CONSOLIDATED ANNUAL REPORT

2016

Creating the future of dairy

Contents

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The consolidated annual report is published in Danish, Swedish, German, French and English.
Only the original Danish text is legally binding. The translation has been prepared for practical reasons.

Financial statement of the parent company
Under section 149 of the Danish Financial Statements Act, this consolidated annual report represents an extract of Arla's complete annual report. In order to make this report more manageable and user-friendly, we have decided to publish a consolidated annual report 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 is available on www.arlafoods.com. Profit sharing and supplementary payment from the parent company are set out in the equity section of the consolidated annual report. The full annual report contains the statement from the Board of Directors and the Executive Board as well as the independent auditor's report.

Glossary

Brand share is the ratio of revenue from strategic branded products of Arla's total revenue. Strategic branded products are defined as products sold under one of the three global brands - Arla®, Lurpak® and Castello® and strategic brands.

Capacity cost includes costs such as staff, maintenance, energy, IT, travelling and consultants.

Conversion cost is the total cost of production per kg raw milk excluding the cost for milk and materials within the production site which are related to the production of goods.

EBIT is an abbreviation of earnings before interest and tax.

EBITDA is an abbreviation of earnings before interest, tax, depreciation and amortization.

EBIT margin is EBIT as a percentage of total revenue.

Equity ratio is the ratio between equity *excluding* minority interests and total assets.

Interest cover is the ratio between EBITDA and net interest costs.

Leverage is the ratio between net interest-bearing debt *inclusive* of pension liabilities and EBITDA.

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

Organic revenue growth is revenue adjusted for the effect of mergers, acquisitions, divestments of businesses and currency effects.

Peer group index evaluates the relative performance of Arla compared to competitors without considering the retainment policy calculated as the performance price for Arla divided by the weighted average performance price of the peer group.

Performance price for Arla is defined as the prepaid milk price plus net profit per kilo member milk weighed in within the period.

Prepaid milk price equals the on-account payment owners receive per kg milk delivered during the settlement period. The price is primarily based on the milk's constituents, i.e. fat and protein, and quality.

Net working capital is the capital that Arla has tied up in inventories, receivables and payables *including* payables for owner milk.

Net working capital excluding owner milk is defined as capital that Arla has tied up in inventories, receivables and payables *excluding* payables for owner milk.

Retail and foodservice volume driven revenue growth is defined as revenue growth associated with growth in retail and foodservice volumes while keeping prices constant.

Scalability is defined as the ratio between retail and foodservice volume driven revenue growth and growth in total capacity cost adjusted for special items.

Strategic branded volume driven revenue growth is defined as revenue growth associated with growth in volumes from strategic branded products while keeping prices constant. Strategic branded products are defined as products sold under one of the three global brands - Arla®, Lurpak® and Castello® and strategic brands.

Trading share measures the total milk volume used to produce commodity products compared to the total milk consumption in Arla. A commodity product is sold with a lower amount of value added or no value added at all.

Volume driven revenue growth is defined as revenue growth associated with growth in volumes while keeping prices constant.

2016 in short

We evaluate our performance and the success of our strategy and business model by utilising key performance indicators. We have chosen to measure these key performance indicators because we believe they best demonstrate how we are driving the business and creating value for our owners.

Our strong performance in 2016 reflects the successful execution of our strategy, Good Growth 2020. Despite a lower milk price and volumes, we achieved nearly all of our key performance indicators.

√ Target achieved.

(√) Target not fully achieved.

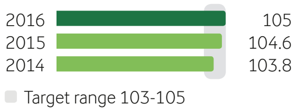
X Target not achieved.

All key performance indicators include the gain from sale of Rynkeby.

Peer group index for 2016 is preliminary before year-end results have been published for Royal FrieslandCampina N. V. and Deutsches Milchkontor eG.
*** Brand and International shares are based on retail and foodservice revenue excluding third party manufacturing (TPM) revenue. Trading share is based on milk consumption.*
**** Based on profit allocated to owners of Arla Foods amba.*

Peer group index*

105



Target for 2016: 103-105 √

Brand share**

44.5%

Scalability

>2.0

2014: >2.0 2015: >2.0 2016: >2.0

Target for 2016: >2.0 √

Milk volume

13.9

billion kg

2016	13.9 bkg
2015	14.2 bkg
2014	13.6 bkg

Revenue

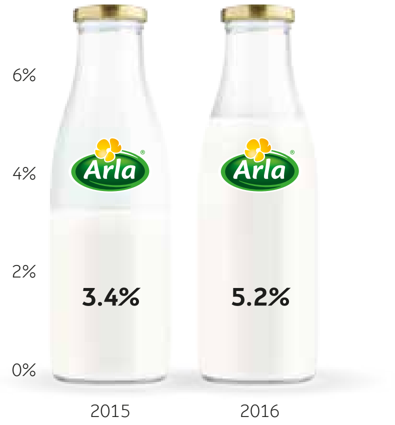
9.6

billion EUR

2016	9.6 EURb
2015	10.3 EURb
2014	10.6 EURb

Strategic branded volume driven revenue growth

5.2%



Target for 2016: 4-5% ✓

Strategic branded volume driven revenue growth rate for 2014 is not available due to the restructure of the organisation.

Retail and foodservice volume driven revenue growth

2.7%

2016	2.7%
2015	3.9%
2014	3.5%

Target for 2016: 3-5% (✓)

International share**

18.0%

2016	18.0%
2015	16.5%
2014	15.5%

Trading share**

20.1%

2016	20.1%
2015	21.5%
2014	20.9%

Conversion cost

99.2

2016	99.2
2015	98.0
2014	95.0

Target for 2016: 98.5 X

Leverage

2.4

2016	2.4
2015	3.3
2014	3.7

Target range 2.8-3.4

Target for 2016: 3.2 ✓

Profit share***

3.6%

of revenue

2016	3.6%
2015	2.8%
2014	3.0%

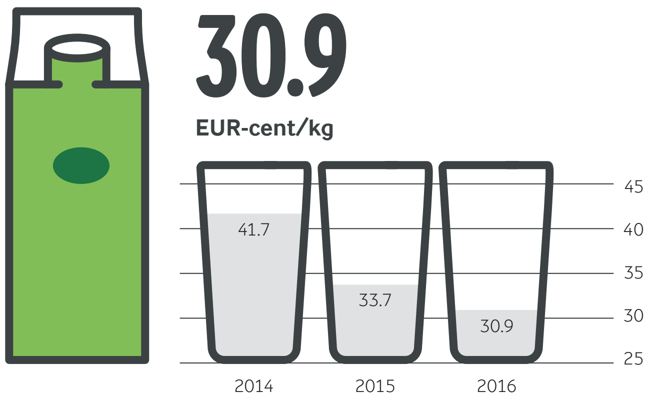
Target range 2.8%-3.2%

Target for 2016: 2.8-3.2% ✓

Performance price

30.9

EUR-cent/kg



Arla's milk wheel

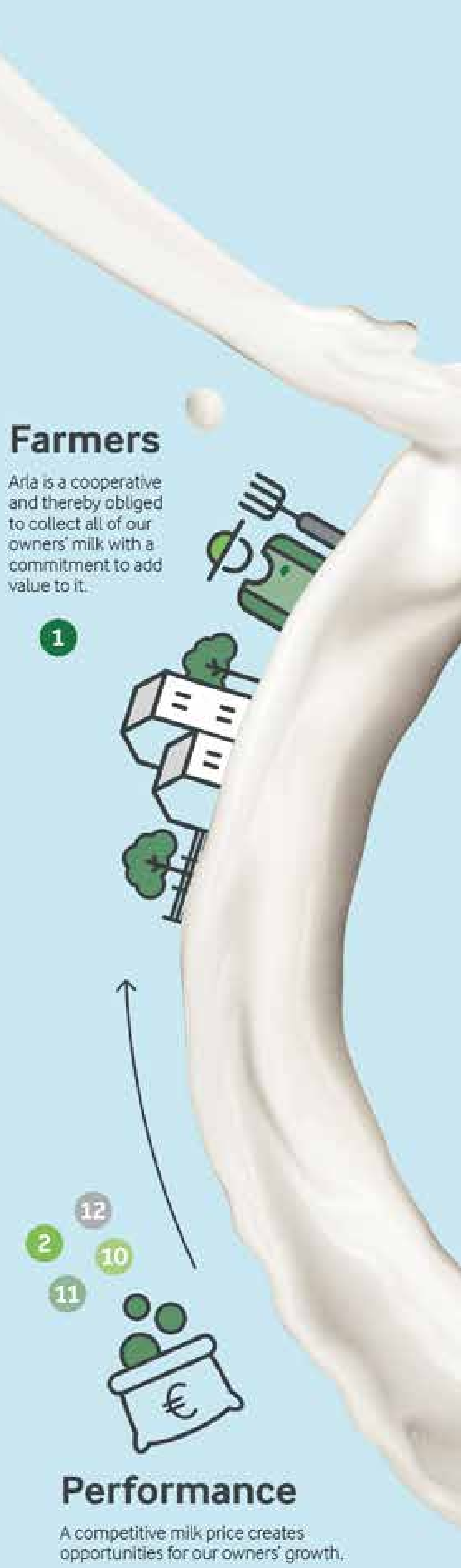
When it comes to milk intake, Arla is ranked fourth in the world. Rooted in our mission as a farmer-owned cooperative and driven by our strategy, Good Growth 2020, our main objective is to secure the highest value for our owners' milk.

Arla's cooperative business model is built on the principle of the milk wheel, whereby continuous milk volumes keep the wheel turning and provide the opportunity for economies of scale, innovation, product development and brand building leading to value creation.

Creating value for our owners' milk is embedded throughout the value chain from the cow to the consumer. We strive to keep the wheel turning by continuously seeking growth opportunities worldwide, pushing for sustainable market leadership and improving value creation driven by innovation and brand building, while creating economies of scale and streamlining our business internally. We operate our entire value chain with a continuous focus on efficiency and optimisation of our raw materials, capital and human resources. This promotes growth among our current owners, inspires new members to pursue their future with Arla and drives a sustainable increase in milk supply. As a result, further economies of scale and leverage of innovation and brands across the business are enabled. This in turn drives more value creation per kg of milk from our owners.

Our key performance indicators are closely linked to our business model.

1. **Milk volume**
2. **Revenue**
3. **Retail and foodservice volume driven revenue growth**
4. **Strategic branded volume driven revenue growth**
5. **Brand share**
6. **International share**
7. **Trading share**
8. **Scalability**
9. **Conversion cost**
10. **Profit share**
11. **Performance price**
12. **Peer group index**
13. **Leverage**



Production

Large milk volumes enable scalability and provide the opportunity for innovation, product development and brand building.

Mission

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

Vision

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

Consumers and customers

The increasing demand around the world for healthy and natural products presents an opportunity for Arla. We have the platform to meet this demand.

Performance price (EUR-cent/kg)

** Including gain from sale of Rynkeby.*

“In a tough year, the Board of Directors found it very reassuring to have a solid strategy in place to guide the business.”

Åke Hantoft, Chairman of the Board of Directors

Moving forward after a volatile year

Mission

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

How would you summarise 2016?
In 2016, we experienced unprecedented market volatility in raw milk production, as well as farm gate prices. However, Arla's strong brands and broad product portfolio, combined with the presence in markets across the world, prevented our milk price from hitting the extremely low levels we saw in the industry. Unfortunately, the market situation meant the effort was not sufficient to secure a sustainable income on our farms.

How would you describe the situation among owners during the year?
It was extremely challenging. Reactions were different from owner area to owner area, which mirrors the local market, political and industry issues. From a milk price perspective, 2016 was a terrible year, during which we experienced unsustainably low prices for our milk. The relief from my farmer colleagues was huge when we were able to start increasing the Arla milk price in autumn. This really highlighted the pressure that every single farmer had been under as a consequence of the tough market conditions. On a positive note, it does look like we now have a period of recovery ahead of us.

What role does Arla's strategy, Good Growth 2020, play for the owners?
Good Growth 2020 is the vehicle to execute our mission. It was developed to take account of every kg of raw milk supplied and to create the highest possible value for us as owners.

As a result of our high quality milk, Arla has become one of the world's largest dairy companies. Our business is based on many building blocks from brands, products, markets to production sites and core processes. Put together, they drive Arla and our milk price. Our current strategy provides very clear guidance on Arla's focus areas, not only to employees working to deliver our strategy, but also to our owners. In a year as tough as 2016, the Board of Directors found it very reassuring to have a solid strategy in place to guide the business.

The Board of Directors and Board of Representatives have been working on the new owner strategy. What is the impact of the decisions and direction set out in 2016?
Following the mergers between 2011 to 2014, we decided to align our local democratic structures to strengthen the dialogue between members, elected representatives and management. This also enables us to streamline administration and ensure a harmonised approach.

Face to face meetings once again proved to be the backbone of our cooperative. We want to further strengthen this dialogue and engagement among our owners. The Board of Directors is also investigating if it is possible, from a legal and cooperative perspective, to offer all owners direct membership in Arla Foods amba in the coming years. If we succeed in doing this, it would certainly be a true milestone in the history of our multinational cooperative.

What are the biggest challenges and opportunities that lie ahead?
Through our strategy we have identified key opportunities. Demand for natural and healthy products, e-commerce and other trends will guide our business and brands towards 2020. We will continue to tell our cooperative story and share with consumers and customers the effort every single farmer puts in to their farm every day of the year. This includes care for animals and nature and the pride taken in producing nutritious, high quality milk. The challenge is to grow our business in a year in which we expect the same level of raw milk from our owners. This requires strong prioritisation from the business, and again, we will be guided by our strategy.

