and payment terms improve working capital

Net working capital decreased by EUR 76 million to EUR 894 million, which corresponds to a decrease of 7.8 per cent compared to last year. Adjusted for M&A and currency exchange effects the cash release from net working capital was EUR 101 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, optimisation of inventory levels, improved payments terms, as well as utilization of supply finance programmes with our customers and suppliers. Overall the net working capital measured in days improved by 3.8 compared to last year. This is calculated as the change in trade receivables, inventories and trade payables relative to revenue respectively production value measured in days.

Excluding payables relating to owner milk, net working capital decreased by EUR 72 million.

Inventory

Inventory decreased by EUR 52 million to EUR 1,074 million, compared to EUR 1,126 million last year. Excluding currency and M&A effects, inventory decreased by EUR 63 million, mainly attributable to optimised inventory positions and milk price development.

Trade receivables

Trade receivables increased by EUR 47 million to EUR 989 million, compared to EUR 942 million last year. The net movement, excluding currency and M&A effects, was an increase of EUR 36 million. The increase was a result of a decision to reduce utilization of financing programmes offered by customers. This was possible due to a strong cash position and resulted in cost savings. Despite the increase in receivables, the overdues reduced by EUR 8 million compared to last year, due to strong focus on the collection process.

The implementation of IFRS 9 and the expected losses model on 1 January 2018, had only a minor effect on the valuation of trade receivables. Refer to note 5.6 for more detail.

Exposure to credit risk on trade receivables is guided by Group-wide policies. Credit limits are set based on the customer's financial position and current market conditions. Generally, Arla does not hold collateral as security for trade receivables. The customer portfolio is diversified in terms of geography, industry sector and customer size. The Group was not extraordinarily exposed to credit risk related to significant individual customers, but to the general credit risk in the retail sector. Historically, amounts written off as irrecoverable have been relatively low, which was also the case in 2018. EUR 2 million was recognized in the income statement as a loss arising on bad debt compared to EUR 4 million last year.

Trade and other payables

Trade and other payables increased by EUR 71 million, to EUR 1,169 million, compared to EUR 1,098 million last year. The movement in trade and other payables, excluding owner milk, currency and M&A effects, was an increase of EUR 69 million. The increase was driven by a Calcium initiative to further utilisation of global contracts, improved payment terms and the use of supply chain finance programmes. Payables related to owner milk remained at the same level as last year.

At 31 December 2018, a number of Arla's strategic suppliers participated in supply chain finance programmes, where the supply chain finance provider and related financial institutions act as a funding partner. When suppliers are participating in these programmes, the supplier has the option, at their own discretion and flexibility, to receive early payment from the funding partner based on the 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 a transaction that is exclusively between the supplier and the supply chain finance provider.

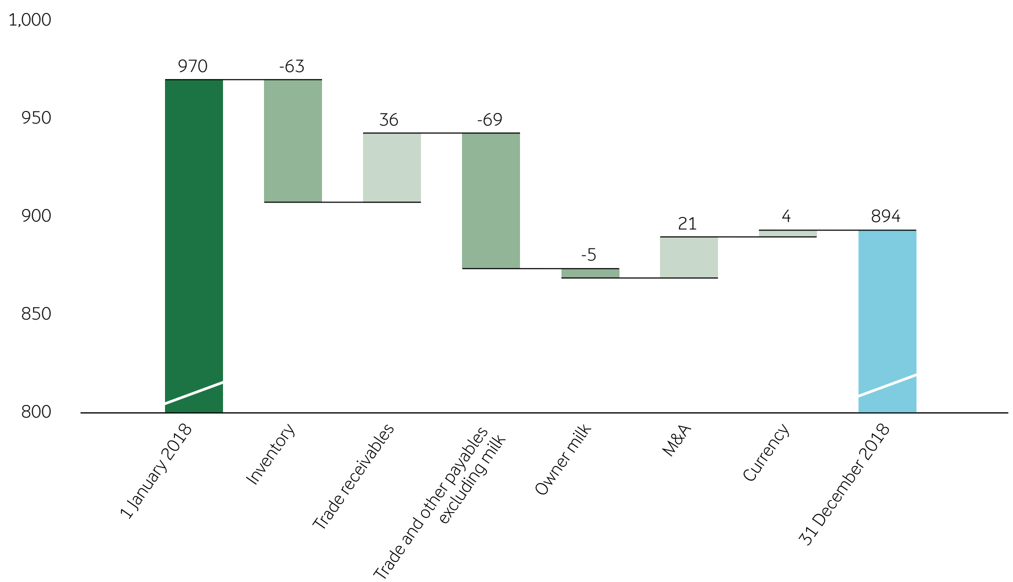
The liability for Arla, which is in the form of the invoice, is recognised within trade and other payables until maturity. The programme, which provides extended payment terms, is one of many components of the overall relationship between strategic suppliers and Arla in order to improve the cash position for both parties. Should a supply chain finance programme be terminated, the liquidity risk for Arla is limited, hence Arla will continue to maintain the payment terms to each single supplier. The payment terms for suppliers that are participating in the programmes are no more than 180 days. These programmes have a positive effect on our net working capital position.

Other receivables and other current liabilities

Other receivables increased EUR 72 million to EUR 254 million compared to EUR 182 million last year. Other receivables include, but are not limited to, VAT receivables, deposits and subsidies. The increase is mainly attributable to repayment of a VAT loan that in previous years was netted of against corresponding VAT receivables.

Other current liabilities increased EUR 13 million to EUR 292 million compared to from EUR 279 million last year. Other current liabilities include HR related payables of EUR 170 million.

Development in net working capital
(EURm)



Note 2.1 Net working capital, other receivables and other current liabilities *(continued)*

Table 2.1.a Net working capital
(EURm)

	2018	2017
Inventory	1,074	1,126
Trade receivables	989	942
Trade and other payables	-1,169	-1,098
Net working capital	**894**	**970**

Net working capital
(EURm)

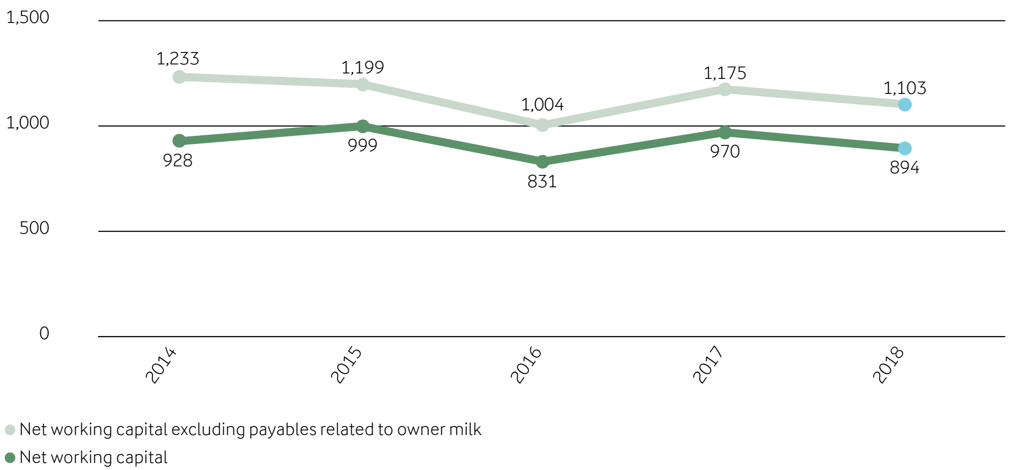


Table 2.1.b Inventory
(EURm)

	2018	2017
Inventory before the write-downs	1,099	1,153
Write-downs	-25	-27
Total inventory	**1,074**	**1,126**
Raw materials and consumables	260	264
Work in progress	332	366
Finished goods and goods for resale	482	496
Total inventory	**1,074**	**1,126**

Table 2.1.c Trade receivables
(EURm)

	2018	2017
Trade receivables before provision for expected losses	1,000	954
Provision for expected losses (incurred losses in 2017)	-11	-12
Total trade receivables	**989**	**942**

Table 2.1.d Trade receivables overdue
(EURm)

	2018		2017	
	Gross carrying amount	Expected loss rate	Gross carrying amount	Incurred loss rate
Not overdue	808	0%	755	0%
Overdue less than 30 days	131	0%	145	0%
Overdue between 30 & 89 days	33	3%	33	3%
Overdue more than 90 days	28	29%	22	41%
Total trade receivables	**1,000**		**954**	

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

Note 2.1 Net working capital, other receivables and other current liabilities *(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. The calculated expected losses are adjusted for specific significant negative developments in geographical areas. In 2017 the loss on trade receivables was based on the incurred loss model in accordance with IAS 39.

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

Intangible asset increased due to acquisitions

Intangible assets amounted to EUR 887 million, representing an increase of EUR 76 million compared to last year.

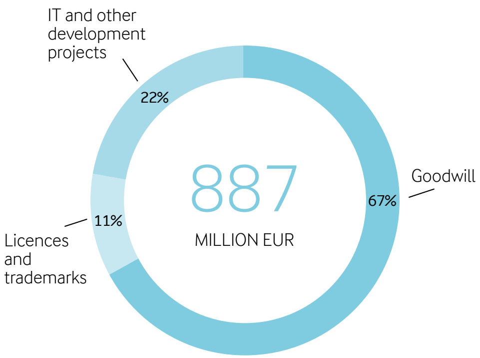
Goodwill
The carrying value of goodwill amounted to EUR 597 million, compared to EUR 596 million last year. Goodwill increased due to the acquisition of Arla Foods Ingredients S.A., Argentina, largely offset by currency effects. Of the total carrying value of goodwill, EUR 463 million related to activities in the UK, compared to EUR 470 million last year. This decrease in goodwill was due to exchange rate adjustments. Refer to Note 3.1.1 for more detail.

Licences and trademarks
The carrying value of licences and trademarks recognised amounted to EUR 96 million, compared to EUR 26 million last year. The increase was due to trademarks recognised in relation to the acquisition of Yeo Valley and the consolidation of Svensk Mjölk. Other major brands include Cocio®, Anchor® and Hansano®.

The strategic brands, Arla®, Lurpak®, Castello® and Puck®, are internally generated trademarks and are therefore not capitalised. 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.

IT and other development projects
The carrying value of IT and other development projects was EUR 194 million, compared to EUR 189 million last year. The Group continued to invest in the development of IT. In 2018 the Group continued strengthening its SAP access controls, whilst also introducing comprehensive solutions to support GDPR governance and the product life cycle management process. Other capitalised development costs include innovation activities and the development of new products.

Intangible assets, 2018



Intangible assets, 2017

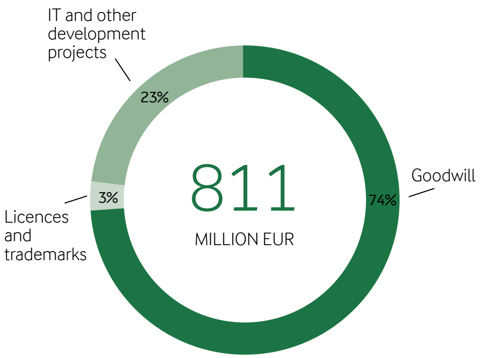


Table 3.1.a Intangible assets
(EURm)

	Goodwill	Licenses and trademarks	IT and other development projects	Total
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	-	0	-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**
2017				
Cost at 1 January	615	100	327	1,042
Exchange rate adjustments	-19	-2	-2	-23
Additions	-	-	50	50
Mergers and acquisitions	1	1	-	2
Reclassification	-	-	7	7
Disposals	-	-	-2	-2
Cost at 31 December	**597**	**99**	**380**	**1,076**
Amortisation and impairment at 1 January	-	-70	-147	-217
Exchange rate adjustments	-	2	2	4
Amortisation and impairment for the year	-1	-5	-48	-54
Amortisation on disposals	-	-	2	2
Amortisation and impairment at 31 December	**-1**	**-73**	**-191**	**-265**
Carrying amount at 31 December	**596**	**26**	**189**	**811**

Note 3.1 Intangible assets *(continued)*

Accounting policies

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

		2018	2017
Europe	UK	463	470
	Finland	40	40
	Sweden	23	23
	Europe general	60	60
Europe total		**586**	**593**
International	Russia	2	3
International total		**2**	**3**
Arla Foods Ingredients	Agentina	9	-
Arla Foods Ingredients total		**9**	**-**
Total		**597**	**596**

Note 3.1.1 Impairment test of goodwill

Goodwill supported by positive market development despite Brexit uncertainty

Goodwill is allocated to the relevant activities within the commercial segments, primarily to our activities in the UK and Finland, within the Europe commercial segment where it is monitored for internal management purposes.

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. 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.

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. Other key assumptions are made around sustainability of various cost reduction initiatives.

Test results
Impairment testing showed that there was no need for impairment in 2018. In this regard, sensitivities to changes in milk prices and discount rates were calculated. Uncertainties relating to Brexit were reflected as risk adjusted cash flow in the impairment test. The discount rate could rise up to 3 percentage points, before the goodwill in the UK would be at risk of being impaired. The underlying performance in Finland has improved in 2018 compared to last year. The impairment test performed, showed that expected future cash flow can support the carrying value of our net assets, including goodwill.

Table 3.1.1 Impairment tests
(EURm)

	Applied key assumptions	
	Discount rate, net of tax	Discount rate, before tax
2018		
UK	7.1%	8.7%
Finland	6.3%	7.8%
Sweden	6.4%	8.2%
Europe general*	6.3%	7.1%
2017		
UK	6.9%	8.4%
Finland	6.3%	7.6%
Sweden	6.5%	8.3%
Europe general*	6.4%	7.1%

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

Note 3.1 Intangible assets *(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 are determined based on the management structure and internal financial reporting. The cash-generating units and grouping 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 unit of which the asset is part of.

An impairment loss on other non-current assets is recognised in the income statement under production costs, sales and distribution costs or administration costs, respectively. Impairment 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 are defined based on the management structure for Commercial segments and are 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 during the budget period 2019-2020. 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 includes moving milk intake into value-added products, more profitable markets and cost reduction initiatives. The growth rate beyond the strategy period has been set to the expected inflation rate in the terminal period and assume 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 20 for more on Brexit.

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

Note 3.2 Property, plant and equipment

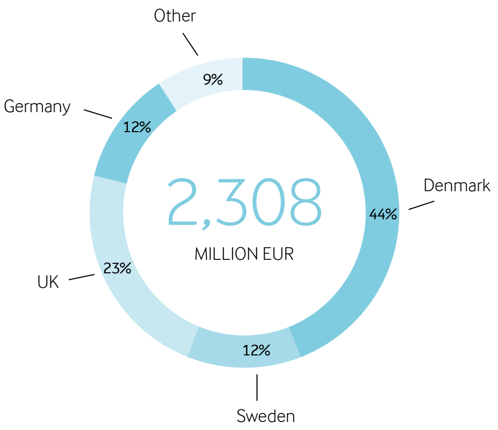
Strategic capital expenditure supporting innovation

Arla's main tangible assets are located in Denmark, the UK, Germany and Sweden. The carrying value increased by EUR 96 million to EUR 2,308 million in 2018, driven by increased capital expenditure (CAPEX) investments in property, plant and equipment.

CAPEX investments increased 54.4 per cent to EUR 383 million compared to EUR 248 million last year. This reflects the significantly increased CAPEX investment budget for 2018 as approved by the Board of Directors. However, due to the scope and timing of projects, the investments have not fully materialised to the level of CAPEX expenditure. The increase is mainly seen within assets in course of construction, reflecting increased investments in 2018 that are not yet finalised and capitalised in the other main asset categories.

Major investments in 2018 included a general upgrade and expansion of production facilities with a particular focus on our ingredients business, optimising production capacity within the yoghurt and nutrition categories as well as initial investments in powder capacity expansion.

Property, plant and equipment by country, 2018



Property, plant and equipment by country, 2017

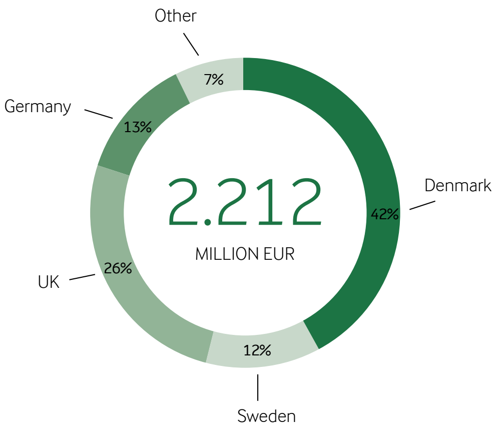


Table 3.2.a Property, plant and equipment
(EURm)

	Land and building	Plant and machinery	Fixture and fitting, tools and equipment	Asset in course of construc-tion	**Total**
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**
Of which assets held under finance lease	-	1	1	-	**2**
2017					
Cost at 1 January	1,430	2,664	500	164	**4,758**
Exchange rate adjustments	-28	-41	-14	-2	**-85**
Additions	5	30	7	206	**248**
Mergers and acquisitions	2	4	-	2	**8**
Transferred from assets in course of construction	43	142	29	-214	**-**
Disposals	-36	-19	-13	-	**-68**
Reclassification	26	-14	-7	-4	**1**
Cost at 31 December	**1,442**	**2,766**	**502**	**152**	**4,862**
Depreciation and impairments at 1 January	-573	-1,499	-376	-	**-2,448**
Exchange rate adjustments	9	23	10	-	**42**
Depreciation for the year	-46	-209	-44	-	**-299**
Depreciation on disposals	30	13	13	-	**56**
Reclassification	-22	14	7	-	**-1**
Depreciations and impairment at 31 December	**-602**	**-1,658**	**-390**	**-**	**-2,650**
Carrying amount at 31 December	**840**	**1,108**	**112**	**152**	**2,212**
Of which assets held under finance lease	34	18	2	-	**54**

Note 3.2 Property, plant and equipment *(continued)*

Investments and depreciation property, plant and equipment
(EURm)

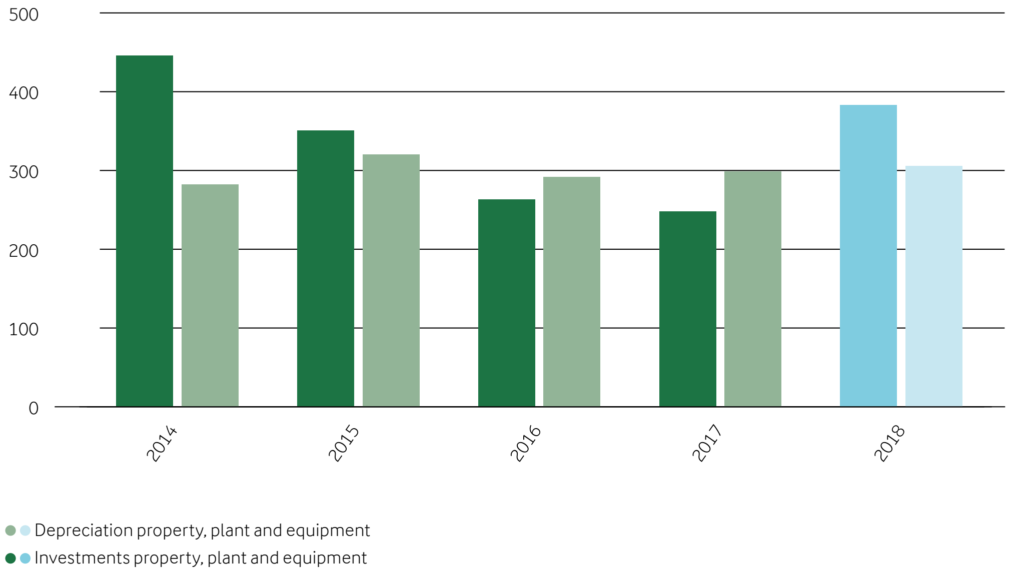


Table 3.2.b Estimated useful life in years	2018	2017
Office buildings	50	50
Production buildings	20-30	20-30
Technical facilities	5-20	5-20
Other fixtures and fittings, tools and equipment	3-7	3-7

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 3.3 Associates and Joint ventures

Financial comments

Share in result in joint ventures and associates decreased 22 pct to EUR 29 million compared with EUR 37 million last year. This primarily consist of recognised results from our investments in Mengniu and LRF. The lower result follows the acquisition of the remaining shares in Arla Foods Ingredients S.A., Argentina where after the result from this is entity is no longer recognised as results from joint ventures. The recognised value of associates decreased to EUR 386 million compared to EUR 401 million due to the step acquisition of Svensk Mjölk. Refer to Note 3.5 for more detail.

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 311 million, compared to EUR 295 million last year. The carrying amount of the investment in COFCO includes goodwill amounting to EUR 147 million, compared to EUR 140 million last year driven by the development in USD and CNY.

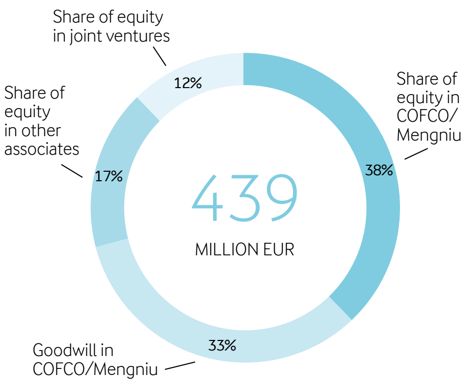
The fair value of the indirect share in Mengniu equals EUR 567 million, compared to EUR 519 million last year based on the official listed share price at 31 December 2018.

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 7,890 million and a result of EUR 266 million in 2017. 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 decreased to EUR 32 million compared to EUR 53 million last year due to the acquisition of the remaining shares in Arla Foods Ingredients S.A., Argentina. The investment was previously classified as a joint venture. In October 2017, the investment in Vigor Alimentos S.A, Brazil was divested, realising a gain on EUR 44 million. The carrying value does not include goodwill. Refer to Note 3.5 for more detail.