Our cooperative story
Arla's cooperative foundation has a long history. More than 100 years ago, the first dairy cooperatives were founded in Scandinavia with the purpose of buying, processing and selling owners' milk in the best possible way. Today, our cooperative owners are still both owners and suppliers of Arla. This is the cooperative's key strength: long-term, mutually obliging cooperation. Arla's owners are obliged to supply milk to Arla thereby securing supply of our most important raw material and Arla is obliged to buy their milk at the highest possible price.

“2016 proved our strategy to be the right one for Arla.”

Peder Tuborgh, CEO

Vision

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

Branded growth in a volatile market

2016 was the first year of working with the new strategy, Good Growth 2020. How did it play out?
Good Growth 2020 has truly guided our business in 2016 and we have already come far on our strategy journey. We are more focused than ever on brand and category development as well as geographies. We managed to mitigate the impact of the extremely volatile market in Europe, and in many regions we succeeded in building our market shares with our International business. Furthermore, with a focused effort, we increased our brand share from 42.1 per cent in 2015 to 44.5 per cent in 2016. We also improved our equity and leverage. I have no doubt that in 2016 we proved our strategy to be the right one for Arla.

In 2016, the new Executive Management Team and the new organisational structure was introduced. What was the thinking behind these changes?
In spring we restructured the organisation to match our new strategic scope with a functional set-up driving synergies and clear responsibilities across the business. Through a more unified and lean approach, we made more than 500 administrative roles redundant. At the same time, an efficiency programme within supply chain delivered savings of EUR 100 million.

Can you give some examples of how Arla contributed to the market in 2016?
A very successful example is our Puck® portfolio. A relaunch of the brand combined with a new compelling campaign has boosted sales in the Middle East and North Africa. In Europe we are also strengthening our business and the Arla® brand. Examples are the Arla® branded skyr and protein products, which are resonating extremely well with consumers. This is just one example of how we continuously respond to consumer trends for natural and healthy products. These characteristics are also the essence of Arla products and have been for many years.

It is in Arla's cooperative DNA and company mission to welcome and process all owner milk, unconditionally, however, in 2016 volumes decreased. How does this affect Arla going forward?
Arla has the processing capacity and logistics solutions in place to handle more milk than our owners are currently supplying. In 2015, and during the first months of 2016, when our milk volumes were still increasing, our dairies operated at full speed, improving our conversion costs. However, Arla's owners responded to the unsustainably low milk prices in the same way as other European dairy farmers did in autumn 2016, and we experienced significantly decreasing milk volumes.

Currently, increasing milk prices are generating renewed trust in the future, and hopefully, Arla will see increasing milk volumes coming from owners in all countries in the coming years. We need the milk to keep the milk wheel turning and pursue the full growth potential of our brands and markets.

What is the outlook for 2017?
You will see Arla take an even stronger position in the market as an innovative and responsible farmer-owned dairy company, which provides natural and healthy food to consumers and customers.

We aim to significantly increase our engagement in the foodservice sector, as Arla has solid experience and unique solutions to offer. We will build on the current growth in e-commerce. Guided by our vision, identity and strategy, I am convinced that we will create growth in the market and generate a stronger performance price for our owners. Following a very challenging and volatile 2016, the entire organisation has never been more committed to deliver in 2017.

Brand share

44.5%

2015: 42.1%

International share

18.0%

2015: 16.5%

Scalability

>2.0

2015: >2.0

Brand portfolio
Our strong brand portfolio is at the core of our business and an important driver for our success. Our strategic brands are Arla®, Lurpak®, Castello® and Puck®.

Significant business events in 2016

For Arla, 2016 was characterised by change from both the internal and external environments. Following the restructure of the organisation and cross-market alignment of our business, we stepped up value creation as outlined in our strategy, Good Growth 2020. This is clearly reflected in the business highlights for the year.

Contributing to local dairy production in Nigeria

Arla has officially committed to contributing to local dairy production in Nigeria. In doing so, Arla contributes to the sustainable development and growth of the dairy sector in the country.

Q1

New strategic partnership in the US

Arla and the world's largest farmer-owned cooperative, Dairy Farmers of America, entered into a cooperation that includes a new dairy plant for cheddar cheese production and the exploration of premium product opportunities.

Q1

ONE cooperative created in the UK

Following the merger between Arla Milk Link and Arla Milk Cooperative, on 1 January, Arla's owners in the UK united to form a new cooperative, the UK Arla Farmers' Cooperative Ltd. This has ensured a more aligned approach for the UK members, thereby maximising efficiency within Member Relations.

Q1

Closure of Hatfield Peverel dairy

Following a review of the processing requirements across the UK and significant investments in the Aylesbury facility, the decision was made to close the milk processing production facilities at Hatfield Peverel dairy in the UK.

Q1

The new organisation goes live

On 1 March, the organisational restructure went live. As part of the restructure the workforce was reduced by more than 500 white collar colleagues. The new functional organisation is designed to deliver the strategy, Good Growth 2020, and optimise Arla's performance in a highly competitive global dairy market by strengthening value creation and efficiency.

Q1

Q1 *First quarter*
Q2 *Second quarter*
Q3 *Third quarter*
Q4 *Fourth quarter*

Corporate responsibility plan towards 2020

The Executive Management Team approved the corporate responsibility plan underlining Arla's pledge to drive a responsible business. Part of this plan is to ensure that responsibility in Arla is embedded throughout the business.

Q2

Arla incentivises non-genetically modified feed

Based on commercial opportunities, the Board of Directors decided to actively encourage farmers to produce milk using non-genetically modified feed by paying an extra one EUR-cent per kg milk. In Sweden, all dairy products are already produced from non-genetically modified feed.

Q2

Sale of Rynkeby Foods A/S

In order to focus on the core business and following the sale process initiated in 2015, Arla sold Rynkeby Foods A/S to the largest producer of fruit-based beverages in Europe, Eckes-Granini Group GmbH. Rynkeby was the last major non-strategic asset.

Q2

New packaging site opened in Senegal

A new Dano® long-life milk powder packaging facility opened in Dakar, Senegal with the capacity to handle 5,000 tonnes of milk powder. Senegal will be an important gateway for further expansion in West Africa.

Q2

1 billion SEK bonds issued

Arla issued 5-year SEK bonds for a principal amount of SEK 1 billion targeted at professional investors. The issue refinances elements of Arla's existing bank debt as a supplement to other financing sources.

Q2

Full ownership of Westbury Dairies Ltd.

Arla took full ownership of the operations at Westbury Dairies Ltd. in the UK, and strategically moved a substantial proportion of butter production from Lockerbie to Westbury to secure economies of scale.

Q4

New business in Ghana

In line with the strategy, Good Growth 2020, Arla established a fully-owned subsidiary in Accra, Ghana. The goal is to create opportunities for European farmers by promoting the Dano® brand. Ghana is the second largest economy in Africa and an effective gateway to other opportunities in West Africa.

Q4

Democratic structure alignment with new owner strategy

Following the mergers during the period 2011 to 2015, the Board of Representatives decided to align Arla's democratic ownership structure and processes across the seven owner countries.

Q4

Significant marketing events in 2016

Brands successfully delivered the majority of our growth in 2016, helped by the launch of new innovative branded products and strong marketing campaigns. To create further awareness of our cooperative roots among consumers, we continued to strengthen our farmer-owned campaign. All of these developments are clearly reflected in the marketing highlights for the year.

Arla cheese spread launches in the Philippines

In April, Arla® Cheesy Spread was launched in the Philippines, and has been a game changer in the market. The natural product made from real milk is perceived to be of higher quality compared to competing products. The successful campaign raised extensive awareness of the Arla® brand, and helped us grow five per cent in the ambient cheese spreads category.

Launching Arla® B.O.B

In the UK, Arla successfully launched Arla® 'Best of Both', which is a unique and innovative fat-free milk product that tastes as good as semi-skimmed milk. Arla® B.O.B exemplifies our focus on launching healthy products and inspiring good food habits. Arla® B.O.B was also commended by The Grocer and won 'best dairy launch' of 2016.

Arla Lactofree® champions dairy revolution

Responding to the increasing consumer demand for lactose free products, new Arla Lactofree® products were launched, supported by a marketing campaign in the UK. In Denmark, the Arla Laktosefri® brand hit retailers' shelves. This is the fastest growing fresh milk product launch ever.

Coffee you love, with a twist

In 2016, a new campaign introducing everyone's favourite hot beverage in a chilled and accessible on-the-go size was launched. The Starbucks chilled coffee drink is continuing its strong momentum and is available in 28 markets worldwide. Finishing the year on a high note, distinctive Christmas packaging was released and consumers were invited to share a moment of connection with Arla's first-ever Snapchat campaign in the UK, which helped us reach nearly five million users.

Growing speciality cheeses

To inspire more everyday consumption of speciality cheeses, a successful smorging campaign and impactful TV commercials were released to drive growth and value. Our Castello® brand is a strong performer in a long list of markets, particularly in the UK, Australia and Sweden.

Farmer-owned campaign is going strong

Our farmer-owned campaign raises consumer awareness, differentiates us from competitors and instills higher consumer trust in our products. By the end of 2016, we have integrated the marque on 70 per cent of all Arla® branded packaging, which means it is visible on more than 750 different products.

Puck® wins gold

In the Middle East and North Africa the Puck® brand won a Gold Effie at one of the world's most acclaimed marketing events. The relaunch campaign celebrating the everyday chef proved highly successful and led to brand leadership in the region, where Puck® holds the number one position in jar cheese across core markets. Puck® also reached thousands of cooking enthusiasts through sponsorship of Top Chef, a popular reality cooking show. The campaign achieved a gross rating point 55 per cent above expectations.

Global Lurpak® campaign kicked-off

By getting consumers back in the kitchen, the global Lurpak® campaign 'Game on, Cooks' aims at strengthening its position as the world's biggest butter brand. The campaign has reached 34 million people through digital content in the UK alone. Since the start of the campaign brand awareness showed an increase of 13 per cent and there was a 35 per cent increase in sales of Lurpak® block butter in the UK, driven by value rather than volume.

Nothing but great taste

It has been nothing but a great year for the signature chocolate milk, Cocio®. The brand celebrated its 65th anniversary by delivering double digit growth and rapid global expansion. Cocio® is now available in 17 markets, with India and Israel being the latest additions.

Strategy

Good Growth 2020

Our strategy, Good Growth 2020, sets out how we will grow our business in eight global dairy categories and six market regions around the world as ONE effective and unified cooperative.

EXCEL
in eight categories

FOCUS
on six regions

WIN
as ONE Arla

Content

Responding to change

Key market dynamics impact the global dairy market as we move towards 2020. The exponentially changing world is presenting new challenges and opportunities for Arla. We have identified the trends that will impact Arla significantly in order to respond to them efficiently. The transformational drivers embedded in our strategy, Good Growth 2020, will determine our future success.

KEY MARKET DYNAMICS

Supply and demand of milk

The dairy industry is global but the supply and demand for milk are increasingly geographically detached. Some regions like Europe, USA and Oceania have a milk surplus, while regions like Asia, the Middle East and Africa have a milk deficit.

In Europe, the low price level in 2016 drove volatility in milk production. Milk volumes decreased in 2016, which was a big change compared to the expectations a year ago. As a result, the latest outlook shows a postponement of the expected increase in milk intake towards 2020. However, with the milk price increase towards the end of 2016 renewed trust in the future is being generated. Meanwhile, the demand for milk globally is unchanged.

OPPORTUNITY FOR ARLA

We need to ensure that we create the most value possible for the existing milk pool. We will channel our milk to the markets in which the highest value can be added, irrespective of origin. To support this ambition, we have established ONE European milk pool to ensure a more holistic use of our raw milk across Arla. Please read more about ONE milk pool on page 76.

PIN code of the world

Developed markets are stable, however they have low growth rates, while emerging markets are growing significantly but also carry higher risk. Approximately 95 per cent of dairy growth is generated outside of Europe and the growth outlook remains unchanged.

The PIN code of the world identifies the world population as we know it. In 2016, the code is 1114; 1 billion people living in Europe, 1 billion people in the Americas, 1 billion in Africa and 4 billion in living in Asia. In 30 years this combination will change to the PIN code 1125, doubling the population of Africa and indicating massive growth in Asia.

Understanding the way the world is growing and the shift to urban locations is a global differentiator. Until now, Arla has been very Europe-centric with 66.1 per cent of sales in Europe. Our long-term growth opportunities in Europe are challenged by low growth rates, whilst International is delivering solid double digit growth rates and a positive growth outlook for the foreseeable future. To sustain double-digit International growth and balance risks, we need to broaden our distribution networks and strengthen our production footprint. Our growth focus needs to be balanced between Europe and International towards 2020 and our strategy is designed to turn these changes into local opportunities for Arla.

A branded business drives earnings

Prices are volatile and will continue to be volatile in the future, which emphasises the need to improve the underlying business composition. With strong brands as a key differentiator the business can be close to consumers, driving trust, loyalty and better returns. The price premium of a branded business generates higher margins than trading and private label alternatives. In the long run, the branded business will win over the commodity market through increased stability and higher prices.

Our branded business has grown dramatically in recent years and now represents 44.5 per cent of total revenue and generates approximately 80 per cent of Group earnings. As a result, brand growth is key for stronger profitability and to drive less volatile earnings. Increasing marketing spend is critical to ensure continued delivery on branded sales growth towards 2020.