Recognised value of associates, 2018



Recognised value of associates, 2017

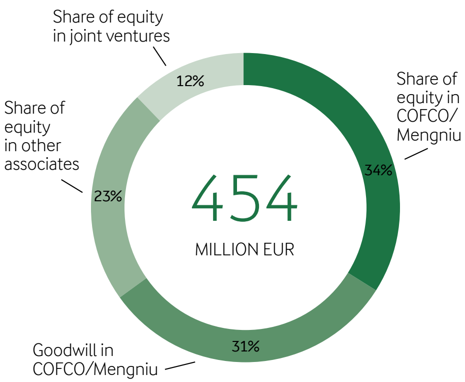


Table 3.3.a Associates and Joint ventures
Reconciliation of recognised value of associates
(EURm)

	2018	2017
Share of equity in COFCO/Mengniu	165	155
Goodwill in COFCO/Mengniu	147	140
Share of equity in other associates	74	106
Recognised value of associates	**386**	**401**
Share of equity of joint ventures	53	53
Recognised value of associates and joint ventures	439	454

Table 3.3.b Material associates
Financial information for associates that are considered material to the Group*
(EURm)

	COFCO Dairy Holdings Limited 2018	COFCO Dairy Holdings Limited 2017
Revenue	5	12
Results after tax	5	12
Non-current assets	683	656
Dividends received	3	2
Ownership share	30%	30%
Group share of result after tax	19	16
Recognised value	311	295

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

Fair value based on listed share price	567	519

Note 3.3 Joint ventures and associates *(continued)*

Table 3.3.c Transactions with joint ventures and associates (EURm)	**2018**	**2017**
Sales of goods to joint ventures	4	14
Sales of goods to associates	37	78
Total sale of goods to joint ventures and associates	**41**	**92**
Purchase of goods from joint ventures	62	57
Total purchase of goods from joint ventures and associates	**62**	**57**
Trade receivables joint ventures*	2	18
Trade receivables associates*	10	9
Total trade receivables joint ventures and associates	**12**	**27**
Trade payables joint ventures*	-2	9
Total trade payables joint ventures and associates	**-2**	**9**

** Included in other receivables and other payables*

Accounting policies

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

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

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

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

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

An impairment test is performed when there is objective evidence of impairment, such as significant adverse changes in the environment in which the equity-accounted investee operates, or a significant or prolonged decline in the fair value of the investment below its carrying value.

Where the equity-accounted investment is considered to be an integral part of a cash generating unit (CGU), the impairment test is performed at the CGU level, using expected future net cash flow of the CGU. An impairment loss is recognised when the recoverable amount of the equity-accounted investment (or CGU) becomes lower than the carrying amount. The recoverable amount is defined as the higher of value in use, and fair value less costs to sell, of the equity-accounted investment (or CGU).

Uncertainties and estimates

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

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 the underlying agreements, it is our assessment that Arla has significant influence in Mengniu.

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

Based on a detailed analysis of the LRF arrangement, Arla's active ownership interest constitutes significant influence over LRF. This includes, but is not limited to, 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 28 million in 2018, compared to EUR 23 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. A general provision for occupational injuries of EUR 7 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 2018
Arla acquired the remaining 50 per cent of the shares in the joint venture, Arla Foods Ingredients S.A, acquired 100 per cent of the shares in Yeo Valley Dairies Ltd, and gained control in Swedish Mjölk ek för.

The total purchase price for the aforementioned transactions was EUR 127 million, of which EUR 51 million was paid in 2018. Net assets acquired amounted to EUR 118 million, resulting in an addition to goodwill of EUR 9 million.

Arla Foods Ingredients S.A., Argentina
In February 2018, Arla acquired 50 per cent of the shares in Arla Foods Ingredients S.A located in Argentina. As a result, the Group's equity interest increased from a 50 per cent owned joint venture to a 100 per cent fully owned subsidiary. The assets that were acquired as a result of obtaining control of whey-based production facilities and related working capital items. Goodwill recognised amounts to EUR 9 million, which relates the value of future synergies following full ownership. A fair value assessment based on the original investment holding was performed, which generated a EUR 11 million gain was recognised in the income statement as other operating income. Refer to Note 1.3 for more detail.

Argentina has recently been classified as a country with hyperinflation. The majority of the sales in Arla Foods Ingredients S.A. are carried out in USD. Similarly, a substantial part of both the operational costs, investments and funding are in USD. Arla has assessed that the functional currency of the Company is USD and not ARS. Currency adjustments pertaining to local transactions denoted in ARS are recognised within other financial income and costs.

In 2018, the revenue contribution from the Arla Foods Ingredients S.A. transaction was EUR 45 million.

Yeo Valley Dairies Ltd., UK
In July 2018, Arla acquired 100 per cent of the shares in Yeo Valley Dairies Ltd, a UK based Company. As part of the transaction, Arla was provided a license to use the Yeo Valley brand for products within the categories of fresh milk, cheese butter and spreadable. The acquisition is in line with Arla's strategy on branded organic products. The net assets acquired primarily consist of the value of the license agreement that will be amortised over 20 years. No goodwill was recognised as part of the transaction. In 2018 the revenue contribution from the Yeo Valley transaction was EUR 47 million. The effect on profit was insignificant due to initial integration activities.

Svensk Mjölk ek för, Sweden
As a result of the acquisition of Gefleortens in 2017, Arla was in 2018 allocated the majority of the voting rights in both the Board of Directors and at the General Assembly for Svensk Mjölk ek för, a Swedish dairy association, whose activities include ownership of three Swedish cheese brands. Following obtaining control, the investment was reclassified from associate to a subsidiary. The net assets recognised primarily consist of trademarks, which will be amortised over 10 years. After obtaining control of the entity, a fair value assessment of the previous investment held was performed, which generated a EUR 17 million gain that was recognised in the income statement as other operating income. Refer to Note 1.3.

Acquisitions during 2017

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

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

Divestments during 2017
As a strategic choice to reduce our involvement in the Brazilian market, Arla divested its shares in the Brazilian based associate, Vigor Alimentos S.A, recognising a gain of EUR 44 million in 2017. The investment had previously been classified as an associated company.

Table 3.5.a Mergers and acquisitions
(EURm)

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

Note 3.5 Purchase and sale of business or activities *(continued)*

Table 3.5.b Sale of business or activities in 2017
(EURm)

Selling price on divestment of enterprise	74
Cash transferred as part of the transaction	-
Net cash received	74
Other assets transferred	-30
Liabilities transferred	-
Gain on divestment	**44**

Accounting policies

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

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

In a business combination achieved in stages (step acquisition), the shareholding held immediately before the step acquisition is remeasured at fair value at the acquisition date. The resulting gain or loss is recognised in the income statement as a gain or loss from the sale of the enterprise. 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 goodwill that arises, which is not amortised, is tested annually for impairment. The methodology outlined above also applies to mergers with other cooperatives, where the owners of the acquired company become owners of Arla Foods amba. The purchase consideration is calculated at the acquisition date when fair values of the assets transferred and equity instruments issued. Positive differences between the consideration and fair value are recognised as goodwill.

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

Enterprises divested are recognised in the consolidated income statement up to the date of disposal. Comparative figures are not restated to reflect disposals. 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 to when this should be effective from.

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

Lower financial costs

Net financial costs decreased by EUR 2 million, to EUR 62 million in 2018, mainly due to currency adjustments.

Net interest costs amounted to EUR 52 million, representing a decrease of EUR 5 million compared to last year due to a lower average level of net interest-bearing debt, whilst average interest costs, excluding pension liabilities, were 2.6 per cent and equal to last year. Interest cover increased to 14.8 per cent compared to 12.9 per cent last year.

Exchange rate losses were at a lower level compared to last year. The exchange rate losses predominantly is a result of converting liquidity from surplus currencies, into currencies with funding needs.

Table 4.1 Financial income and financial costs (EURm)	2018	2017
Financial income:		
Interest securities, cash and cash equivalents	1	5
Fair value adjustments and other financial income	1	8
Total financial income	**2**	13
Financial costs:		
Interest on financial instruments measured at amortised cost	-47	-53
Net exchange rate losses	-13	-18
Interest on pension liabilities	-6	-9
Interest transferred to property, plant and equipment	6	6
Fair value adjustments and other financial costs, net	-4	-3
Total financial costs	**-64**	-77
Net financial costs	**-62**	-64

Accounting policies

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

Capitalisation of interest was performed by using an interest rate, matching the Group's average external interest rate in 2018. Financial income and costs relating to financial assets and financial liabilities were recognised using the effective interest method.

Note 4.2 Net interest-bearing debt

Lower pension liabilities resulting in reduced net-interest bearing debt

Net interest-bearing debt, excluding pension liabilities, increased slightly to EUR 1,647 million compared to EUR 1,636 million last year. A solid operational cash flow from the underlying business and working capital was offset by higher capital expenditure, acquisitions and the supplementary payment for 2017.

Net pension liabilities decreased EUR 57 million to EUR 220 million mainly due to higher interest rate level, contributions and currency effects. As a result, net interest-bearing debt, including pension liabilities, amount to EUR 1,867 million compared to EUR 1,913 million last year.

The leverage ratio was 2.4, a decrease of 0.2 compared to last year and outperformed the long-term target range of 2.8 and 3.4, underpinning a strong financial position.

The average maturity of interest-bearing borrowings decreased by 0.1 years to 5.6 years. The 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 measured 37 per cent, compared to 36 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 creditor 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 loan.

The credit facilities contain financial covenants on equity/total assets and minimum equity, as well as standard non-financial covenants. The Group did not default on, or fail to fulfil any loan agreements in 2018.

During 2018 the Group raised the following mix of funding:

- A new five-year bond issue totalling SEK 1.5 billion (EUR 146 million), to refinance a SEK 1.5 billion bond issue that matured in 2018.
- A EUR 100 million loan dedicated to fund R&D activities.
- Arla had a commercial paper program in Sweden denominated in SEK and EUR. The average utilization in 2018 was EUR 175 million. Arla obtained debt with a negative interest, including the credit margin.
- 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 was in 2016 exstraordinary affected by the divestment of Rynkeby. Adjusted for this leverage would have been 2.8.

Leverage
2.4
2017: 2.6

Table 4.2.a Net interest-bearing debt (EURm)	2018	2017
Securities, cash and cash equivalents	-584	-602
Other interest-bearing assets	-10	-8
Long-term borrowings	1,369	1,206
Short-term borrowings	872	1,040
Net interest-bearing debt excluding pension liabilities	**1,647**	**1,636**
Net pension liabilities	220	277
Net interest-bearing debt including pension liabilities	**1,867**	**1,913**

Note 4.2 Net interest-bearing debt *(continued)*

Table 4.2.b Borrowings
(EURm)

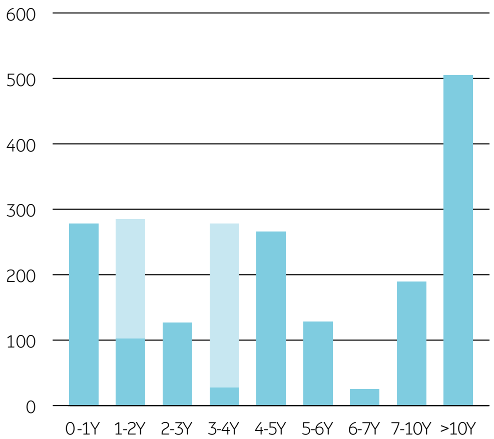
	2018	2017
Long-term borrowings:		
Issued bonds	244	254
Mortgage credit institutions	796	790
Bank borrowings	329	160
Finance lease liabilities	-	2
Total long-term borrowings	**1,369**	**1,206**
Short-term borrowings:		
Issued bonds	146	152
Commercial papers	112	213
Mortgage credit institutions	-	9
Bank borrowings	600	628
Finance lease liabilities	2	11
Other current liabilities	12	27
Total short-term borrowings	**872**	**1,040**
Total interest-bearing borrowings	**2,241**	**2,246**

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

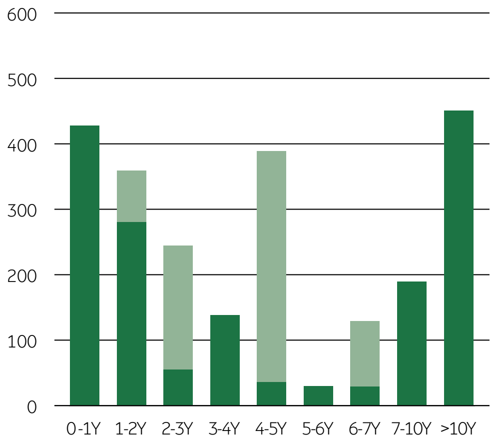
		Cash flow	Non-cash changes				
	1 January	Included in financing activities	Acqui-sitions	Reclasses	Foreign exchange move-ments	Fair value changes	31 December
2018							
Pension liabilities	277	-37	1	-1	-7	-9	224
Long-term borrowings	1,206	247	6	-78	3	-15	1,369
Short-term borrowings	1,040	-242	-	77	-3	-	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**
2017							
Pension liabilities	369	-39	2	-1	-9	-45	277
Long-term borrowings	1,281	-19	-	-26	-18	-12	1,206
Short-term borrowings	967	58	-	26	-11	-	1,040
Total interest-bearing debt	**2,617**	**-**	**2**	**-1**	**-38**	**-57**	**2,523**
Securities and other Interest-bearing assets	-516	11	-	-	3	-17	-519
Cash	-84	-12	2	-2	5	-	-91
Net interest-bearing debt	**2,017**	**-1**	**4**	**-3**	**-30**	**-74**	**1,913**

Note 4.2 Net interest-bearing debt *(continued)*

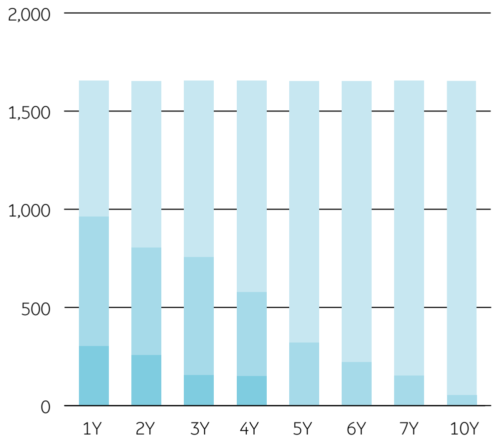
Maturity of net interest-bearing debt excluding pension liabilities at December 2018
(EURm)



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



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



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

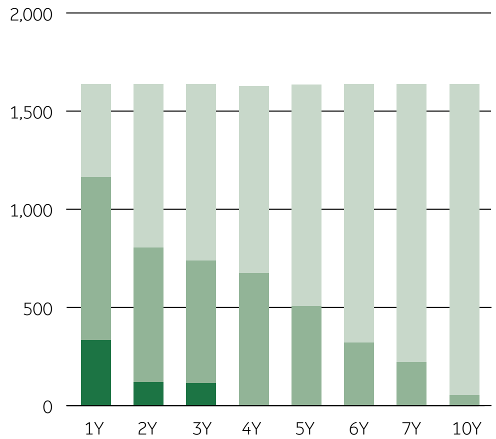


Table 4.2.d Net interest-bearing debt excluding pension liabilities, maturity
(EURm)

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**

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

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

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**
2017			
DKK	815	-	815
SEK	639	-457	182
EUR	136	254	390
GBP	16	203	219
Other	30	-	30
Total	**1,636**	**-**	**1,636**

Note 4.2 Net interest-bearing debt *(continued)*

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

2018	Interest rate	Average interest rate	Fixed for	Carrying amount	Interest rate risk
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**	

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

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

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 costs.

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 costs
Financial assets measured at amortised costs 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 as 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 the income statement
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 financial 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, are impacted by the development in currencies, interest rates and certain types of commodities. The global financial markets are volatile and thus it is critical for the Group to have a properly implemented financial risk management approach in place to mitigate short-term market volatility, whilst simultaneously achieving the highest possible milk price.

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

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

Note 4.3.1 Liquidity risk

Adequate liquidity reserves

Liquidity reserves decreased by EUR 392 million, to EUR 646 million in 2018. Due to a strong balance sheet, the Group reduced its liquidity reserves to an adequate level, in order to reduce costs.

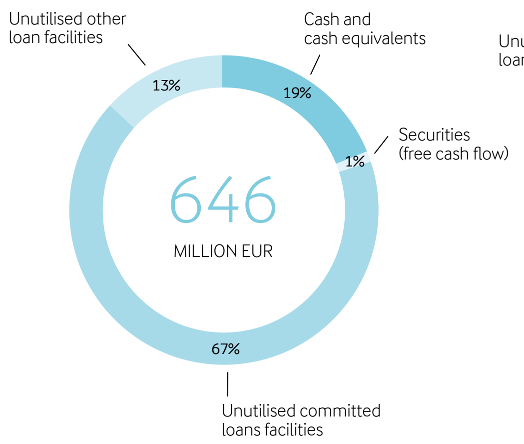
Ensuring availability of sufficient operating liquidity and credit facilities for operations is the primary goal of managing liquidity risk. Inspired by the liquidity models suggested by the rating agencies, the liquidity reserves are assessed as adequate for the coming 12 month.

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 achieves a cost-efficient utilisation of credit facilities.

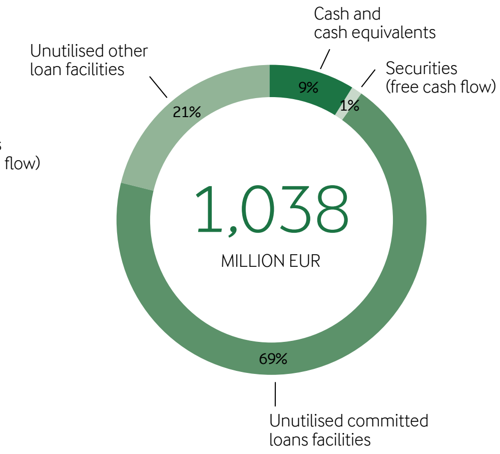
Table 4.3.1.a Liquidity reserves
(EURm)

	2018	2017
Cash and cash equivalents	119	91
Securities (free cash flow)	7	6
Unutilised committed loan facilities	434	721
Unutilised other loan facilities	86	220
Total	**646**	**1,038**

Liquidity reserves, 2018



Liquidity reserves, 2017



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	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 payable	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**

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

Assumptions
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.

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

	2018	2017	Policy Minimum	Policy Maximum
Average maturity, gross debt	5.6 years	5.7 years	2 years	-
Maturity < 1 year, net debt	-	-	-	25%
Maturity > 2 year, net debt	92%	97%	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, cost and financial position

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

Transactions effects are 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 decreased by EUR 24 million compared to last year due to 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 13 million was recognised in financial costs compared to a net loss of EUR 18 million 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 14 million was recognised within other cost compared to a gain of EUR 29 million last year. A loss from hedges will be expected in years where export currencies strengthen during the year and vice versa.

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 decreased by EUR 186 million compared to the revenue reported last year. Correspondingly costs were reduced by EUR 180 million in comparison 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 2018 a net amount of EUR -13 million was recognised in other comprehensive income compared to EUR -73 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 SEK, USD and GBP weakened by 6 per cent, 5 per cent and 1 per cent respectively.

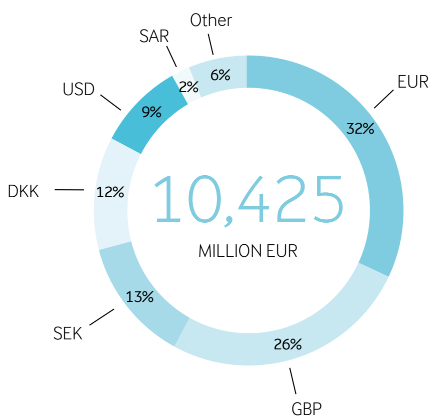
Despite the average rate for the USD and SAR being weaker when compared with last year, the USD and SAR strengthened by 4 per cent during 2018. This was the primary reason that hedging activities delivered a loss of EUR 14 million.

26 per cent of the Group's revenue is in GBP. Due to uncertainties surrounding Brexit Arla decided to hedge a significant proportion of the 2019 export to the UK by purchasing options. Consequently, the downside risk on GBP is limited for the export flow in 2019.

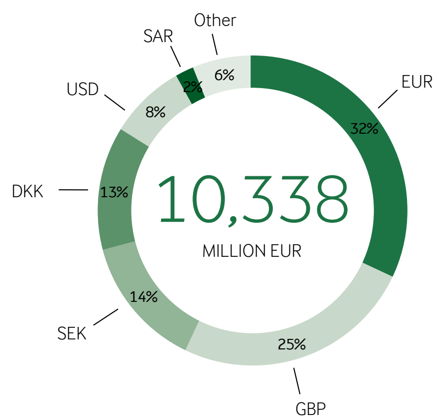
The Group is increasingly involved in emerging markets where efficient hedging is often not feasible due to currency regulations, illiquid financial markets or expensive hedging costs. These markets are mainly Nigeria, Dominican Republic, Bangladesh, Ivory Coast, Senegal and Egypt.

Our business in Saudi Arabia is a large part of the Group's export to MENA. SAR has been pegged to the USD since 1986. However, given the uncertainty regarding the Saudi Arabia economy, Arla monitors the currency situation closely and is hedged for longer than it would normally be.