On-the-go snacking and convenience products

Convenience and on-the-go consumption of healthy and filling snacks is expected to continue to grow significantly and growth is exceeding expectations. The dairy category is strong within snacks with yogurt and milk-based beverages, and cheese snacks are expected to be the next big trend. Furthermore, on-the-go products in convenient packaging for consumers on the road, in schools and in offices are expected to continue to grow at a fast pace in 2017.

To be a leading dairy company we need to develop strong concepts that support market trends. As a result, we will explore our opportunities within new categories, for example, within milk-based beverages and high-protein products. We will invest in innovation and product development making it easy for consumers to meet their daily nutritional needs on-the-go.

Digital and e-commerce are game changers

The digital consumer trend has the potential to become a disruptive factor for the dairy industry. Digitalisation of the industry is progressing at a fast pace and on multiple levels with, for example, digital platforms and digital marketplaces expected to rapidly gain ground in 2017. In China, e-commerce grew approximately 100 per cent from 2011 to 2014.

Another digital trend potentially affecting the dairy industry is mobile consumers requiring a new operating model, where the consumer's experience becomes more important than the product itself. It is important to adapt to the new commerce landscape in order to stay relevant to consumers.

Digitalisation is essential to creating the future of dairy and has the power to fundamentally change Arla's business model, with e-commerce, digital marketing, as well as product development and packaging. We need to stay ahead of the game and become more experimental, bold and collaborative in our ways of working and digital is the perfect platform to spearhead this journey.

The traditional way of working with distribution and in store product placement are still a vital part of Arla's business. However, sales from e-commerce platforms offer not only an online store, but also a new distribution setup and this will increasingly change the way of doing business for Arla.

Health agenda is accelerating

Global dairy trends point towards health and wellness, and conscious living. A growing concern regarding health and wellness among consumers leads to the creation of new dairy products, as well as dairy-free alternatives. Consumers are increasingly looking for transparency and authenticity in products and packaging. Rapidly changing macro trends lead to diverse consumer requirements for products, formats and packaging.

Retailers increasingly seek differentiation and focus on non-genetically modified feed and animal welfare product claims and they are pushing for continued ways to differentiate milk in order to gain consumer loyalty.

Our success will be defined by our ability to turn consumer trends into assets, rather than considering them to be external disruptions, and we are in a good position to do so. For Arla, naturalness is at the core of our identity, Good Growth, and being farmer-owned is in our DNA. With our focus on healthy products and authenticity, we build trust and credibility with consumers. We continuously work with product innovation to meet consumers' demands and we will drive initiatives for the benefit of the commercial business, production and owners.

We will create credible market claims to differentiate and leverage trends and develop strong product concepts.

Creating Good Growth towards 2020

In December 2015, Arla presented a new corporate strategy for the next five years called Good Growth 2020. The strategy is our response to the changing world around us where supply and demand for milk are increasingly geographically detached, competition is fierce and there are new demographic realities and consumer trends. We strongly believe that Arla now faces new opportunities for global growth and creating value for our owners.

With Good Growth 2020, we have a clear focus on growing our brands and volumes through innovation that has consumers and customers wants and needs at its core. This helps us create the most profitable value for our owners' milk. With the strategy, Arla sets out to grow our business by focusing on increased value creation, strengthening and expanding our footprint and creating a global, coherent and efficient business.

Good Growth 2020 makes a strong start

A year into our Good Growth 2020 strategy, we remain convinced that it is absolutely the right direction for Arla. Following the restructure of the organisation in 2016, Good Growth 2020 is now even more strongly anchored within the business and progress against targets is monitored closely on a regular basis.

We initiated 25 strategic bets to drive Good Growth 2020, within our categories, regions and efforts to unite Arla as ONE. By the end of 2016, we experienced strong traction on each of the strategic bets. Throughout the organisation, we have numerous ambassadors, including owners of strategic bets who drive a strong focus on execution, speed and cross-functional collaboration.

Ambitious targets for Good Growth 2020

We have set ambitious targets for the key performance indicators of Good Growth 2020 and continuously work to deliver based on these targets.

Read more about how we performed in 2016 in the financial review on page 45.

	Baseline in 2015	Target in 2020
Peer group index	103-104	103-105
Retail and foodservice volume driven revenue growth	2%	4%
Brand share	42%	>45%
Trading share	22%	<20%
International share	17%	>23%

Our strategy will help Arla to create the future of dairy towards 2020.

Excel in eight categories to increase value creation

The global dairy industry is developing at high speed and is characterised by a constant evolution of consumer habits and preferences. We have analysed consumer needs and trends and matched these to our own strengths. As a result, we have identified eight product categories that will be the core focus for our efforts to shape the dairy market, by offering new products with natural ingredients, great taste and good nutrition, thereby making it easier to live healthy lives.

Within these eight categories, we want to excel and increase value creation with innovative products, a world class supply chain, compelling marketing and strong partnerships with our customers. We will grow the categories through our global brands, as well as through foodservice and business to business sales. Furthermore, to be a leading dairy company, Arla needs to focus on expanding leading category positions to grow across markets, regionally or globally.

The eight prioritised product categories are focused around our global brands:

Arla Puck

1 Milk and powder: we will lead and shape the market with nutritious value-added products.

2 Milk-based beverages: we will shape the market for on-the-go products that are made from natural ingredients.

3 Spreadable cheese: we will be a leader in cream cheese that is made from both natural ingredients and high quality processed cream cheese.

4 Yogurt: we will build a strong market position that is based on health benefits and natural ingredients.

LURPAK

5 Butter and spreads: we will be a global leader with world class products made from natural ingredients.

CASTELLO

6 Speciality cheeses: we will be a leading player with creatively crafted products and concepts.

Foodservice sales

7 Mozzarella: we will create a global foodservice position with high quality mozzarella.

Business to business sales

8 Ingredients: we will be the global leader in value-added whey.

Read more about how we excel within eight categories on page 20.

Focus on six regions to strengthen and expand our footprint

We have identified the markets in which Arla has the biggest potential to grow a long-term profitable business. Between now and 2020, we expect approximately 50 per cent of our growth to come from Europe, while the remaining share of growth will come from regions outside of Europe that we manage in International.

Over the years, Arla has built a strong position in Northern Europe, where we are the preferred dairy company for consumers, and the Middle East where our brands are among the strongest in the food industry. Arla has also begun to build a business in new growth markets such as China and South East Asia and Sub-Saharan Africa. With Good Growth 2020, we will continue to expand these market positions, whilst further stepping up our efforts in the Americas and North Africa. We are focusing our innovation, investments and competences in these markets.

Read more about how we focus on six regions on page 22.

Win as ONE to create a global, coherent and efficient Arla

Arla has grown significantly in Europe with mergers and acquisitions in Central Europe, the UK and Sweden. The past few years have been spent aligning the different companies into one, thereby harvesting the synergies that the mergers created. With Good Growth 2020, we will take this unity to the next level.

We will improve our skills and use the same processes and tools across the organisation. We will put clear focus on strengthening our global category and brand building, our innovation across borders and our commercial acumen. Our marketing will become more global and we will drive innovation. Our entire supply chain will become more efficient as we established ONE European milk pool to ensure a more holistic use of our milk across Arla.

These changes will help us achieve our new ambitious cost improvement target of accumulated EUR 400 million over four years.

Read more about how we win as ONE Arla on page 24.

Excel in eight categories to increase value creation

The eight product categories, which are prioritised in our strategy, Good Growth 2020, are focused around the Arla® brand, Lurpak®, Castello® and Puck®. In 2016, we delivered exceptional brand growth in a challenging market, attributable to a focused effort within these eight categories.

Milk and powder

Milk-based beverages

Speciality cheeses

Mozzarella

Spreadable cheese

Yogurt

Butter and spreads

Ingredients

Deep dive on adjacent page.

Strategic branded volume driven revenue growth in 2016 of 5.2 per cent driven by:

Arla®	Lurpak®	Castello®	Puck®
The dairy champion that brings health and natural goodness to the world.	Champion of good food.	Creatively crafted cheeses.	Celebrating the everyday chef.
4.5%	**7.7%**	**3.0%**	**10.6%**
2015: 2.5%	**2015: 6.1%**	**2015: 0.1%**	**2015: 9.9%**

2016 showcased the strength of our global and strategic brands. Our brands performed well, exceeding our overall expectation range of four to five per cent by achieving a strategic branded volume driven revenue growth of 5.2 per cent.

Puck® is the leading performer, delivering a strategic branded volume driven revenue growth of 10.6 per cent on top of 9.9 per cent last year. This was strongly driven by exceptional performance in the Middle East and North Africa, where the brand now holds the number one position in jar cheese across all core markets.

Lurpak®, our hero in the butter, spreads and margarine category, delivered strategic branded volume driven growth of 7.7 per cent, compared to 6.1 per cent in 2015. We kicked off a global campaign in 2016 'Game on, Cooks', which significantly increased the brand's awareness, strengthening Lurpak® as the butter champion.

Arla® showed strong strategic branded volume driven growth of 4.5 per cent, mainly due to increased investment in innovative and specialised product ranges such as Arla Natural®, Arla Lactofree®, skyr and other high protein products, as well as infant nutritional formulas such as Arla Baby & Me®.

In 2016 we inspired more everyday consumption of speciality cheeses for any occasion. Our Castello® brand is a strong performer across many markets, particularly in the UK, Australia and Sweden. Castello® achieved a strategic growth rate of 3.0 per cent in 2016, showing positive performance compared to last year.

Expanding the milk-based beverages category

An important strategic bet is to capture the opportunities within the beverage market with a portfolio including healthier milk-based alternatives. Supporting the Arla® brand growth, we successfully set an ambition to triple our business outside standard white milk in the beverage market towards 2020 from EUR 230 million in 2015.

The global market for milk-based beverages is approximately EUR 100 billion in annual retail sales, equaling the size of the global standard white milk market. However, the market for milk-based beverages is growing much faster. Going forward, we will approach the milk-based beverage market more strategically and double the size of our playing field for liquid milk products.

By 2020, we aim to be the leading provider of milk-based beverages in Northern Europe, as well as one of the leading importers in Asia, the Middle East and North Africa.

Modern urban lifestyles have led people across the world to increasingly snack, thereby getting their nourishment outside of their homes. Mealtimes are blurring, more women are working and more people are living in bigger cities. As a result, we have an opportunity to provide people with nourishment when they need it, based on the natural goodness of our high quality milk. Our milk should not only be enjoyed from litre-sized packages bought in supermarkets, it should also be available as tasty beverages on the go.

A sparkling milk and fruit drink, a milk and tea drink and a protein rich energy drink are part of the plans for expansion of the category combined with innovative packaging. This will create new sales opportunities for us in places outside traditional retail channels.

Within beverages, Arla has had success through its Cocio® subsidiary and its cooperation with Starbucks®, through which coffee drinks and new innovative milk-based beverages have been introduced in 2016.

The butter and spreads category is growing fast

The butter and spreads category is key for Arla in creating Good Growth towards 2020. It is a highly branded category and so butter and spreads are strong profit contributors for Arla.

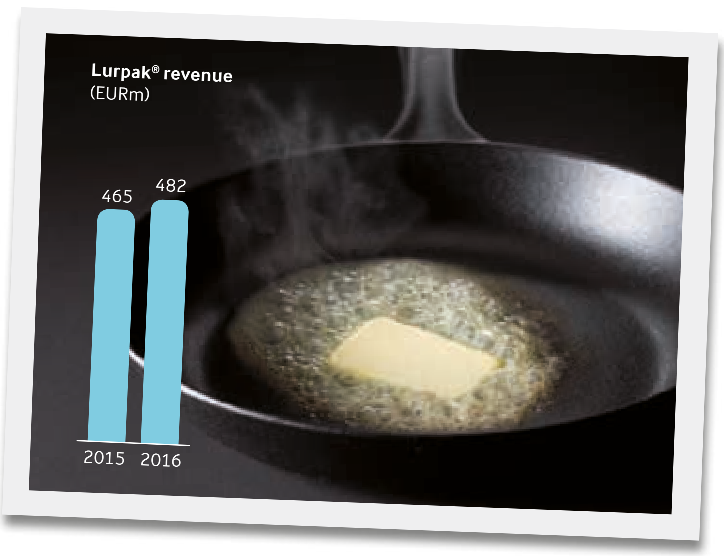
Overall, the butter and spreads category showed strong results in 2016. Volume driven revenue growth was 10.5 per cent in 2016 compared to negative growth rates in 2015 and as a result, we have managed to grow the category significantly more than expected in 2016. Furthermore, we succeeded in growing our market share in the majority of our markets.

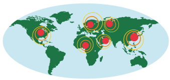
Within the category, we delivered a brand share of 74.8 per cent in 2016. The Arla® and Lurpak® brands are important for the category, amounting to 74.5 per cent of total revenue. These are also the brands present in our key markets. For Arla, the European markets and the Middle East and North African markets are vital to the butter and spread category as these regions amount to 90.8 per cent of total revenue.

Lurpak® is contributing especially positively to the category growth, with increasing sales and a growing International share moving from 12.7 per cent in 2015 to 13.5 per cent in 2016.

To deliver our growth ambition towards 2020 and become the butter champion, we must continue to build leading market positions, drive category growth, and strengthen our brands. We have a clear and consistent strategy with a number of great initiatives enabling us to succeed. Especially the Middle East and North Africa show great opportunities for Arla if we maintain our strong performance.