Revenue split by currency in 2018



Revenue split by currency in 2017



Note 4.3 Financial risks *(continued)*

Table 4.3.2.a Exchange rates	Closing rate			Average rate		
	2018	**2017**	Change	**2018**	**2017**	Change
EUR/GBP	0.901	0.888	-1.4%	0.885	0.876	-0.9%
EUR/SEK	10.261	9.848	-4.2%	10.253	9.632	-6,5%
EUR/DKK	7.467	7.445	-0.3%	7.453	7.439	-0.2%
EUR/USD	1.145	1.194	4.2%	1.180	1.128	-4.6%
EUR/SAR	4.293	4.479	4.2%	4.426	4.229	-4.6%

Table 4.3.2.b Currency exposure (EURm)	EUR/DKK	USD/DKK*	GBP/DKK	SEK/DKK	SAR/DKK
2018					
External exposure:					
Financial liabilities	-250	-118	-89	-728	-5
Financial assets	255	181	164	56	91
Derivatives	-640	-296	-852	496	-252
Net external exposure	**-635**	**-233**	**-777**	**-176**	**-166**
Internal exposure:					
Financial assets	130	11	342	7	14
Derivatives	47	-	217	202	-
Net internal exposure	**177**	**11**	**559**	**209**	**14**
Net exposure	**-458**	**-222**	**-218**	**33**	**-152**
The net exposure relates to:					
Hedging of expected commercial cash flow that qualify for hedge accounting	-	-379	-279	-	-
Hedging of expected commercial cash flow where hedge accounting is not used	-458	-	61	-	-152
Exposure not hedged	-	157	-	33	-
Applied sensitivity	1%	5%	5%	5%	5%
Impact on profit or loss	-5	8	3	2	-8
Impact on other comprehensive income	-	-19	-14	-	-

** Incl. AED*

Table 4.3.2.b Currency exposure (EURm)	EUR/DKK	USD/DKK*	GBP/DKK	SEK/DKK	SAR/DKK
2017					
External exposure:					
Financial liabilities	-155	-15	-212	-844	-2
Financial assets	164	218	123	34	76
Derivatives	-367	-398	-803	592	-153
Net external exposure	**-358**	**-195**	**-892**	**-218**	**-79**
Internal exposure:					
Financial assets	268	3	522	8	13
Derivatives	47	-	192	210	-
Net internal exposure	**315**	**3**	**714**	**218**	**13**
Net exposure	**-43**	**-192**	**-178**	**-**	**-66**
The net exposure relates to:					
Hedging of expected commercial cash flow that qualify for hedge accounting	-	-235	-192	-	-58
Hedging of expected commercial cash flow where hedge accounting is not used	-43	-	-	-	-8
Exposure not hedged	-	43	14	-	-
					-
Applied sensitivity	1%	5%	5%	5%	5%
Impact on profit or loss	-	2	1	-	-
Impact on other comprehensive income	-	-12	-10	-	-3

** Incl. AED*

Note 4.3 Financial risks *(continued)*

Risk mitigation

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

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 can 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 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 at 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 4.3.3 Interest rate risk

Limited hedging activities due to decreased debt levels

The average duration of the Group's interest on interest-bearing debt, including derivatives, but excluding pension liabilities, has decreased by 0.6 to 3.2. The duration is reduced due to matured interest rate hedges and a reduction in time to maturity on the remaining hedges.

Even though interest rates were low in 2018, our hedging activity was limited due to the low level of net interest-bearing debt.

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

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

Note 4.3 Financial risks *(continued)*

Risk mitigation

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

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

Cash flow sensitivity
A change in interest rates will impact interest rate payments on the Group's unhedged floating rate debt. Table 4.3.3 shows the one-year cash flow sensitivity, depicting a 1 per cent increase in interest rates on the unhedged floating rate for instruments recognised as at 31 December 2018. A decrease in the interest rate would have an 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	
	2018	**2017**	Minimum	Maximum
Duration	3.2	3.8	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 4.3.4 Commodity price risk

Difficult hedging conditions in a volatile marked

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, in Denmark, Germany, Sweden and the UK. The total energy commodity spend, excluding taxes and distribution costs, amounts to approximately EUR 100 million per year.

The purpose of hedging is to reduce volatility in costs related to energy. In 2018, hedging activities have resulted in gains of EUR 9 million. The result of hedging activities, classified as hedge accounting, is recognised in other income and costs

In 2018, approximately 41 per cent of our energy spend was hedged. At the end of 2018, 42 per cent of the energy spend for 2019 was hedged. A 25 per cent increase in commodity prices would negatively impact profit by approximately EUR 16 million. Conversely, other comprehensive income would be positively impacted by EUR 18 million.

Table 4.3.4 Hedged commodities
(EURm)

			Potential accounting impact	
	Sensitivity	Contract value	Income statement	Other comprehen-sive income
2018				
Diesel / natural gas	25%	-3	-8	12
Electricity	25%	4	-8	6
2017				
Diesel / natural gas	25%	1	- 10	5
Electricity	25%	-	-5	2

Note 4.3 Financial risks *(continued)*

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 4.3.5 Credit risk

Limited losses

In 2018 the Group continued to experience very limited losses from defaulting counterparties such as customers, suppliers and financial counterparties.

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

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

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

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

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

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

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

Note 4.3 Financial risks *(continued)*

Table 4.3.5 External rating of financial counterparties
(EURm)

	Assets, carrying amount	Qualifying for netting	Net assets exposure	Liabilities, carrying amount	Qualifying for netting	Net liabilities exposure
2018						
AA-	8	8	-	41	8	33
A+	4	4	-	11	4	7
A	20	18	2	27	18	9
A-	5	5	-	6	5	1
Total	**37**	**35**	**2**	**85**	**35**	**50**
2017						
AA-	3	3	-	39	3	36
A+	4	4	-	11	4	7
A	7	7	-	36	7	29
A-	5	1	4	1	1	-
Total	**19**	**15**	**4**	**87**	**15**	**72**

In addition, the Group has entered into sales and repurchase agreements on mortgage bonds. Refer to Note 4.6 for more detail.

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 as the Group has decided to grow and invest in emerging markets.

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

Note 4.4 Derivative financial instruments

Hedging of future cash flows
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)

	Carrying value	Fair value recognised in other comprehensive income	Expected recognition 2019	2020	2021	2022	Later than 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**

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

Table 4.4.b Value adjustment of hedging instruments (EURm)	**2018**	**2017**
Deferred gains and losses on cash flow hedges arising during the period	-7	11
Value adjustments of hedging instruments reclassified to other operating income and costs	-5	29
Value adjustments of hedging instruments reclassified to financial items	15	11
Value adjustments of hedging instruments reclassified to production costs	-	-3
Total value adjustment of hedging instruments recognised in other comprehensive income during the year	**3**	**48**

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 disclosed

Table 4.5.a Categories of financial instruments (EURm)	**2018**	**2017**
Derivatives	28	12
Shares	10	12
Financial assets measured at fair value through the income statement	**38**	**24**
Securities	465	511
Financial assets measured at fair value through other comprehensive income	**465**	**511**
Currency instruments	4	5
Interest rate instruments	-	-
Commodity instruments	5	2
Derivative assets used as hedging instruments	**9**	**7**
Trade receivables	989	942
Other receivable	254	182
Financial assets measured at amortised cost	**1,243**	**1,124**
Derivatives	7	8
Financial liabilities measured at fair value through the income statement	**7**	**8**
Currency instruments	7	1
Interest rate instruments	67	77
Commodity instruments	4	1
Derivative liabilities used as hedging instruments	**78**	**79**
Long term borrowings	1,369	1,206
Short term borrowings	872	1,040
Trade payables and other payables	1,169	1,098
Financial liabilities measured at amortised cost	**3,410**	**3,344**

Table 4.5.b Fair value hierarchy - carrying amount (EURm)	Level 1	Level 2	Level 3	Total
2018				
Financial assets:				
Bonds	466			466
Shares	10			10
Derivatives		37		37
Total financial assets	**476**	**37**	**-**	**513**
Financial liabilities:				
Issued bonds		390		390
Mortgage credit institutions	796			796
Derivatives		85		85
Total financial liabilities	**796**	**475**	**-**	**1,271**
2017				
Financial assets:				
Bonds	511			511
Shares	12			12
Derivatives		19		19
Total financial assets	**523**	**19**	**-**	**542**
Financial liabilities:				
Issued bonds		406		406
Mortgage credit institutions	799			799
Derivatives		87		87
Total financial liabilities	**799**	**493**	**-**	**1,292**

Note 4.5 Financial instruments disclosed *(continued)*

Risk mitigation

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

Bonds and shares
The fair value is determined using 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.

Table 4.6 Transfer of financial assets
(EURm)

	Carrying value	Notional amount	Fair value
2018			
Mortgage bonds	461	455	461
Repurchase liability	-461	-454	-461
Net position	**-**	**1**	**-**
2017			
Mortgage bonds	504	499	504
Repurchase liability	-498	-497	-498
Net position	**6**	**2**	**6**

Note 4.7 Pension liabilities

Reduced pension liabilities

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 220 million, which represents a decrease of EUR 57 million compared to last year. The carrying value of defined benefit plans improved in the UK primarily due to actuarial gains.

Pension plans in Sweden
The defined benefit plan in Sweden does not currently require the Group to make cash contributions. The recognised net liability was EUR 199 million, a decrease of EUR 1 million compared to last year. An actuarial loss of EUR 9 million was offset by currency translation.

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

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 4 million, representing an improvement of EUR 51 million compared to last year. The improvement is primarily related to actuarial gains of EUR 76 million, due to a higher discount rate applied in assumptions (+0.4%), and payments to the plans of EUR 15 million while adverse movement in the value of plan assets reduced the improvement of the overall position by EUR 38 million. The Trustee agreed to sell all investments in diversified growth funds due to relatively high investment manager fees as well as the fact that diversification can be obtained through individual investments in different asset classes. Following a ruling in the High Court in October 2018 regarding guaranteed minimum pensions in the UK EUR 8 million was recognized as an additional service cost.

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 amounts to EUR -1,235 million by end of 2018 vs. EUR -1,289 million by end of 2017.

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. During 2018 the investment portfolio has been significantly adjusted to improve the asset/liability match, increase flexibility and at the same time save investment manager fee's without jeopardising the expected return. By the end of 2018 the interest hedging of the liabilities was 57% (33% by end of 2017) and the inflation hedge inflation linked assets was 61% (59% by end of 2017), thereby reducing the overall risk.