Our focus areas for butter and spreads are the story behind them, innovative packaging, the products themselves and communication. In 2016 we started this journey by launching the Lurpak® Spreadable Infusion range and our new global campaign 'Game on, Cooks'.





Focus on six regions to strengthen and expand our footprint

The six regions, chosen as strategic focus areas in our strategy Good Growth 2020, are embedded in our two commercial zones: Europe and International. This allows country management to strengthen its commercial focus on consumers, customers and categories, supported by strong marketing driven from a global category perspective.

Europe is our core commercial zone and contributed to 66.1 per cent of Group revenue. The International commercial zone encompasses the Middle East and North Africa, Russia and others, Americas, China and South East Asia as well as Sub-Saharan Africa and delivered 14.9 per cent of Group revenue in 2016. Arla Foods Ingredients, our growing innovative whey business, contributed with 5.7 per cent of Group revenue, whilst other revenue, for example revenue from trading activities, comprised 13.3 per cent of Group revenue.

Our International business achieved the largest volume driven revenue growth rate of 9.5 per cent in 2016, primarily due to strong performance in Sub-Saharan Africa and China and South East Asia.

China and South East Asia is booming

The aim for China and South East Asia towards 2020 is to maintain high growth rates, working towards the target of quadrupling revenue from retail and foodservice by 2020 compared to 2015 when the strategy was originally launched. Currently, we are on track to deliver this strategic target, with sales growing 32.4 per cent to EUR 158 million in 2016 from EUR 120 million in 2015.

The population in China and South East Asia is growing and the middle class is booming. The majority of this growth is attributable to China, where we are focusing on several product categories to further pursue the growing demand for dairy products. For example, Arla is aiming to be a leader within the cheese category in China, particularly focusing on foodservice. Furthermore, we will use digital and e-commerce platforms to engage with and sell to consumers. In 2016, Arla ASCX Naifu® was test launched in China and, for the first time, e-commerce and digital channels played a central role in the launch.

Arla Baby & Me® is one of our flagship product ranges within organic milk powder products for children aged up to five years. In 2016, a new campaign was launched to support this brand. This was our first initiative with Chinese dairy company Yashili, which is part of the Mengniu Group, that we collaborate with closely in this important category.

China is a crucial market for Arla's success in the region. However, other markets in South East Asia remain equally important to maintaining growth rates. In 2016, Bangladesh significantly contributed to the growth in the region, with retail and foodservice volume driven revenue growth of 24.0 per cent.

Ambitious goals in the Middle East and North Africa

With Good Growth 2020, we aim to double our revenue from retail and foodservice in the Middle East and North Africa by 2020 compared to 2015 when the strategy was launched. This ambitious goal should be achieved by a combination of increasing sales of branded cheese, butter, spreads and cream cheese across both retail and foodservice, developing our business in Egypt and entering the liquid category with the Arla® brand.

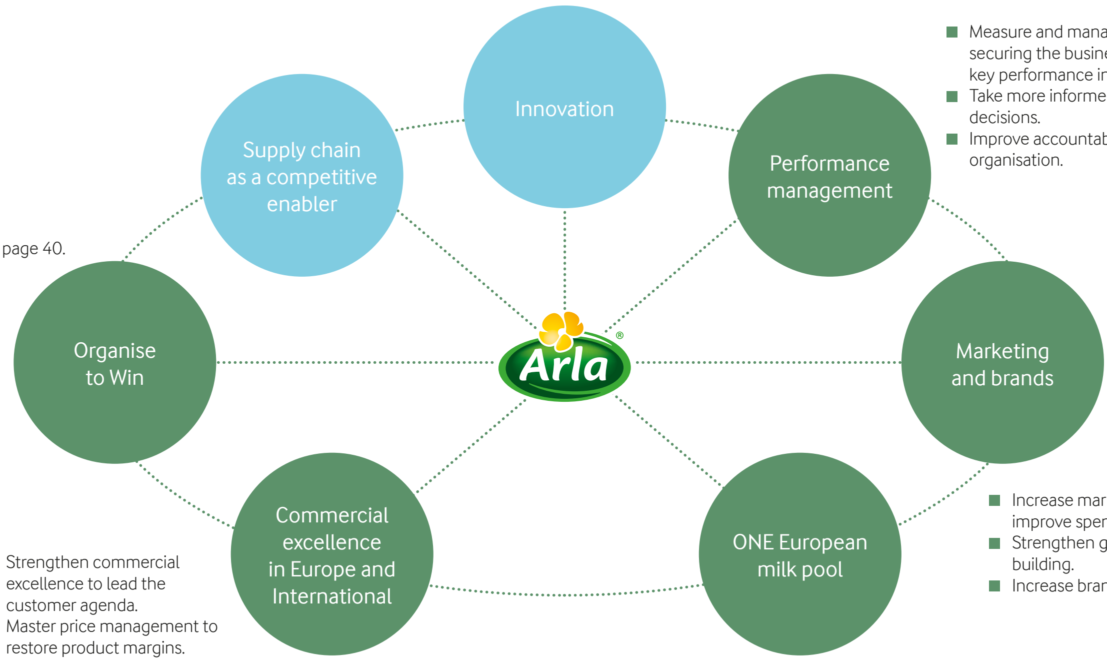
In 2016, we managed to deliver volume driven revenue growth in the region of 3.8 per cent.

The Puck® product range is especially popular, showing volume driven revenue growth of 11.7 per cent in 2016 compared to 9.4 per cent in 2015 in the region. The Middle East and North Africa have a population of approximately 380 million people. In the region, dairy products are incorporated into most meals, therefore serving as a great opportunity for Arla. Our Puck® range fills a gap in the market, helping local consumers to be the star at the dinner table. The Puck® brand also won a Gold Effie at one of the world's most acclaimed marketing events. Using the Puck® website and social media channels, the brand celebrated mothers as the everyday hero chef.

Win as ONE to create a global, coherent and efficient Arla

Winning as ONE is a continuous effort to unite Arla across business functions and commercial zones. The strategic bets identified are the foundation and building blocks for creating Good Growth towards 2020. The initiatives are tracked continuously by the organisation and at the end of 2016 we are progressing according to plan.

Win as ONE building blocks for Good Growth 2020



- Measure and manage performance securing the business delivers on key performance indicators.
- Take more informed and effective decisions.
- Improve accountability in the organisation.

Read more on page 40.

- Increase marketing spend and improve spend effectiveness.
- Strengthen global brand building.
- Increase brand share.

- Strengthen commercial excellence to lead the customer agenda.
- Master price management to restore product margins.
- Execute the strategy locally.

Read more on page 76.

Deep dive on adjacent page.

'Organise to Win' is the name we gave to the restructuring of our organisation, that was successfully implemented during 2016. The restructure supports our ambition to create commercial excellence in our Europe and International market zones. Read more about the restructure on page 40.

Performance management is about measuring and actively managing performance, securing the business to deliver the key performance indicators of our strategy, and engaging everyone in the organisation. It will bring data-driven, outside-in insight to how we steer, course-correct and manage our business. This will enable us to better drive conversations and make clearer decisions, helping the organisation take more informed and effective actions.

Another important strategic bet for creating Good Growth towards 2020 is our focus on marketing and brands, supported by increased marketing spend in 2016 and a continuous focus on increasing our brand share. Read more on page 44.

The establishment of ONE European milk pool supports our ambition of channelling our owners' milk into the markets where the highest possible value can be added, irrespectively of origin. Read more about ONE milk pool on page 76.

Creating the future of dairy with bold innovation

Innovation is at the core of a branded business with a broad product portfolio. Arla needs innovation to create the future of dairy, remain attractive to consumers and customers around the world and to stay ahead of future trends. Competition is getting tougher and consumers have more choices, which is why innovation has an important role to play in adding value to our milk.

Consumers and customers want healthy, natural food that is produced responsibly. They want access to food and information about it through interesting channels, including online shopping, eating out, creating their own products to fit their needs or to get exciting inspiration on how to eat. As a result, innovation is not just about developing new products. It is also about considering packaging from a fresh perspective and adding new functionalities to the product portfolio.

The global innovation team will boost our innovations and the new Arla Innovation Centre, which opens in 2017, will be the epicenter for this. Their main task is to find new ways of making the milk from our owners into products with the highest possible value.

New science and technology enable us to keep transforming milk into new kinds of dairy products. By constantly rethinking and challenging what the business is able to do, we are more likely to create growth and stand out from our competitors. Innovation is about taking risks and sometimes we make mistakes, but we learn from our mistakes and use the experiences to create new ideas.

An example of how Arla transformed innovative ideas into a European success is skyr. A few years ago, skyr was a novelty and a niche product. Today sales in Europe are booming, with growth rates of 200 per cent from 2014 to 2016. Following the introduction of skyr in the UK, Germany and the Netherlands, sales outside Denmark now make up half of the skyr business.

According to the international consultancy Future Market Insight, there is a global market for skyr worth billions of EUR. As a result, we have tested skyr in China and the Middle East with good results. The next step is to establish local production to get the great tasting skyr products to consumers in these markets.

Supply chain as a competitive enabler

In 2016, supply chain activities were simplified and streamlined into ONE function encompassing production, procurement, QEHS and logistics. Supply chain is now in a position to deliver on cost, quality and service targets, supporting our strategy, Good Growth 2020. We can create centres of excellence rather than producing all products in all countries, generate efficiencies on a global scale and utilise our milk pool in the best possible way.

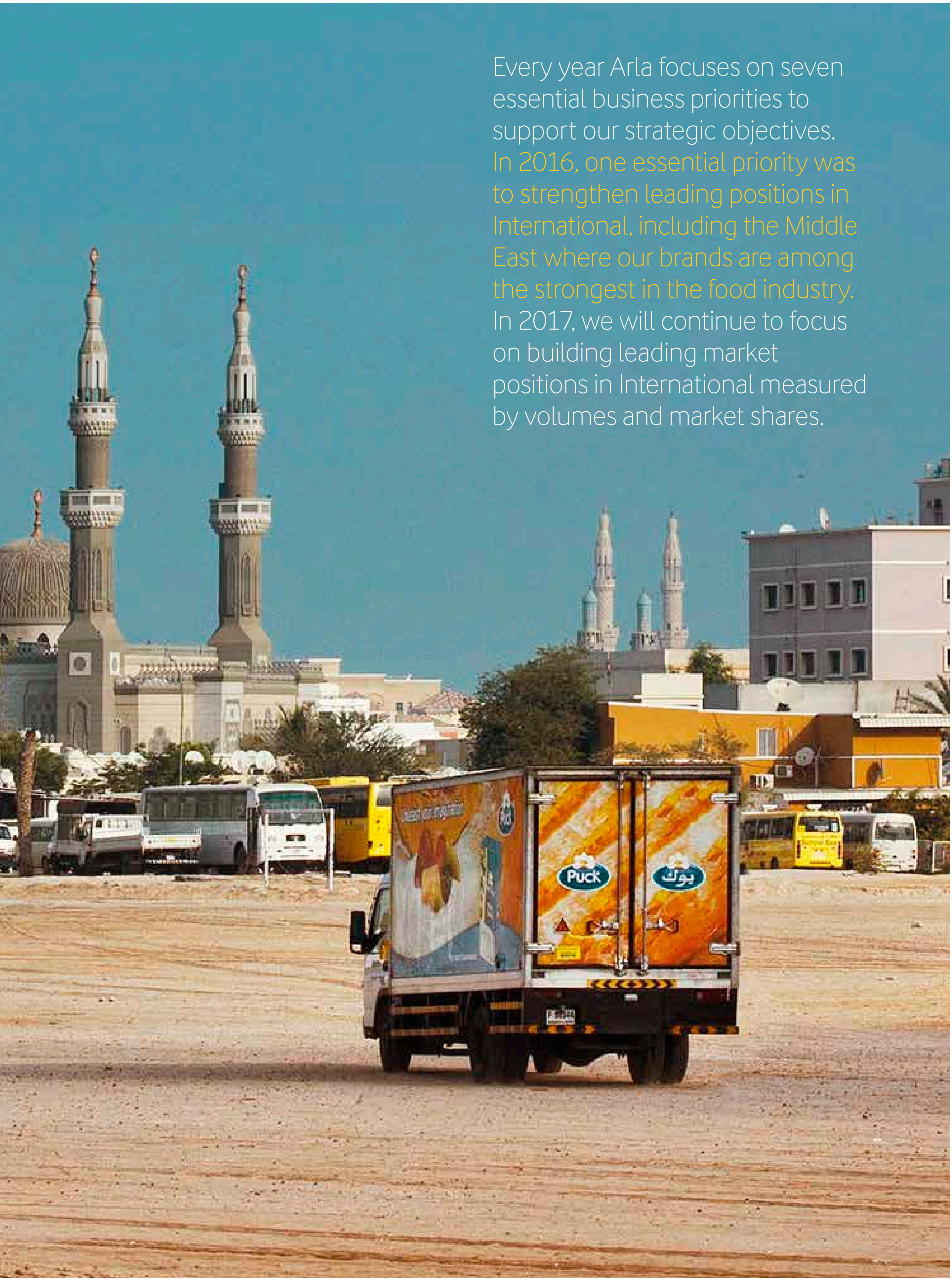
At the beginning of 2016, Arla set an ambitious cumulative cost improvement target of accumulated EUR 400 million over four years. Over time, all business functions and commercial zones will contribute to the cost savings, but initial focus will be on cost improvements in supply chain. In 2016, the supply chain delivered targeted cost savings of EUR 100 million, clearly indicating that working as ONE integrated team is paying off.

This achievement was the result of many factors, from individual site specific projects to large scale structural projects, such as the reorganisation of inbound logistics in Germany with the new central warehouse in Heidenau and the closure of Hatfield Peverel dairy in the UK.

In addition, many ongoing continuous improvement programmes have delivered great results. Our cost improvement initiatives build on existing efficiency programmes, such as LEAN, OPEX, Total Cost of Ownership, Design to Value and our net working capital project, Programme Zero.

However, the success in 2016 has not been without significant challenges, as several factors outside of supply chain's control put pressure on the function. The strategy means supply chain has to be more consumer-oriented than ever before, increasing complexity at sites with expanding product ranges. Another challenge was that supply chain planned to process more milk in 2016, but Arla experienced a decline in milk intake, which impacted efficiencies.

Every year Arla focuses on seven essential business priorities to support our strategic objectives. In 2016, one essential priority was to strengthen leading positions in International, including the Middle East where our brands are among the strongest in the food industry. In 2017, we will continue to focus on building leading market positions in International measured by volumes and market shares.



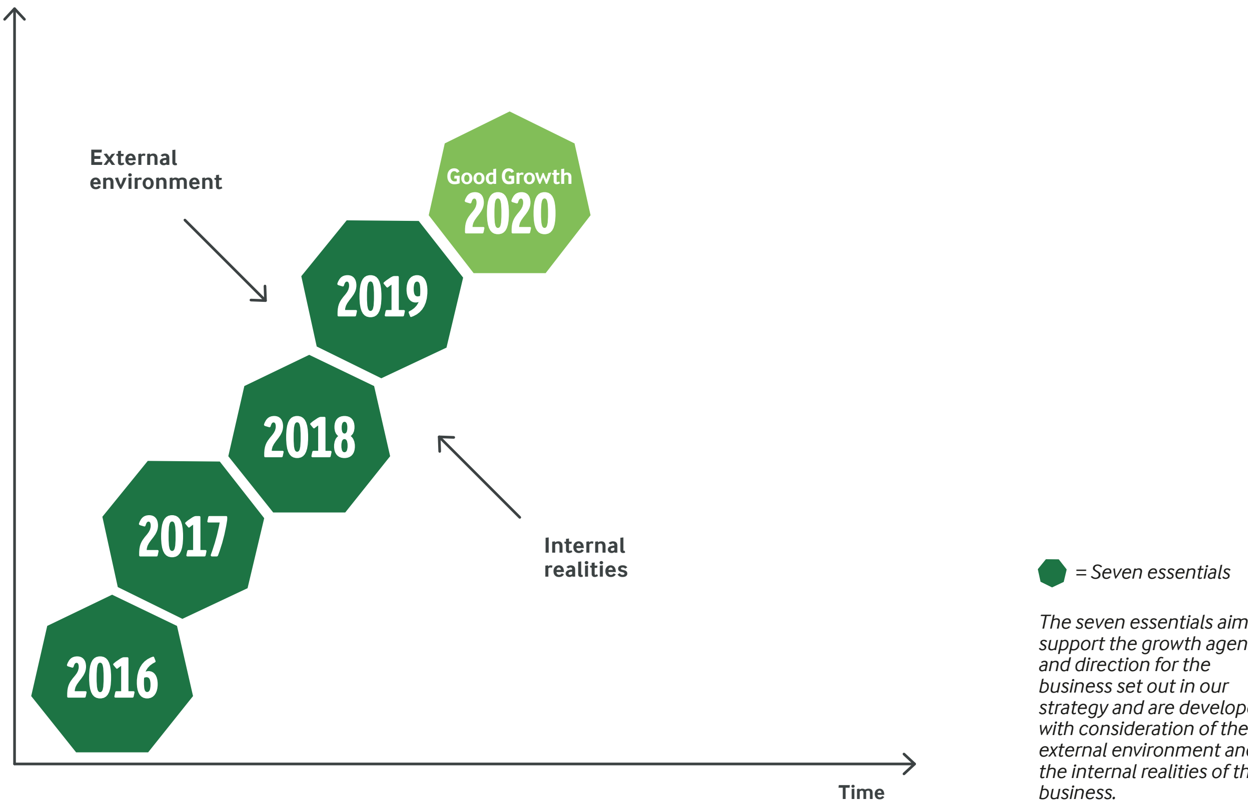
Seven essential business priorities are an enabler for Good Growth 2020

We define our annual business plan as the seven essential priorities. Our business plan should not be confused with our strategy. It complements our strategy with more detail and activities that are implementable and measurable within the course of 12 months. We consider our seven essential priorities to be an enabler for our strategy, Good Growth 2020, as they consist of critical priorities that we need to achieve on our journey to success.

In order to continuously deliver strong results for our owners and ensure the success of our strategy, the Executive Management Team determines the seven essentials business priorities each year, subject to approval by the Board of Directors. The seven essentials are a set of clear and aligned business priorities, with a defined and coherent approach on how to succeed on each of them.

The seven essentials are cascaded throughout the organisation, with all business functions and commercial zones setting goals and activities to ensure that all teams are aligned and deliver as ONE united Group.

Connecting our essentials with our strategy



The seven essentials aim to support the growth agenda and direction for the business set out in our strategy and are developed with consideration of the external environment and the internal realities of the business.

Seven essential business priorities for 2016

The seven essential priorities are the outcome of our annual business planning process, outlining the core priorities for the coming year, key activities, as well as associated key performance indicators and targets that define success. The seven essential priorities are utilised throughout all business functions and commercial zones to ensure delivery of our most important strategic priorities as ONE united group.

Volume is king

Target: Add an additional 400 million kg owner milk into retail and foodservice.

Status:

Result: In 2016, we delivered retail and foodservice volume driven revenue growth of 2.7 per cent, slightly below our target of three to five per cent. We successfully increased retail and foodservice volumes by 341 million kg. This was a great delivery close to target, despite total milk volumes being more than 800 million kg less than initially expected. Certain tradeoffs between volume and price were made during the second half of 2016 based on the increasing raw material shortage and rapidly increasing milk prices. The reduction in milk intake expectations during 2016 exemplifies this change in strategic perspective.

Deliver significant growth on brands

Target: Deliver significant growth on strategic brands, covered by Arla®, Lurpak®, Castello® and Puck®.

Status:

Result: Delivering strategic branded volume driven revenue growth at 5.2 per cent is an all-time high for Arla. In 2016, almost the entire growth in our core retail and foodservice business has been driven by our brands. Intensified sales efforts and increased investment in marketing have resulted in our branded growth being driven by the Arla® brand (4.5 per cent), Lurpak® (7.7 per cent), Castello® (3.0 per cent) and Puck® (10.6 per cent). With a brand share of 44.5 per cent, the proportion of high profit products is the strongest in years.

Improve Central Europe peer performance*

Target: Improve Central Europe peer performance by addressing cost and brand performance and competitively export milk into retail and foodservice outside the EU.

Status:

Result: The business delivered significant cost improvements according to plan in supply chain, across administrative and commercial functions, as well as significantly improving the results in the German cheese business. In addition, branded positions grew by 3.4 per cent, a solid achievement in a difficult market. Milk supply and price volatility have unfolded more rigorously in Germany than any other region, and the market has become even more fragmented, tough and competitive. This proved to be even more challenging than expected, although some improvements have become visible towards year-end.

Strengthen market positions in International**

Target: Strengthen leading positions in China, the Americas, Nigeria, Middle East and North Africa measured by volume and market share.

Status:

Result: In 2016, we have succeeded in growing volumes in these International regions by 9.5 per cent and our branded business by 10.7 per cent. China and South East Asia grew by 31.2 per cent, Sub-Saharan Africa grew by 15.8 per cent, the Middle East and North Africa grew by 3.8 per cent, and the Americas grew by 3.4 per cent. In a volatile year impacted significantly by low oil prices and the spill over economies in the Middle East and Nigeria, we are satisfied with the results, although they are below our 15 per cent growth target.

Structurally reduce the cost level

Target: Volume driven revenue growth should be >2.0 times higher than the growth in capacity costs. Deliver a conversion cost in production at an index level of 98.5.

Status:

Result: Our strong cost performance is, in part, due to huge efforts to run an efficient supply chain, however, our conversion cost has fallen short of the target at 99.2, impacted by the lower milk volume. Scalability ensures that capacity costs are increasing at a lower rate than revenue. Our scalability met the target of >2.0 due to firm control of capacity costs. EUR 100 million of our new ambitious cost improvement target of EUR 400 million in supply chain has been delivered in 2016.

Improve cash flow

Target: Improve cash flow to achieve leverage of 2.8 to 3.2 and release EUR 130 million*** in cash within net working capital.

Status:

Result: In 2016, we achieved leverage of 2.8, which is at the low range of our long-term target range of 2.8 to 3.4, underpinning the Group's strong financial position. Including the gain on divestment of Rynkeby, leverage is 2.4. Our primary net working capital position, excluding owner milk, was significantly improved and a cash release of EUR 165 million was achieved.

Strengthen the Arla cooperative

Target: Establish a process with the Board of Directors, National Councils and Board of Representatives to create strong owner relations.

Status:

Result: The new owner strategy will prepare Arla for the future and ensure a competent and aligned fundamental owner structure that unites owners across countries. In October, the Board of Representatives decided on an aligned structure, annual calendar and to explore if the UK and Central European owners can be offered direct membership in Arla Foods amba. The first elements of the strategy will come into effect in 2017.

** After the restructure, Consumer Central Europe is referred to as Central Europe. The priorities remain unchanged.*
*** After the restructure Consumer International is referred to as International. The priorities remain unchanged.*
**** Changed at mid-year from EUR 150 million due to a higher share of sales in International.*

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

Seven essential business priorities for 2017

Our ability to translate the price increases into higher retail prices will be the key to our success. We must continue transforming our business, prioritising high-margin branded products and keeping strong discipline on our cost and cash agendas to best position us for the future. To support these ambitions, we will increase our focus on price management, strengthen our innovation pipeline, grow targeted brand investments and drive efficiency in our supply chain and administrative cost programmes.

Deliver price increases and drive margin focus

To deliver appropriate retail price increases across all European and International markets and categories, we will introduce enhanced price management analytics and processes that optimise the balance between highest potential margin for our products with minimal market share impact. With commercial and financial discipline, we are confident that we can ensure a competitive milk price for our owners, as well as strong peer group performance.

Control costs, drive operational efficiencies and release cash

We will deliver strong cost control by continuously improving our cost positions within supply chain, administrative and commercial functions. Our aim is to achieve a conversion cost index in supply chain of <100 and attain scalability of >2.0. We will also continue our strong cash delivery orientation to ensure appropriate capital is available to fund our Good Growth 2020 ambitions. To do this, we will expand our successful working capital programmes and deliver a financial leverage within our long-term target range of 2.8 to 3.4.

Drive bold brand growth and bold innovation

We believe increasing our share of branded sales is the most important structural change we can make to ensure higher growth and profitability going forward. Although the growth rate will be under pressure in 2017 due to our focus on price increases, we remain committed to achieving a goal of >45 per cent of our sales coming from Arla®, Lurpak®, Castello® and Puck® by 2020. With the new global Innovation Centre opening this year, we plan to visibly increase our short, medium and long-term innovation pipeline. We will again increase our marketing spend to drive globally focused big bets in markets and categories with the biggest impact.

Make leadership matter in the milk, yogurt and powder category

We are committed to showcasing clear market leadership in our biggest product category. We will demonstrate best-in-class innovation and brand building, particularly around speciality offerings such as organic, lactose free, as well as skyr and protein. We also plan to expand cross-regional product launches, moving winning products and competencies more quickly into multiple markets. We will continue to innovate with non-genetically modified feed and other dedicated innovations, as well as improve customer service. Lastly, leading in the white milk category also requires winning with private label products.

Build leading market positions in International

In markets outside Europe, we will accelerate growth of our global categories and brands. This means growing both on an absolute level, but also expanding market share in focus regions. Whether it be the Middle East and North Africa, Sub-Saharan Africa, the Americas, China and South East Asia or Russia and distributor sales, our goal is to improve our relevance with consumers, through increased market investments and strengthened partnerships with local distributors.

Partner for growth with leading customers

Across Europe, we will strengthen our customer-centric business and focus on winning with leading customers. This requires special focus on growth, profitability, customers, category collaboration and delivery of service, amongst others. Core initiatives will be category management, mutual category and brand plans, collaboration across functions to lift online sales and the utilisation of digital opportunities. Within foodservice, we will launch a new organisation in Europe.

Strengthen the important German market position

In 2017, we will strengthen our most challenging market, Germany, by creating a winning plan, executing focused commercial bets and enhancing operational basics. An increased focus on brands and innovation will be crucial to improve quality and profitability. Within supply chain, we will focus on cost competitiveness, as well as continued development of our production footprint.

Governance

ONE

ONE is a continuous effort to unite Arla on three levels:

ONE | Shared Focus
At the core are the ideas and beliefs that unite us and drive everything we do.

ONE | Aligned Leadership
Shared management practices align leaders.

ONE | Aligned Functions
Functions are united by ways of working encompassed within global ONE programmes.