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
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**
2017				
Present value of funded liabilities	210	1,336	38	1,584
Fair value of plan assets	-11	-1,289	-20	-1,320
Deficit of funded plans	**199**	**47**	**18**	**264**
Present value of unfunded liabilities	1	-	12	13
Net pension liabilities recognised on the balance sheet	**200**	**47**	**30**	**277**
Specification of total liabilities:				
Present value of funded liabilities	210	1,336	38	1,584
Present value of unfunded liabilities	1	-	12	13
Total liabilities	**211**	**1,336**	**50**	**1,597**

Note 4.7 Pension liabilities *(continued)*

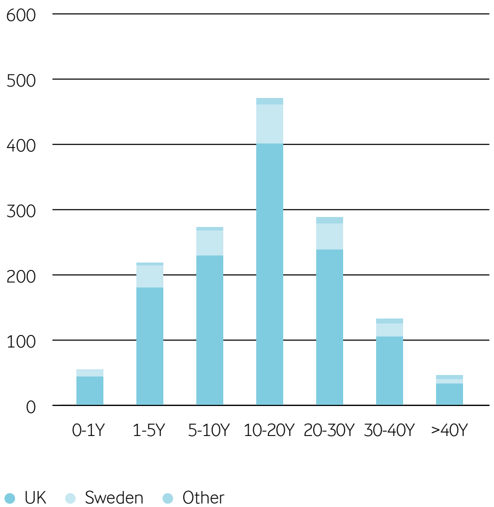
Table 4.7.b Development in pension liabilities (EURm)	**2018**	**2017**
Present value of liability at 1 January	1,597	1,679
Reclassification	-6	-3
New pension liability from acquired companies	1	2
Paid in by employees	-	1
Current service cost	10	3
Interest cost	38	42
Actuarial gains and losses from changes in financial assumptions (OCI)	-69	-4
Actuarial gains and losses from changes in demografic assumptions (OCI)	4	0
Benefits paid	-65	-60
Exchange rate adjustment	-25	-63
Present value of pension liability at 31 December	**1,485**	**1,597**

Table 4.7.c Development in fair value of plan assets (EURm)	**2018**	**2017**
Fair value of plan assets at 1 January	1,320	1,310
Reclassification	-	-2
Interest income	32	33
Return on plan assets, excluding amounts included in net interest on the net defined benefit liability	-40	54
Contributions to plans	27	30
Benefits paid	-55	-50
Administration expenses	-1	-1
Exchange rate adjustments	-18	-54
Fair value of plan assets at 31 December	**1,265**	**1,320**

The Group expects to contribute EUR 26 million to the plan assets in 2019 and EUR 96 million in 2020-2023.

Actual return on plan assets:		
Calculated interest income	32	33
Return excluding calculated interest	-40	54
Actual return	**-8**	**87**

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



Maturity of pension liability, at 31 December 2017
(EURm)

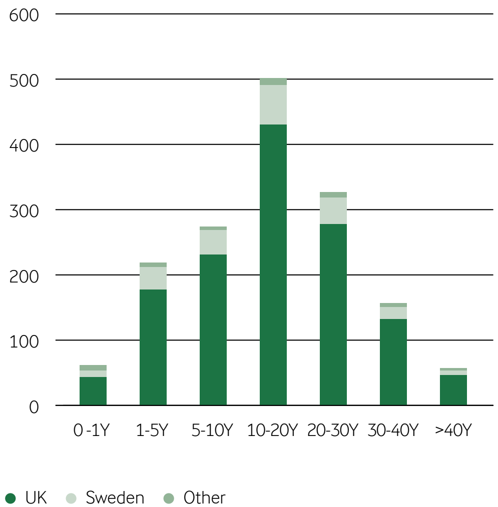


Table 4.7.d Sensitivity of pension liabilities to key assumptions (EURm)

	2018	**2018**	**2017**	**2017**
Impact on pension liabilities at 31 December	+	-	+	-
Discount rate +/- 10bps	-14	16	-19	20
Expected salary increases +/- 10bps	2	-2	2	-2
Life expectancy +/- 1 year	59	-58	64	-64
Inflation +/- 10 bps	15	-14	17	-17

Note 4.7 Pension liabilities *(continued)*

Table 4.7.e Pension assets recognised (EURm)	**2018**	**%**	**2017**	**%**
Liability hedge portfolio	364	29%	163	12%
Debt vehicles	274	21%	224	17%
Bonds	200	16%	154	12%
Equity instruments	166	13%	165	12%
Properties	117	9%	100	8%
Infrastructure	59	5%	70	5%
Diversified growth funds	-	0%	355	27%
Other assets	85	7%	89	7%
Total assets	**1,265**	**100%**	**1,320**	**100%**

Table 4.7.f Recognised in the income statement for the year (EURm)	**2018**	**2017**
Current service cost	10	3
Administration cost	1	1
Curtailments and settlements	-	-
Recognised as staff costs	**11**	**4**
Interest cost on pension liability	38	42
Interest income on plan assets	-32	-33
Recognised as financial cost	**6**	**9**
Total amount recognised in the income statement	**17**	**13**

Table 4.7.g Recognised in other comprehensive income (EURm)	**2018**	**2017**
Actuarial gains and losses on liabilities from changes in financial assumptions (OCI)	69	4
Actuarial gains and losses on liabilities from changes in demographic assumptions (OCI)	-4	-
Return on plan assets, excluding amounts included in net interest on the net defined benefit liability	-40	54
Re-measurements of defined benefit schemes	**25**	**58**

Table 4.7.h Assumptions for the actuarial calculations (EURm)	**2018**	**2017**
Discount rate, Sweden	2.4%	2.5%
Discount rate, UK	2.9%	2.5%
Expected payroll increase, Sweden	2.3%	2.3%
Expected payroll increase, UK	2.5%	2.5%
Inflation (CPI), Sweden	1.9%	1.9%
Inflation (CPI), UK	3.1%	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 the plan members, and not the Group. Amounts payable for contributions to defined contribution plans are expensed in the income statement as incurred.

Defined benefit plans
Defined benefit plans are characterised by the Group's pension liabilities 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 increased to EUR 41 million, compared to EUR 22 million last year. The underlying driver for the increase in tax costs was changes in deferred tax for the year arising in the UK and Finland

Current income tax
Current income taxes paid during 2018 totaled EUR 29 million, which is similar to last year.

Deferred tax
Net deferred tax liabilities amounted to EUR 54 million, which represents an increase of EUR 38 million compared to last year. The movement in the year is driven by the tax costs reported in the income statement of EUR 20 million, an increase in deferred tax liabilities totaling EUR 12 million, as a result of the full consolidation of Svensk Mjölk ek för and Arla Foods Ingredients S.A. and an increase in tax recognised in other comprehensive income of EUR 7 million due to a decrease in pension liabilities.

Net deferred tax liabilities for 2018 comprise of gross deferred tax liabilities of EUR 84 million mainly relate to taxable temporary differences on intangible fixed assets, property, plant and equipment and other temporary differences. These are offset by deferred tax assets of EUR 30 million on deductible temporary differences pertaining to property, plant and equipment, tax losses carried forward, and pension liabilities.

Table 5.1.a Tax recognised in the income statement (EURm)	**2018**	**2017**
Current income tax		
Current income tax on result for the year relating to:		
Cooperative tax	7	7
Corporate income tax	17	19
Adjustment for current tax of previous years	-2	-3
Total current income tax costs	**22**	**23**
Deferred tax		
Change in deferred tax for the year	20	2
Adjustment for deferred tax of previous years	1	-3
Impact of changes in tax rates and laws	-2	-
Total deferred tax costs/income	**19**	**-1**
Total tax costs in the income statement	**41**	**22**

Table 5.1.b Calculation of effective tax rate (EURm)	**2018**		**2017**	
Profit before tax		348		321
Tax applying the statutory Danish corporate income tax rate	22.0%	76	22.0%	71
Effect of tax rates in other jurisdictions	-2.7%	-9	-4.7%	-15
Effect of companies subject to Cooperative taxation	-15.5%	-54	-18.8%	-61
Tax-exempt income, less non-deductible costs	-2.4%	-8	-2.6%	-8
Impact of changes in tax rates and laws	-0.6%	-2	-	-
Adjustment for tax cost of previous years	-0.3%	-1	-1.9%	-6
Other adjustments	11.3%	39	12.9%	41
Total	**11.8%**	**41**	**6.9%**	**22**

Note 5.1 Tax *(continued)*

Table 5.1.c. Deferred tax (EURm)	**2018**	**2017**
Deferred tax liabilities at 1 January	-16	-6
Deferred tax recognised in income statement	-21	1
Deferred tax recognised in other comprehensive income	-7	-11
Acquisitions in connection with business combinations	-12	0
Impact of change in tax rates	2	-1
Exchange rate adjustments	0	1
Deferred tax liabilities at 31 December	**-54**	**-16**
Deferred tax, by gross temporary difference		
Intangible assets	-10	-3
Property, plant & equipment	3	9
Provisions, pension liabilities and other assets	-7	15
Tax losses carried forward	8	8
Other	-48	-45
Total deferred tax, by gross temporary difference	**-54**	**-16**
Recognised in the balance sheet as:		
Deferred tax assets	30	43
Deferred tax liabilities	-84	-59
Total	**-54**	**-16**

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 8 million. Temporary differences on which deferred tax assets have not been recognised totaled EUR 51 million, of which EUR 38 million 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 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 on 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 business combinations.

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)	**2018**	**2017**
Statutory audit	1.4	1.4
Other assurance engagements	0.1	-
Tax assistance	0.8	1.3
Other services	0.5	0.7
Total fees to auditors	**2.8**	**3.4**

Note 5.3 Management remuneration and transactions

Remuneration paid to management

The BoD's remuneration is assessed and adjusted on a bi-annual basis and approved by the Board of Representatives. The last adjustment made was in 2017 and therefore the BoD's remuneration was unchanged in 2018. Principles applied to the remuneration of the Board of Directors are described on page 43. Members of the Board of Directors are paid for milk supplies to Arla Foods amba, in accordance with the terms for the other owners of the Company. Similarly, individual capital instruments are issued the Board of Directors on the same terms as to other owners.

Following the retirement of Executive Vice President and Vice CEO, Povl Krogsgaard, in January 2018, the Executive Board was in 2018 represented by the Executive Director in solitary. The Executive Board assumes the authority and responsibility for planning, directing and controlling the Group's activities. Principles applied for the remuneration of the Executive Board, Executive Management Team and other senior leaders are described on page 43.

Table 5.3.a Management remuneration (EURm)	**2018**	**2017**
Board of Directors		
Wages, salaries and remuneration	1.3	1.3
Total	**1.3**	**1.3**
Executive Board/CEO		
Fixed compensation	1.5	2.2
Pension	0.2	0.2
Other benefits	-	0.1
Short-term variable incentives	0.1	0.6
Long-term variable incentives	0.3	0.2
Total	**2.1**	**3.3**

Note 5.3 Management remuneration and transactions *(continued)*

Table 5.3.b Transactions with the Board of Directors (EURm)	2018	2017
Purchase of raw milk	14.9	14.0
Supplementary payment regarding previous years	0.5	0.4
Total	**15.4**	**14.4**
Unsettled milk deliveries in trade and other payables	0.7	1.2
Individual capital instruments	1.8	1.4
Total	**2.5**	**2.6**

Note 5.4 Contractual commitments, contingent assets and liabilities

Financial comment

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.

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

Table 5.4 Contractual commitments and contingent liabilities (EURm)	2018	2017
Guarantee commitments	2	2
0-1 years	61	53
1-5 years	113	108
Over 5 years	23	43
Operating rent and lease commitments	**197**	**204**

Commitments in relation to IT licenses and agreements on the purchase of property, plant and equipment was EUR 148 million 31 December compared to EUR 132 million 31 December last year..