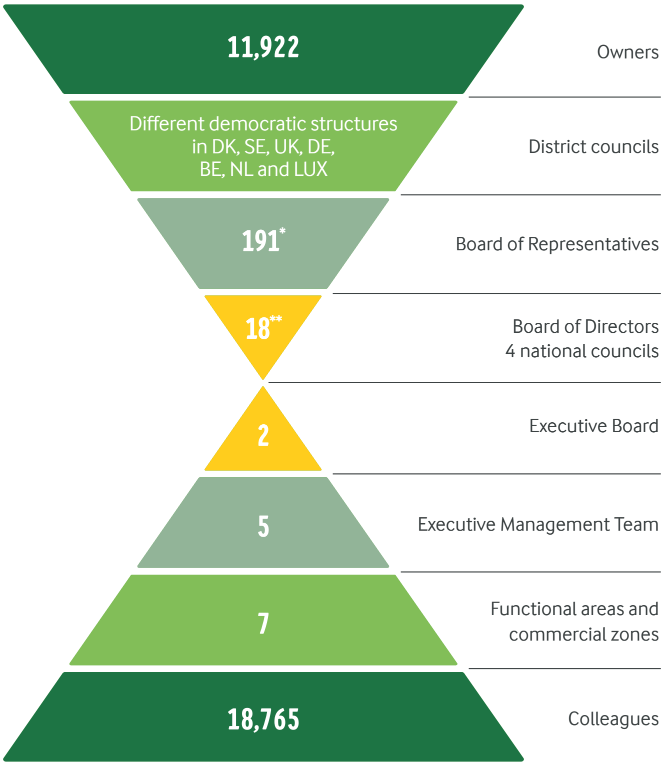
Content

Governance framework

Arla is a cooperative owned by dairy farmers. Being a large cooperative is an important differentiator for us. Operating it across seven owner countries is both very rewarding and challenging. In 2016, Arla's governance structure was improved with a successful reorganisation of the mangement structure further streamlining the democratic structure of the cooperative.

Corporate governance stands for responsible and transparent management and corporate control, oriented towards a sustainable increase in value. We are convinced that good corporate governance is an essential foundation for sustainable corporate success and enhances the confidence placed in our Group by our owners and colleagues.

Arla's governance model



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

"Over the years Arla has grown through a number of mergers. We have focused on aligning basic principles in recent years. This is a huge achievement. Now the time has come for us to align how we work within our democratic structure."

Åke Hantoft, Chairman of the Board of Directors

Cooperative governance

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

Owners
11,922 milk producers in Denmark, Sweden, the UK, Germany, Belgium, Luxembourg and the Netherlands were joint owners of Arla in 2016. As a cooperative, all of our farmers have the opportunity to influence significant decisions. As we expand into new markets, our diverse group of owners elect representatives from their ranks to the company's governing bodies.

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

Board of Representatives
The Board of Representatives is the supreme governing body comprising 191 members of whom 179 are cooperative owners, while 12 are Arla colleagues. Cooperative owners are elected every other year in odd years. The Board of Representatives makes decisions including appropriation of profit for the year and elects the Board of Directors. The Board of Representatives meets at least twice a year.

Board of Directors
Together with the Board of Representatives, the Board of Directors is responsible for decisions relating to long-term strategies, major investments, as well as mergers and acquisitions. The Board of Directors consists of 15 elected Arla farmers and three employee representatives with the knowledge, skills and professional expertise required to properly perform their tasks. The composition of the Board of Directors reflects Arla's ownership. The Board of Directors is responsible for monitoring the company's activities and asset management, satisfactorily maintaining the accounts and appointing the Executive Board. The Board of Directors is also responsible for ensuring that Arla is managed in the best interest of its owners and making decisions concerning the ownership structure.

In 2016, the attendance rate at the Board of Directors meetings was

98%

National councils
Arla has four national councils that are sub-committees of the Board of Directors and consist of members of the Board of Directors, as well as members of the Board of Representatives. The national councils are established in the four democratic areas of Sweden, Denmark, Central Europe and the UK to take care of the matters that are of special interest to the owners in each country.

New owner strategy
In 2016, the Board of Representatives took the first steps in developing the new owner strategy. Read more about the new owner strategy on page 41.

Arla is made up of thousands of people who share an aspiration to make a difference in the world. While we each have an important individual role to play in achieving our mission and vision, our shared success is best assured if we are united as ONE global company.

Corporate governance

In the first half of 2016, a restructure of the organisation was efficiently executed in order to deliver the strategy, Good Growth 2020, faster, stronger and in a more united way. Read more about the restructure of the business on page 40.

Executive Board
The Executive Board consists of Arla's CEO and vice CEO appointed by the Board of Directors. They are responsible for independently managing the company, ensuring the proper long-term growth of the company from a global perspective, driving the strategic direction, following up on targets for the year and defining company policies, while striving for a sustainable increase in company value. Furthermore, the Executive Board ensures appropriate risk management and risk controlling, as well as compliance with statutory regulations and internal guidelines. This is where the Group's ambitions are defined for cross-disciplinary efforts.

Executive Management Team
The Executive Management Team is responsible for Arla's day-to-day business operations and for preparing strategies and planning the future operating structure. The Executive Management Team is based around specific functional areas such as Supply Chain, Marketing and Innovation, Human Resourses and Corporate Affairs, Milk, Member and Trading, as well as Finance, IT and Legal. It also includes two commercial zones, Europe and International. Irrespective of their overall responsibility, the members of the Executive Management Team are individually responsible for managing their respective business areas. The members of the Executive Management Team keep one another informed on all significant developments in their business area and align on all cross-functional measures.

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

Colleagues
Arla has 18,765 colleagues globally, who are represented in the Board of Directors and the Board of Representatives.

Arla remuneration philosophy
The remuneration package is designed to ensure attraction and retention of the right senior leaders, at the same time driving both short and long-term business results. This is achieved by offering a benchmarked remuneration package with the right balance of fixed and variable pay. The competitive remuneration package is reviewed annually by external advisors using market data sources.

Executive Board
The remuneration package for members of the Executive Board is based on external benchmarks against European and International 'fast-moving consumer goods' companies, providing a competitive and sustainable mix of fixed and variable pay. The fixed pay component consists of an annual base salary, a pension contribution, as well as an executive benefit package. The variable pay component consists of both an annual variable incentive plan, as well as a three-year long-term incentive programme.

The members of the Executive Board are employed on terms according to international standards, including adequate non-compete restrictions as well as confidentiality and loyalty restrictions.

Whistleblower service
Arla is an organisation with a strong sense of responsibility and integrity. Arla's Code of Conduct contains general guidelines for conducting business. In addition to this, Arla has a whistleblower service to enable its colleagues in all companies that are majority owned or controlled by Arla to report information about possible irregularities. It is also a channel to voice concerns regarding potential violation of Arla's Code of Conduct or legislation.

Since the implementation in 2012, Arla has received 52 reports from its whistleblowing service. The reports have come from most parts of the organisation and include areas such as auditing, accounting, theft, anti-bribery, entertainment, as well as health and safety. In 2016, the whistleblowing service received 25 reports of which 15 led to further investigation. Depending on the outcome of the investigation, appropriate measures have been taken. Ten reports have been classified as inappropriate behaviour towards an individual, which means that we cannot register and process these due to legal reasons. Instead, the reporter is informed of which person to contact within Human Resources.

Inclusion and diversity

In Arla, we believe that inclusion and diversity are imperative to our business and that diverse teams lead to enhanced commercial outcomes. We define diversity broadly as differences between people with a diverse range of backgrounds, while inclusion is about valuing differences among individuals to create synergies. As an organisation, we strive for an inclusive and welcoming culture for all colleagues.

Diversity from an owner perspective

In compliance with legislation, Arla has set a target for the underrepresented gender in the Board of Directors. As men are highly overrepresented in our industry, the target reflects the gender composition among our owners. We consider the demographics of the Board of Representatives to be representative of the owner group due to elections in a democratic process every other year.

In 2016, the representation of females in the Board of Representatives was 13 per cent compared to seven per cent in the Board of Directors. Our aim is that female representation in the Board of Directors reflects the female representation of the Board of Representatives following the election in 2019.

Gender in the Board of Representatives*

Year	Female	Male
2016	13%	87%
2015		

Gender in the Board of Directors**

Year	Female	Male
2016	7%	93%
2015		

Striving for Good Growth 2020

As part of our strategy, Good Growth 2020, we aim to drive change in the composition of our teams by ensuring that a maximum of 70 per cent of members in any given team represents the same set of criteria. These criteria include nationality and ethnic background, gender, generation, educational and professional background.

Gender representation in 2016

We have focused primarily on reporting gender composition in 2016. Women comprise 28 per cent of Arla's entire workforce, representing an increase in scope coverage versus the prior year.

Gender in Arla

Year	Female	Male
2016	28%	72%
2015	28%	72%

In January 2016, the appointment of two females to the Executive Management Team was announced bringing the female representation to 29 per cent. This is a significant achievement and has established a foundation for further progress.

Gender in the Executive Management Team

Year	Female	Male
2016	29%	71%
2015	0%	100%

Since 2013, we have aimed at having more than 20 per cent of our employee population at director level and above as female. In 2016, our population at director level and above improved modestly, with female representation following our recent restructure amounting to 22 per cent.

Gender at director level and above

Year	Female	Male
2016	22%	78%
2015	21%	79%

Examples of inclusion and diversity activities in 2016

In 2016, we have worked with several inclusion and diversity initiatives.

Relaunching 'Our Leadership' framework

We have refreshed and relaunched Arla's 'Our Leadership' framework, making all materials transparent and available to everyone. The refresh includes clear statements that demonstrate great leadership is available to all colleagues, irrespective of job type or hierarchy, with clear guidance as to how best to show these capabilities at any career stage. To support the relaunch of 'Our Leadership', all the leadership programmes have been redesigned to support colleagues to realise their full potential in Arla.

Future 15 Graduate Programme

The Arla 'F15® Graduate Programme' allows promising candidates to experience a versatile picture of Arla. The programme consists of three global job rotations in diffferent functions. Across 2015 and 2016, Arla welcomed 18 different nationalities in the application process, consisting equally of male and female candidates. In 2015, there was a female representation of 50 per cent, compared to 75 per cent in 2016. For the 2017 application round, we received 1,485 applications from 72 countries, with an equal gender distribution.

Talent Accelerator Programme

Our 'Talent Accelerator Programme' draws together some of the brightest and most ambitious young leaders, giving them the opportunity to broaden their leadership skills. In 2016, managers were asked to nominate their best female and best male high potentials, removing any gender bias. This resulted in the same number of males and females being given the opportunity to join the programme. Of the nominees who were successful in their assessment, 53 per cent were female, constituting an increase of 18 per cent from last year.

** Excluding employee representation in the Board of Representatives.*
*** Excluding employee representation in the Board of Directors.*

Executive Management Team

Executive Board

1
Peder Tuborgh
CEO
Head of Milk, Members and Trading
Head of Arla Foods Ingredients

Year of birth: 1963
Nationality: Danish

2005: CEO, Arla Foods
2002: Executive Group Director, Arla Foods
2000: Divisional Director, Denmark Division, Arla Foods
1994: Marketing Director, Denmark Division, MD Foods
1990: Marketing Manager, Danya Foods Saudi Arabia
1987: Product Manager, Germany, MD Foods

2
Povl Krogsgaard
Vice CEO
Executive Vice President, Supply Chain

Year of birth: 1950
Nationality: Danish

2004: Vice CEO, Arla Foods
2000: Executive Group Director, Arla Foods
1998: Executive Group Director, MD Foods
1994: CEO, Mejeriernes Produktionsselskab
1991: Director, Home Market Division, MD Foods
1989: Production Manager, Yellow Cheese, MD Foods
1988: Head of Home Market Division, MD Foods
1987: Head of Mejeriselskabet
1979: Danske Mejeriers Fællesorganisation

Other Executive Management Team

3
Natalie Knight
CFO
Executive Vice President, Finance, IT and Legal

Year of birth: 1970
Nationality: American

2016: CFO, Arla Foods
2015: Senior Vice President, Group Functions Finance, adidas
2011: Senior Vice President, Brand and Commercial Finance, adidas
2008: CFO, North America, adidas
2004: Vice President, Mergers and Acquisitions and Investor Relations, adidas
1999: Vice President, Head of Investor Relations, adidas
1998: Investor Relations Manager, BASF
1995: Investor Relations Specialist, Bankgesellschaft Berlin

4
Ola Arvidsson
CHRO
Executive Vice President, HR and Corporate Affairs

Year of birth: 1968
Nationality: Swedish

2007: CHRO, Arla Foods
2006: HR Director, Arla Foods
2005: HR Vice President, Unilever Nordic
2003: HR Director, Unilever Home and Personal Care Europe
2001: HR Director, Unilever
2000: HR Director, Lever Faberge Nordic, Unilever
1998: HR Director, Diverseylever Nordic, Unilever
1995: HR Manager, Unilever
1988: Officer, Royal Combat Engineering Corps, Swedish Army

5
Hanne Søndergaard
CMO
Executive Vice President, Marketing and Innovation

Year of birth: 1965
Nationality: Danish

2016: CMO, Arla Foods
2012: Senior Vice President, Global Categories and Brands, Arla Foods
2010: Senior Vice President, Butter, Spreads and Margarines and Arla Brand, Arla Foods
2007: Vice CEO, Arla Foods UK
2001: Marketing Director, Arla Foods UK
1999: Sainsbury's BU Controller, MD Foods UK PLC
1996: Category Controller, MD Foods UK PLC
1994: Cheese Product Manager, MD Foods UK PLC

6
Peter Giørtz-Carlsen
Executive Vice President, Europe

Year of birth: 1973
Nationality: Danish

2016: Executive Vice President, Europe, Arla Foods
2014: Executive Vice President, Consumer UK, Arla Foods
2011: Executive Vice President, Consumer Denmark, Arla Foods
2010: Vice CEO, China, Bestseller Fashion Group
2008: Managing Director, Cocio Chokolademælk A/S
2003: Vice President, Corporate Strategy, Arla Foods
2002: Business Development Director, Semco/Bravida
1999: Management Consultant, Accenture Strategy Practice

7
Tim Ørting Jørgensen
Executive Vice President, International

Year of birth: 1964
Nationality: Danish

2016: Executive Vice President, International, Arla Foods
2012: Executive Vice President, Consumer Central Europe, Arla Foods
2007: Executive Vice President, Consumer International, Arla Foods
2001: Divisional Director, Denmark Division, Arla Foods
1999: Group Project Manager, MD Foods
1996: Commercial Manager, MD Foods do Brasil/Dan Vigor
1993: Product Manager, Danya Foods
1992: Trade Marketing Manager, France, MD Foods
1991: Trade Marketing Assistant, Cheese Division, MD Foods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1
5
4
7
3
6

Board of Directors

Åke Hantoft
Chairman

Year of birth: 1952
Nationality: Swedish
Member of the board since 2000

Jan Toft Nørgaard
Vice Chairman

Year of birth: 1960
Nationality: Danish
Member of the board since 2000

Thomas Johansen

Year of birth: 1959
Nationality: Danish
Member of the board since 2002

Viggo Ø. Bloch

Year of birth: 1955
Nationality: Danish
Member of the board since 2003

Manfred Graff

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

Jonas Carlgren

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

Bjørn Jepsen

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

Markus Hübers

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

Palle Borgström

Year of birth: 1960
Nationality: Swedish
Member of the board since 2008

Heléne Gunnarson

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

Johnnie Russell

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

Manfred Sievers

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

Jonathan Ovens

Year of birth: 1957
Nationality: British
Member of the board since 2014

Torben Myrup

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

Harry Shaw
Employee representative

Year of birth: 1952
Nationality: British
Member of the board since 2013

Ib Bjerglund Nielsen
Employee representative

Year of birth: 1960
Nationality: Danish
Member of the board since 2013

Steen Nørgaard Madsen

Year of birth: 1956
Nationality: Danish
Member of the board since 2005

Haakan Gillström
Employee representative

Year of birth: 1953
Nationality: Swedish
Member of the board since 2015

A global organisation fit for the future

In February 2016, Arla announced significant structural changes to the organisation that will enable the business to deliver its ambitions. The restructure included the creation of a new Executive Management Team, as well as a more efficient, global and functional orientated structure, which enables markets to strengthen their commercial and consumer focus.

Arla has grown its business significantly in recent years, both organically and through mergers. However, more milk is expected to be produced globally and Europe is experiencing pressure on prices and very little growth, which means competition is fierce. In addition, consumers' needs are becoming more diverse and customers expect increased levels of service. In order to increase our competitiveness, Arla changed its ways of working to be more agile and cost efficient.

The new organisation is designed to optimise Arla's performance in a highly competitive global dairy market, by strengthening value creation and functional efficiency as outlined in the strategy, Good Growth 2020. The new organisation drives clear functional responsibilities and efficient execution in global functions and develops more collaborative ways of working, while reducing duplication across countries. Arla made more than 500 white collar employees redundant across markets and removed them from the business by June. We expect to achieve the cost improvement in 2017 and beyond.

A new Executive Management Team

The changes commenced at the top of the organisation. On 1 March, the new organisational restructure went live, with a new Executive Management Team built around specific functional areas and commercial markets organised into two geographical areas. There are seven members of the Executive Management Team, compared to nine previously.

The main changes

Arla has streamlined and simplified the global organisational structure and prioritised its resources to support the Good Growth 2020 work streams.

The new operating model, following the restructure of the organisation, is based on a functional logic with deep capabilities and clear accountability. The model ensures our global functional ambitions meet the realities of our markets in order to create Good Growth on our journey towards 2020.

With the new organisation, responsibility for marketing and innovation has been elevated to the Executive Management Team, to deliver global brands and category leadership. Similarly, two commercial zones have been formed: Europe and International. This allows country management to strengthen its commercial focus on consumers, customers and categories supported by strong marketing driven from a global category perspective.

Furthermore, ONE European milk pool and ONE global supply chain functions have been formed, encompassing production, procurement, QEHS and logistics to utilise our milk in the best possible way, generate efficiencies on a global scale and ensure that the capacity across our 60 sites is optimised.

Operating model: From farmers to consumers

A living cooperative true to its principles

As a thriving cooperative democracy, we are continuously working to further develop our democratic processes. In 2016, we reviewed our cooperative owner structure, as well as the democratic bodies that oversee the interests of cooperative owners through elections, meetings and decision making. In the coming year our new owner strategy will drive change in all owner countries.

In 2015, the Board of Directors, in cooperation with the Board of Representatives, decided to create a more streamlined structure for Arla's member democracy. A structural change was needed to align different structures following several mergers which occurred between 2011 to 2015, and it is a natural step in achieving harmonisation.

Based on the founding principle from the 1880s, 'One man, one vote – in a cooperative owned and managed by farmers for farmers', the aim of the new owner strategy is to further develop and prepare Arla as a cooperative for the future. The majority of Arla's elected farmer representatives were involved in this discussion during 2016 including discussions at the Board of Representatives meeting in October. At the meeting, the 191 elected members decided on a course of action that will result in a more streamlined democratic structure over the coming years. Going forward, the aim is also to achieve harmonised processes for meetings among Arla's cooperative owners and representatives, and for the election of farmer representatives to the various bodies.

Creating a uniform and transparent structure

Cooperative democracy allows the individual member to influence decision-making in Arla and stay informed about the development of the business. This structural overhaul will make the owner structure more uniform and transparent across all seven owner countries.

Today, the UK and Central European farmers, unlike owners from Denmark and Sweden, are members through their cooperatives, which in turn are members of Arla Foods amba. The Board of Representatives decided to further explore whether it would be possible to offer all Arla farmers direct membership in Arla Foods amba. If possible, each cooperative and its farmers would be able to decide through a local democratic process.

Improving communication across the Group

The strength of an owner-managed company relies on the cooperative democracy to be alive and healthy, and its members engaged. As a result, harmonisation must ensure prompt communication and transparency concerning decision-making processes. The new structure is also expected to improve dialogue across the Group.

Progress on the owner strategy is expected to continue in 2017. Specific priorities include focus on amendments to the Articles of Association to support the new structure, as well as on potential direct membership for the cooperative owners in Central Europe and the UK.

The new owner strategy process

February 2016	Spring 2016	May 2016	Summer 2016	October 2016	2017
The new owner strategy kicked-off with the Board of Representatives.	Discussions among elected representatives in the National Councils.	Principle discussions at the Board of Representatives.	Further discussions amongst members, National Councils and within the Board of Directors ahead of the Board of Representatives meeting in October.	The Board of Representatives decided on an aligned structure, annual calendar and to explore if the UK and Central European owners can be offered direct membership in Arla Foods amba.	Implementation of elements decided at the Board of Representatives meeting in October 2016: ■ Governance structure ■ Eligibility and elections ■ Annual meeting cycle Discussions continue on the cooperative structure in the UK and Central Europe, corporate governance and further development of Arlagården®.

Performance

Our owners are counting on us to add value to every kg of their milk.

Content

Market overview

Milk prices at year-end were the highest in two and a half years, and have improved strongly versus the low mid-year levels. However, farmers realised significant losses on their farms throughout the year and despite increasing optimism driven by higher prices, they remained cautious given the brutal price environment of recent years.

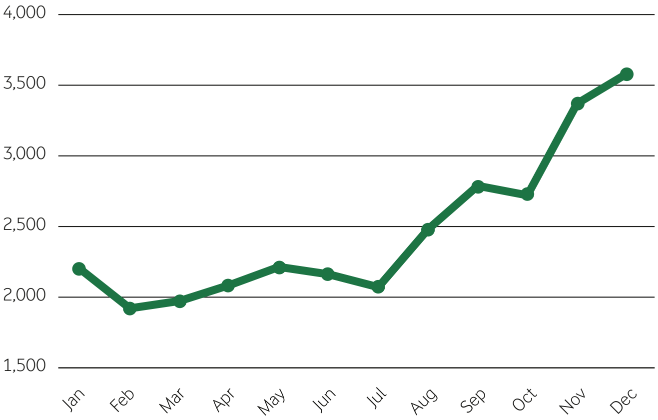
2016 was a challenging and highly volatile year for the global dairy industry. Big swings in European supply were the primary driver of volumes and prices, while American supply grew modestly and Oceania supply continued to contract, as a result of low global milk prices that characterised the market during the first seven to eight months of 2016. Demand grew in line with Gross Domestic Product (GDP) in most markets, which translated to low single-digit growth in most countries. This development also included most emerging markets and the major oil exporting regions of the world such as the Middle East and Sub-Saharan Africa, which grew more slowly than in recent years.

The European milk supply grew sharply in the first four months of the year, mirroring the annualisation effects of the abolition of the EU quota system in April 2015. Farmers who were now able to produce unlimited quantities of milk for the first time ever, produced five per cent more milk in the first quarter of the year. In countries with particularly strong dairy industries, such as Ireland and the Netherlands, growth rates were the highest at 25 and 12 per cent respectively. Although these increases moderated later in the first half of 2016, given no matching increase in demand, prepaid prices moved downward quickly and reached historically low levels in May to June 2016. With limited impulses from other regions, Global Dairy Trade (GDT) prices followed the trend and finished the first half of 2016 at five year low prices, with whole milk powder prices of USD 2,000 to 2,100 per metric tonne.

In stark contrast, milk supply in Europe declined significantly during the second half of 2016, which led to the fastest milk price rally ever recorded. Supply growth, which had slowed in the second quarter, stabilised and then decreased sharply as the year progressed. This development was largely driven proactively by farmers, who quickly reduced milk output by five per cent in the fourth quarter, due to unsustainable milk prices. Following record cullings, farm closures and rigorous political lobbying, the EU also introduced an intervention programme to help stabilise the market. With supply decelerating quickly and no measurable changes in demand, milk prices finally began to increase early in the second half of 2016. Improvements started in the European yellow cheese and butter categories as a direct result of the increasing scarcity of raw material in the European milk market. Price inflation quickly spread to European powder products and then to other dairy commodities traded on the GDT. Global markets initially trailed but eventually equaled these trends by year-end. As a result, milk commodity prices grew 90 to 100 per cent in Europe and 70 per cent on the GDT, within six to seven months and completely reversed the negative pricing trends of the last two years.

In total, the 2016 milk supply declined by approximately one per cent in Europe versus 2015. However, this development masks a huge discrepancy in oversupply in the first half versus significant declines and, in some categories, real shortages in the second half. Although milk prices at year-end were the highest in two and a half years, farmers realised significant losses on their farms throughout the year, and despite increasing optimism driven by higher prices, they remained cautious given the brutal price environment of recent years.

Global Dairy Trade development in 2016, Whole Milk Powder
(USD/tonne)



Financial review

Arla maintained a solid business performance throughout 2016, despite highly volatile milk markets. While revenue declined due to the external price environment, we responded to the change in milk supply by improving the quality of our revenue through focusing on our brands. We continued to drive innovation in order to ensure sustainable growth in our branded portfolio. We delivered financial results above our targets on most measures, with net profit at 3.6 per cent of sales (including the divestment of Rynkeby), a strategic branded volume driven revenue growth of 5.2 per cent and a growth in brand share to 44.5 per cent. The performance price for the year was 30.9 EUR-cent/kg.

Arla's business performance reflected the year's market volatility to a limited extent. This was the result of our ability to utilise low milk prices in the first half to grow market share and volumes in core European and international markets. In the second half of the year, financial results were less strong for the Group as we made the strategic choice to increasingly focus on raising prices at the expense of volumes, driven by lower supply availability. Similarly, as prices improved, we focused on paying out as much to farmers as quickly as possible to help our owners realise market improvements and support their farm economies.

Arla's milk prices reflect a challenging and volatile market

The generally low price level for commodity products that characterised the majority of 2016, impacted Arla's ability to safeguard the milk price for our owners. The average prepaid milk price for 2016 was 9.4 per cent lower at 29.0 EUR-cent/kg, compared to 32.0 EUR-cent/kg in 2015. It is important to note, however, that the development of the prepaid prices improved significantly in the latter part of the year, driven by strong price management. Between August and December 2016, Arla announced increases in the prepaid milk price of nearly 30 per cent or 7.25 EUR-cent/kg. This is the most rapid increase in the prepaid milk price that Arla has ever recorded.

The 2016 performance price decreased 8.3 per cent to 30.9 EUR-cent/kg, compared to 33.7 EUR-cent/kg in 2015. The performance price reflects the ability of the Group to add value to our owners' milk and hence the ability to add value through our innovation, brands, cost programmes, global growth, and other strategic and operational efforts. The performance price is a key element in measuring Arla's relative performance versus our peers, which is done consistently through our peer group index, closely linked to our mission.

The preliminary peer group index for 2016 is 105. This shows that Arla generated an average of five per cent more value per kg of member milk than the average of the peer group in 2016. The peer group includes all publicly available competitors in Northern European markets, such as Germany, the Netherlands, the UK, Denmark and Sweden, representing 80 per cent of all milk produced in the region. The index is a solid measure on Arla's ability to pay a competitive milk price in the market. Our strategic ambition is to deliver a peer group index of 103 to 105 as stated in our strategy, Good Growth 2020.