Uncertainties and estimates

The Group has entered into a number of lease agreements. Management regularly assesses the substance of the agreements in order to classify the lease agreements as either financial or operating leases. The Group mainly entered into lease agreements for standardised assets that are short-term in relation to the asset's useful lives.

As such, the lease agreements have been classified as operating leases. Effective 1 January 2019 IFRS 16 Leasing standard will be applicable. Arla is currently preparing for implementation of this standard. Refer to note 5.6 for more detail.

Note 5.5 Subsequent events after the balance sheet date

In December 2018, Arla signed an agreement with Mondeléz International to acquire their Bahrain based processed cheese business. The planned acquisition will significantly strengthen Arla's footprint in the Middle East complimenting the existing activities with a local state-of-the-art production site and a branded business within the cheese category. Closing is dependent on certain conditions to be fulfilled and is expected to take place during the first half of 2019.

No other subsequent events with a material impact on the financial statements occurred after the balance sheet date.

Note 5.6 General accounting policies

Consolidated financial statements

The consolidated financial statements included in this annual report are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU, and additional disclosure requirements in the Danish Financial Statement Act for class C large companies. Arla is not an EU public interest entity as the Group has no debt instruments traded on a regulated EU market place. The consolidated financial statements were authorised for issue by the company's Board of Directors on 19 February 2019 and presented for approval by the Board of Representatives on 27 February 2019.

The consolidated financial statements are prepared as a compilation of the parent company's and the individual subsidiaries' financial statements, prepared under the Group's accounting policies. Revenue, costs, assets and liabilities, along with items included in equity of subsidiaries are aggregated and presented on a line-by-line basis. Intra-group shareholdings, balances and transactions, as well as any unrealised income and expenses arising from intra-group transactions are eliminated.

The consolidated financial statements comprise Arla Foods amba (parent company) and the subsidiaries in which the parent company directly or indirectly holds more than 50 per cent of the voting rights, or otherwise maintains control to obtain benefits from its activities. Entities in which the Group exercises joint control through a contractual arrangement are considered to be joint ventures. Entities in which the Group exercises a significant but not a controlling influence, are considered as associates. A significant influence is typically obtained by holding or having at the Group's disposal, directly or indirectly, more than 20 per cent, but less than 50 per cent, of the voting rights in an entity.

Unrealised gains arising from transactions with joint ventures and associates, i.e. profits from sales to joint ventures or associates and whereby the customer pays with funds partly owned by the Group, are eliminated against the carrying amount of the investment in proportion to the Group's interest in the company. Unrealised losses are eliminated in the same manner, but only to the extent that there is no evidence of impairment.

The consolidated financial statements are prepared on a historical cost basis, except for certain items with alternative measurement bases, which are identified in these accounting policies.

Translation of transactions and monetary items in foreign currencies

For each reporting entity in the Group, a functional currency is determined, being the currency used in the primary economic environment where the entity operates. Where a reporting entity transacts in a foreign currency, it will record the transaction in its functional currency using the transaction date rate. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency using the exchange rate applicable at the reporting date. Exchange differences are recognised in the income statement under financial items. Non-monetary items, for example property, plant and equipment which are measured based on historical cost in a foreign currency, are translated into the functional currency upon initial recognition.

Translation of foreign operations

The assets and liabilities of consolidated entities, including the share of net assets and goodwill of joint ventures and associates with a functional currency other than EUR, are translated into EUR using the year-end exchange rate. The revenue, costs and share of the results for the year are translated into EUR using the average monthly exchange rate if this does not differ materially from the transaction date rate. Foreign currency differences are recognised in other comprehensive income and accumulated in the translation reserve.

On partial divestment of associates and joint ventures, the relevant proportional amount of the cumulative foreign currency translation adjustment reserve is transferred to the results for the year, along with any gains or losses related to the divestment. Any repayment of outstanding balance considered part of the net investment is not in itself considered to be a partial divestment of the subsidiary.

Adoption of new or amended IFRS

The Group implemented all new standards and interpretations effective in the EU from 2018. None of these newly adopted standards and interpretations had an impact on the consolidated financial statements of Arla. IASB issued a number of new or amended and revised accounting standards and interpretations that have not yet come into effect. Arla expects to incorporate the new standards when they become mandatory.

IFRS 9 – Financial instruments

In November 2016, the EU endorsed IFRS 9 "Financial Instruments", which is effective for annual periods beginning on or after 1 January 2018. IFRS 9 replaces IAS 39 and changes the classification and measurement of financial assets and liabilities.

IFRS 9 introduces a logical classification of financial assets based on the Group's business model and its underlying cash flow. Furthermore, a new "expected loss"-model is introduced, as opposed to an incurred credit loss model under IAS 39. The expected loss model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk.

Furthermore, new requirements for hedge accounting will be more closely aligned to the Group's business risk management policies. An assessment of the Group's current hedging relation- ships confirms that they will qualify as continuing hedging relationships upon application of IFRS 9.

The Group has applied IFRS 9 prospectively with the initial application date of 1 January 2018. This means that 2018 figures are reported using IFRS 9 principles while the comparative figures for 2017 are reported applying IAS 39. Our analysis confirms that application of the new standard did not have a material impact on recognition, measurement and classification on financial assets and liabilities. Due to immateriality no impacts on opening balance are reported and no details on the previous accounting policy applied was disclosed.

IFRS 15 – Revenue

IFRS 15 was issued in May 2014 and amended in April 2016 and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration which an entity expects to be entitled to, in exchange for transferring goods or services to a customer.

Arla applies IFRS 15 Revenue from Contracts with Customers with the start of the financial year 2018. Implementation of the standard is finalized. Arla has decided to apply the modified retrospective approach.

Arla sells consumer dairy products, ingredients and raw milk to customers. The goods are sold based on the respective contracts with customers.

Arla Foods has performed a detailed analysis on IFRS 15 and current accounting procedures. The analysis shows that accounting policies within Arla Foods are compliant with the new IFRS standard "Revenue from Contracts with Customers".

In preparing to adopt IFRS 15, Arla took the variable considerations into account. Some contracts with customers provide trade discounts, listing fees or volume rebates. Arla recognises revenue from the sale of goods measured at the fair value of the consideration received or receivable, net of returns and allowances, trade discounts and volume rebates. Such provisions give rise to variable consideration under IFRS 15 and will be required to be estimated at contract inception and updated thereafter.

IFRS 15 requires the estimated variable consideration to be constrained to prevent over-recognition of revenue. Arla concluded that application of the constraint has no significant effect on the revenue being deferred compared to the previous standard.

The presentation and disclosure requirements in IFRS 15 are more detailed compared to the previous standard, whereby several disclosure requirements in IFRS 15 are new. Arla implemented the disclosures required according to IFRS 15.

Note 5.6 General accounting policies *(continued)*

Due to immateriality no impacts on the opening balance are reported and no details on the previous accounting policy applied were disclosed.

IFRS 16 Leases
IFRS 16 was issued in January 2016 and replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases on-balance, similar to the accounting treatment for finance leases under IAS 17. The standard, which is effective on 1 January 2019 for Arla, will significantly change the accounting treatment for lease contracts that are currently treated as operational leases.

The standard requires that all lease contracts regardless of type, with some exemptions, need to be capitalised as an asset, representing the right to use the underlying asset, with a matching lease liability, representing the lease payments. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets, for example personal computers, and short-term leases, i.e., leases with a lease term of 12 months or less.

Annual leasing costs will be divided into two elements, depreciation and interest costs, as opposed to the current treatment whereby the annual costs relating to operational lease agreements are expensed solely as operating costs. This will have a positive impact on the Group's EBITDA and to a lesser extent on EBIT.

Furthermore, it is expected that the cash flow statement will be impacted due to the current operational lease payments. Operational lease payments are presently disclosed as cash flow from operating activities and will be disclosed as financing activities.

Arla will be required to remeasure the lease liability upon the occurrence of certain events, for example a change in the lease term or a change in future lease payments resulting from a change in an index or rate used to determine those payments. Arla will generally recognise the amount relating to the remeasurement of the lease liability as an adjustment to the right-of-use asset. Furthermore, IFRS 16 requires more extensive disclosures than its predecessor, IAS 17.

In 2018 Arla finalised the implementation of a new tool to support Arla in accounting for leases from 2019. Furthermore, procedures are implemented to secure the completeness of the leasing obligations. Arla has done a proper investigation of its existing leasing contracts to estimate the expected impact from IFRS 16, therefore the impact on the 2019 financial statements can be estimated. According to expectation the majority of the leasing portfolio, in amount of contracts, relates to vehicles. Most the leasing contracts within Arla are identified in the Denmark, the UK, Germany and Sweden.

Arla assessed the impact on the 2019 financial statements of the adoption related to the new standard based on a detailed analysis. The analysis indicates an increase in total assets of approximately EUR 200 million.

Arla's 2019 income statement will show a shift from operating expenses to depreciation and interest at approximately EUR 60 million. This will have an expected increase of around 8 per cent on EBITDA and 1 per cent on EBIT. It is expected that the net result will not be significantly affected.

In accordance with IFRS 16, the annual operational lease payment of approximately EUR 60 million in 2018 needs to be presented as cash flow from financing activities, as opposed to the current treatment as cash flow from operating activities. This change in disclosure will improve the cash flow from operating activities by approximately 9 per cent.

Within the estimated effects on the 2019 financial statements, Arla makes several assumptions and judgements. The discount rates used for calculating the present value of the lease assets is based on the currencies of the leasing contract and the length of a leasing contract. In addition, Arla uses their internal mark-up on the discount rate. Extension options on contracts will be assessed contract by contract and will only be taken into account when it is reasonable certain that they will be exercised.

Arla uses the practical expedient in accordance with IFRS 16 with respect to the recognition exemptions for low value leases. Examples of low value leases include printers, laptops etc. Short-term leases are those identified as contracts with an initial term of less than 12 months. Arla also uses the practical expedient, in accordance with IFRS 16:15, for vehicles, such that the fixed service costs from the leasing amount are not disclosed separately. Arla also uses the practical transition expedient according to para-graph C3 of IFRS 16, such that Arla has not reassessed those contracts with an initial date of application before 31 December 2018, as to whether a contract is, or contains, a lease at the date of initial application.

The difference between the minimum lease payments disclosed, in accordance with IAS 17 and IFRS, mainly relate to the low value and short-term rents.

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 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 Distribution A/S	Denmark	DKK	100
Cocio Chokolademælk A/S	Denmark	DKK	50
Arla Foods International A/S	Denmark	DKK	100
Arla Foods UK Holding Ltd.	UK	GBP	100
Arla Foods UK plc	UK	GBP	100
Arla Foods GP Ltd.	UK	GBP	100
Arla Foods Finance Ltd.	UK	GBP	100
Arla Foods Holding Co. Ltd.	UK	GBP	100
Arla Foods UK Services Ltd.	UK	GBP	100
Arla Foods Nairn Ltd.	UK	GBP	100
Arla Foods Ltd.	UK	GBP	100
Arla Foods limited Partnership	UK	GBP	100
Milk Link Holdings Ltd.	UK	GBP	100
Milk Link Processing Ltd.	UK	GBP	100
Milk Link (Crediton No 2) Ltd.	UK	GBP	100
Milk Link Investments Ltd.	UK	GBP	100
The Cheese Company Holdings Ltd.	UK	GBP	100
The Cheese Company Ltd.	UK	GBP	100
Cornish Country Larder Ltd.	UK	GBP	100
The Cheese Company Investments Ltd.	UK	GBP	100
Yeo Valley Dairies limited	UK	GBP	100
Westbury Dairies Ltd.	UK	GBP	100
Arla Foods (Westbury) Ltd.	UK	GBP	100
Arla Foods Cheese Company Ltd.	UK	GBP	100
Arla Foods Ingredients UK Ltd.	UK	GBP	100
MV Ingredients Ltd. *	UK	GBP	50
Arla Foods UK Property Co. Ltd.	UK	GBP	100
Arla Foods B.V.	Netherlands	EUR	100
Arla Foods Comércio, Importacâo e Exportacão de Productos Alimenticios Ltda.	Brazil	BRL	100
Danya Foods Ltd.	Saudi Arabia	SAR	75
AF A/S	Denmark	DKK	100
Arla Foods Finance A/S	Denmark	DKK	100
Kingdom Food Products ApS	Denmark	DKK	100
Ejendomsanpartsselskabet St. Ravnsbjerg	Denmark	DKK	100
Arla Insurance Company (Guernsey) Ltd.	Guernsey	DKK	100
Arla Foods Energy A/S	Denmark	DKK	100
Arla Foods Trading A/S	Denmark	DKK	100
Arla DP Holding A/S	Denmark	DKK	100
Arla Foods Investment A/S	Denmark	DKK	100
Arla Senegal SA.	Senegal	XOF	100
Tholstrup Cheese A/S	Denmark	DKK	100
Tholstrup Cheese USA Inc.	USA	USD	100
Arla Foods Belgium A.G.	Belgium	EUR	100
Walhorn Verwaltungs GmbH (Under liquidation)	Germany	EUR	100
Arla Foods Ingredients (Deutschland) GmbH	Germany	EUR	100
Arla CoAr Holding GmbH	Germany	EUR	100
ArNoCo GmbH & Co. KG *	Germany	EUR	50
Arla Biolac Holding GmbH	Germany	EUR	100
Biolac GmbH & Co. KG *	Germany	EUR	50
Biolac Verwaltungs GmbH *	Germany	EUR	50
Arla Foods Kuwait Company LLC	Kuwait	KWD	49
Arla Kallassi Foods Lebanon S.A.L.	Lebanon	USD	50
Arla Foods Qatar WLL	Qatar	QAR	40
AFIQ WLL **	Bahrain	BHD	51
Arla Foods Trading and Procurement Ltd.	Hong Kong	HKD	100
Arla Foods Sdn. Bhd.	Malaysia	MYR	100

Note 5.7 Group chart *(continued)*

	Country	Currency	Group Equity interest (%)
Arla Foods Panama S.A.	Panama	USD	100
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 Gefleortens AB	Sweden	SEK	100
Arla Oy	Finland	EUR	100
Massby Facility & Services Oy	Finland	EUR	60
Osuuskunta MS tuottajapalvelu **	Finland	EUR	37
Restaurang akademien Aktiebolag **	Sweden	SEK	50
Vardagspuls AB	Sweden	SEK	100
Arla Foods Russia Holding AB	Sweden	SEK	100
Arla Foods LLC	Russia	RUB	80
Arla Foods Inc.	USA	USD	100
WNY Cheese Enterprise LLC **	USA	USD	20
Arla Foods Production LLC	USA	USD	100
Arla Foods Transport LLC	USA	USD	100
Arla Foods Deutschland GmbH	Germany	EUR	100
Arla Foods Verwaltungs GmbH	Germany	EUR	100
Arla Foods Agrar Service GmbH	Germany	EUR	100
Arla Foods Agrar Service Luxemburg GmbH	Luxembourg	EUR	100
Arla Foods Agrar Service Belgien AG	Belgium	EUR	100
Arla Foods LLC	Russia	RUB	20
Martin Sengele Produits Laitiers SAS	France	EUR	100
Team-Pack GmbH	Germany	EUR	100
Arla Foods France, S.a.r.l	France	EUR	100
Dofo Cheese Eksport K/S °	Denmark	DKK	100
Dofo Inc.	USA	USD	100
Aktieselskabet J. Hansen	Denmark	DKK	100
J.P. Hansen USA Incorporated	USA	USD	100
AFI Partner ApS	Denmark	DKK	100
Arju For Food Industries S.A.E.	Egypt	EGP	49

	Country	Currency	Group Equity interest (%)
Andelssmør A.m.b.a.	Denmark	DKK	98
Arla Côte d'Ivoire	Ivory Coast	XOF	51
Arla Foods AS	Norway	NOK	100
Arla Foods Bangladesh Ltd.	Bangladesh	BDT	51
Arla Foods Dairy Products Technical Service (Beijing) Co. Ltd.	China	CNY	100
Arla Foods FZE	UAE	AED	100
Arla Foods Hellas S.A.	Greece	EUR	100
Arla Foods Inc.	Canada	CAD	100
Arla Foods Logistics GmbH	Germany	EUR	100
Arla Foods Mayer Australia Pty, Ltd.	Australia	AUD	51
Arla Foods Mexico S.A. de C.V.	Mexico	MXN	100
Arla Foods S.A.	Spain	EUR	100
Arla Foods S.a.r.l.	France	EUR	100
Arla Foods S.R.L.	Dominican Republic	DOP	100
Arla Foods SA	Poland	PLN	100
Arla Foods Srl	Italy	EUR	100
Arla Foods UK Farmers Joint Venture Co. Ltd.	UK	GBP	100
Arla Global Financial Services Centre Sp. Z.o.o.	Poland	PLN	100
Arla Milk Link Limited	UK	GBP	100
Arla National Foods Products LLC	UAE	AED	40
Cocio Chokolademælk A/S	Denmark	DKK	50
Hansa Verwaltungs und Vertriebs GmbH (Under liquidation)	Germany	EUR	100
Marygold Trading K/S °	Denmark	DKK	100
Mejeriforeningen	Denmark	DKK	91
PT Arla Indofood Makmur Dairy Import PMA.	Indonesia	IDR	50
COFCO Dairy Holdings Limited **	British Virgin Irlands	HKD	30
Svensk Mjölk Ekonomisk förening	Sweden	SEK	75
Lantbrukarnas Riksförbund upa **	Sweden	SEK	24

* Joint ventures ** Associates

° 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 2018. The annual report was prepared in accordance with International Financial Reporting Standards as adopted by the EU and additional disclosure requirements in the Danish Financial Statements Act.

It is our opinion, that the consolidated financial statements and the parent company financial statements give a true and fair view of the Group's and the parent company's financial position as at 31 December 2018 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 2018.

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, 19 February 2019

Peder Tuborgh CEO	Peter Giørtz-Carlsen Executive Board Member	Jan Toft Nørgaard Chairman	Heléne Gunnarson Vice Chairman
Viggo Ø. Bloch	Jonas Carlgren	Arthur Fearnall	Manfred Graff
Jan-Erik Hansson	Markus Hübers	Bjørn Jepsen	Steen Nørgaard Madsen
Torben Myrup	Johnnie Russell	Manfred Sievers	Simon Simonsen
Inger-Lise Sjöstrom	Håkan Gillström Employee representative	Ib Bjerglund Nielsen Employee representative	Harry Shaw Employee representative

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 2018, 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 2018 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 2018 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, 19 February 2019
ERNST & YOUNG
Godkendt Revisionspartnerselskab
CVR no. 30 70 02 28

Jesper Koefoed State Authorised Public Accountant MNE no. 11689	Jens Weiersøe Jakobsen State Authorised Public Accountant MNE no. 30152

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.

Brand share measures the revenue from strategic brands as a proportion of total revenue, and is defined as the ratio of revenue from strategic branded products and total revenue.

BSM is an abbreviation of the product category containing butter, spreads, and margarine.

CAPEX is an abbreviation of capital expenditure.

Capacity cost is defined as the cost for running the general business, and includes staff cost, maintenance, energy, cleaning, IT, travelling and consultancy etc.

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.

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.

Effie-awards are known by advertisers and agencies as the pre-eminent award in the industry, and recognize any and all forms of marketing communication that contribute to a brand's success.

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.

HDPE-plastic is a thermoplastic polymer produced from the monomer ethylene. With a high strength-to-density ratio, HDPE is used in the production of plastic bottles, corrosion-resistant piping, geomembranes and plastic lumber.

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.

MFGM refers to milk fat globule membrane, which is a complex and unique structure composed primarily of lipids and proteins that surrounds milk fat globule secreted from the milk producing cells of humans and other mammals.

Milk volume is defined as total intake of raw milk in kg from owners and contractors.

M&A is an abbreviation of mergers and acquisitions.

MYPC is an abbreviation for Arla's largest product category which contains' milk, yoghurt, powder, and cooking.

Net interest-bearing debt is defined as current and non-current interest-bearing liabilities less securities, cash and cash equivalents, and other interest-bearing assets.

Net interest-bearing debt inclusive of pension liabilities is defined as current and non-current interest-bearing liabilities less securities, cash and cash equivalents, and other interest-bearing assets plus pension liabilities.

OECD refers to the Organisation for Economic Cooperation and Development.

On-the-go refers to food consumed while on the go, and also to packaging solutions supporting this trend of food consumption.

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.

PET is an acronym for Polyethylene Terephthalate and it is best known as the clear plastic used for water and soda bottle containers. As a raw material, PET is a petroleum-based product that is globally recognized as a safe, lightweight, and flexile material that is also 100% recyclable.

Glossary *(continued)*

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.

SEA is an acronym referring to South-East Asia.

SMP is an abbreviation of skimmed milk powder.

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.

SEA is an acronym for South East Asia.

Strategic brands are defined as products sold under branded products such as Arla®, Lurpak®, Castello® and Puck®.

Strategic branded volume driven revenue growth is defined as revenue growth associated with growth in volumes from strategic branded products while keeping prices constant.

Trading share is a measure for the total milk consumption for producing commodity products relative to the total milk consumption, i.e. based on volumes. Commodity products are sold with lower or no value added, typically via business-to-business sales for other companies to use in their production as well as via industry sales of cheese, butter, or milk powder.

UHT is an abbreviation for ultra-high temperature (UHT) processing, which is a food processing technology that sterilises liquid food, for example milk, by heating it above 135 °C.

Value-added protein segment contains products with special functionality and compounds, compared to standard protein concentrates with a protein content of approximately 80 per cent.

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.

Whey protein isolate is a dietary supplement and food ingredient created by separating components from whey.

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

Financial reports and major events

27-28 February
Board of Representatives meeting

1 March
Publication of the consolidated annual report for 2018

15 May
Board of representatives meeting – Election

29 August
Publication of the consolidated half-year report for 2019

8-9 October
Board of Representatives meeting

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