Strong profit level supported by divestment of Rynkeby

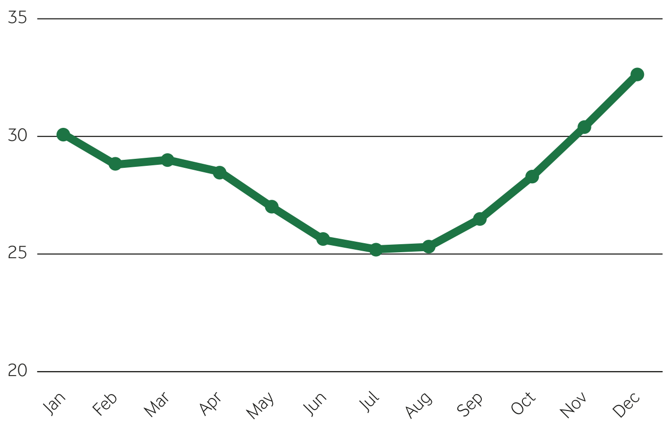
Despite lower sales and milk volumes, Arla's net profit grew 20.7 per cent for the 2016 financial year, to EUR 356 million from EUR 295 million in 2015. As a percentage of sales, 2016 profit, excluding minority interest share of the result, was 3.6 per cent versus 2.8 per cent in 2015, and therefore above the previously communicated target range of 2.8 to 3.2 per cent.

Our net profit was influenced by significant one-offs in 2016. On the positive side, the sale of Rynkeby increased net profit by 1.2 percentage points or EUR 120 million. Net profit was also impacted mainly by losses experienced by our associated company in China, Mengniu, and currency availability and devaluation in Nigeria. Despite having an unfavourable impact on net profit, we deliberately increased the prepaid milk price in the last quarter of the year to support our farmer owners.

Milk volume declines 2.2 per cent after turbulent production year

Total milk volumes declined 2.2 per cent to 13.9 billion kg in 2016, compared to 14.2 billion kg of volume intake in 2015. Milk volumes from farmer owners

Prepaid milk price 2016
(EUR-cent/kg)



reduced by 1.1 per cent to 12,320 million kg, from 12,463 million kg in 2015. Contract milk, speciality milk and milk acquired to meet local market demands, reduced by 10.1 per cent to 1,554 million kg, versus 1,729 million kg in the previous year.

Despite the challenges we have faced in the market, few members have left the cooperative other than through expected developments such as retirement.

Revenue declines 6.8 per cent in 2016

At Arla, there are four primary components that determine sales development: milk prices, volume, product mix and exchange rates. In 2016, revenue declined 6.8 per cent to EUR 9.567 million, compared to EUR 10.262 million in 2015. This is primarily a result of lower milk prices, which dominated the market for the first three quarters of the year. Unfavourable exchange rate developments, primarily as a result of the weakened GBP in the UK, which comprises 25 per cent of Group revenue, also negatively impacted overall revenue development. Read more on page 91.

Price rally in the second half of 2016

Price management has enabled a visible increase of 7.25 EUR-cent/kg in the prepaid milk price from August 2016, Arla being one of the first to do so. This has been achieved by a rapid rollover of commodity prices into Arla's retail and foodservice channels, as well as our branded business.

Price increases are expected to be targeted on an annual basis in the retail and foodservice business sectors when looking forward into 2017.

There is a delay in achieving price increases at retail due to a varying degree of contract negotiation windows across our European and international markets. This is most notably seen in Germany, the UK, Sweden and Denmark where notice periods to retail customers vary. Retail products represent 80 per cent of Arla's business, of which 44.5 per cent is branded business. This makes our business composition significantly more brand-driven relative to our competitors and has had a negative impact on our peer group performance in the second half of 2016.

Significant steps forward on business health and structure

We are committed to realising our strategy and pursuing growth in a volatile market. The core of the strategy is a focus on improving the quality of our revenue with significant increases in our branded and international sales, as well as maintaining a tight control on costs.

Improving the quality of revenue, strengthening brand performance and growing international positions

Improving the quality of our revenue is a core element of our strategy, Good Growth 2020. Historically, more of our products were sold via trading and other commodity-like channels. This is still the case for the majority of our competitors. In an effort to get closer to consumers, reduce sales volatility and achieve higher mid and long-term profitability, we have chosen to move significantly more milk into the retail and foodservice channel. Despite lower overall milk intake, Arla was able to move more than 340 million kg from trading to this significantly more profitable channel. As a result, sales volumes in this channel grew 2.7 per cent in 2016.

In addition to a shift to retail and foodservice, Arla is strongly committed to increasing our share of branded products. We believe this is the strongest opportunity we have to drive maximum value for our products. Consumers pay a premium for brands they know and trust. They are more loyal to brands that ensure the right balance between value, innovation and a positioning they identify with. As a result, we believe that consistently improving the percentage of branded sales in our portfolio strengthens our position in the long-term. In 2016, sales volumes of our strategic branded products grew 5.2 per cent, which is the highest rate ever and double the rate of 2015. Branded sales now total 44.5 per cent of total sales, increasing 2.5 percentage points compared to 2015. To support this development, marketing spend increased to EUR 309 million from EUR 283 million in 2015.

A further area of strong strategic focus is growing our International business. 50 per cent of Arla's topline ambition in Good Growth 2020 comes from growing sales in our above-average margin International markets, where milk supply shortages exist, population growth is high and an emerging middle class all support increased demand for high quality dairy products. In 2016, International volume driven revenue growth was 9.5 per cent. Although this was beneath our 15 per cent target for the year, it still allowed us to add significant incremental value to our owners' milk and achieve an 18.0 per cent International sales share versus 16.5 per cent in 2015. Another key high-margin

Strategic branded volume driven revenue growth in 2016

Arla®

4.5%

2015: 2.5%

EST. 1901 LURPAK®

7.7%

2015: 6.1%

CASTELLO®

3.0%

2015: 0.1%

Puck

10.6%

2015: 9.9%

commercial segment is Arla Foods Ingredients. Sales in this segment increased in 2016 due to very strong growth in value added protein sales.

As a result of the shifts to retail and foodservice, branded and International business, Arla was able to reduce sales to the commodity-driven trading channel to 2,936 million kg milk. This represented 20.1 per cent of sales, compared to 21.5 per cent in 2015. While a base of sales in this channel is important to ensure flexibility with seasonal and demand volatility, Arla is pleased with this development and it is in line with our Good Growth 2020 strategy target to reduce trading business to less than 20 per cent of sales by 2020.

Maintaining tight control on costs

As a low margin business, keeping strict control on costs and rigorously optimising processes is critical to our success and competitive positioning. To ensure that these opportunities are maximised, Arla puts continuous focus on minimising growth in both supply chain and administrative costs to the greatest extent possible.

Costs for Arla include three major areas: production, sales and distribution and administration. These costs declined six per cent to EUR 9,254 million in 2016, compared to EUR 9,847 million in 2015. The decrease of EUR 593 million is mainly attributable to lower milk prices, lower milk volumes, savings and currency translation effects. Read more on page 92.

More important for us than cost development by line item, however, is the development of cost across two key metrics: scalability and conversion costs. These communicate how our costs are progressing across critical dimensions versus changes in sales volumes. Within the Group, we regularly monitor these metrics across all key commercial and functional areas.

Scalability is a core cost measure within Arla, as we believe it provides an objective criterion to evaluate the overall efficiency of our core operations when milk volumes are increasing. Scalability is the ratio between volume driven revenue growth and capacity costs. Capacity costs measure our fixed cost base and hence also the foundation for our scalability measure. We want to consistently grow our volume driven revenue growth at twice the pace as our capacity cost base and hence consistently grow our margins through rigid cost control.
In 2016, Arla's scalability was >2.0, which was in line with our communicated target and exemplifies firm control of capacity costs. In the first half of 2016, we restructured the organisation by making more than 500 white collar employees redundant in order to drive a functional and aligned agenda throughout Arla. The majority of the resulting cost savings will be visible in 2017.

Supply chain efficiency, expressed as our conversion cost index, measures how supply chain costs develop in relation to volumes. After strong first half year performance, lower milk intake in the second half of the year, drove our full year conversion cost index of 99.2 versus our target index of <98.5. Nevertheless, this development highlights a lower absolute expenditure for supply chain costs versus the prior year despite inflation, dairy closures and increasing relative capacity costs in production caused by lower milk volumes. To support our conversion cost ambition, our strategy includes an ambitious cumulative cost improvement target of EUR 400 million. Over time, all zones and functions will contribute to these savings, with the primary focus being on cost improvements within supply chain. The efficiency programme kicked off at the beginning of 2016 and has resulted in a EUR 100 million saving during its first year.

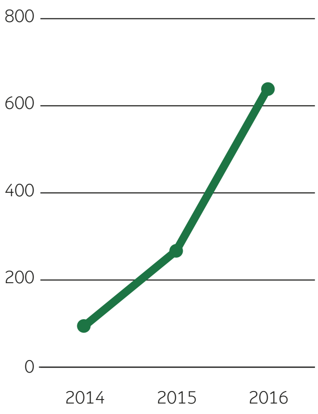
Delivering strong cash flow improvements

In 2016, Arla delivered a very strong cash flow. Cash flow from operating activities increased 20 per cent to EUR 806 million compared to EUR 669 million in 2015, primarily due to stronger cash flow from underlying operational activities, i.e. EBITDA, and improvements in net working capital position.

Cash flow from investing activities reduced by 26 per cent to EUR -305 million compared to EUR -410 million in 2015, mainly as a result of lower investments in property, plant and equipment. This reflected our ability to utilise our production capacity at existing sites more efficiently, which allowed us to temporarily reduce capital expenditure. Capital expenditure at Arla decreased by 25 per cent to EUR 263 million from EUR 350 million in 2015. The Rynkeby divestment also contributed EUR 138 million to Arla's cash flow from other investing activities.

As a result of the developments, free cash flow for 2016 grew 239 per cent to EUR 639 million, versus EUR 267 million in 2015, an improvement of EUR 372 million. The released funds were partly used to pay out a supplementary payment of EUR 108 million related to the 2015 profit appropriation. This was in line with our practice of paying out 1 EUR-cent/kg of member milk to our owners. Furthermore, EUR 22 million was paid out to leaving or retiring farmers to reimburse their individual capital. The remaining amount was used to repay debt, significantly improving our financial position.

Development in free cash flow
(EURm)



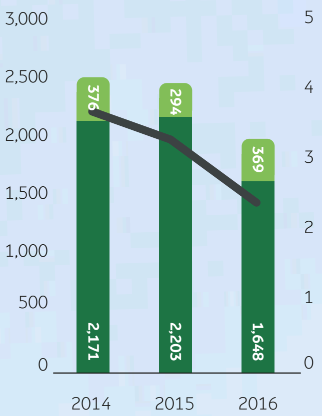
Building a strong financial position for the future

Our strong free cash flow had a favourable impact on our net debt position, and therefore on our healthy leverage of 2.4 (including the divestment of Rynkeby) at year-end, compared to 3.3 in 2015.

The Group has a strong and improved financial position and standing with credit institutions. Financial leverage is our most important balance sheet key performance indicator at Arla, because it is the measure used by external parties to measure our financial strength and creditworthiness. It is calculated as the ratio of net interest-bearing debt to profitability, i.e. EBITDA, and in 2016 both components of leverage improved, signaling Arla's strong cash flow focus. Net interest-bearing debt (excluding pension liabilities) declined 25 per cent to EUR 1.648 million in 2016, compared to EUR 2.203 million in the previous year. EBITDA (including the divestment of Rynkeby) improved 11 per cent to EUR 839 million in 2016, versus EUR 754 million in the prior year. As a result, Arla's year-end financial leverage ratio improved to 2.4, compared to 3.3 in 2015, surpassing our long-term target range of 2.8 to 3.4, which underpins the Group's strong financial position. This is supported by an improved solvency ratio of 34 per cent.

Building a strong balance sheet for the future enables Arla to make strategic choices and utilise opportunities, deliver our strategy, Good Growth 2020, and thereby secure the highest possible milk price for our farmers. Our performance and ability to pay a competitive milk price to farmers in 2016, while significantly strengthening our financial position, was due to strict financial discipline in the business and a determined effort to shift more volumes of milk into higher-margin products. Following the restructure in 2016, we have become an even stronger cooperative, operationally, financially and in our mindset. This gives us the momentum needed to achieve Good Growth towards 2020.

Net interest-bearing debt and leverage
(EURm)



- Leverage
- Pension liabilities
- Net interest-bearing debt excluding pension liabilities

Financial outlook

We are confident that the improved quality of our business, the new organisational structure, as well as our strategy put us in a favourable position and will ensure that we are ready to capture the full potential of the market in 2017 as it continues to evolve and globalise.

Economic growth lower and potentially more volatile in 2017

At Arla, we enter 2017 with the expectation of slightly lower GDP growth in most markets than 2016, especially in emerging markets where oil producing regions continue to face a variety of financial constraints. Across the Western world, recent and pending elections present potential protectionist strategies that could impact trade policies, as well as fiscal and monetary policies in many European and global markets.

Experts predict more stable milk prices in 2017

The significant commodity price increases of the third and fourth quarters in 2016 are expected to drive correlating retail price increases in Europe and other global markets during 2017. This is expected to lead to price increases that will be visible directly in consumer prices.

Looking back, the price rally during the second half of 2016 was driven primarily by a European decline in milk supply that led to an increasing raw material shortage. Unlike the earlier price cycles of 2007 to 2008 and 2012 to 2013, when global demand was the key driver for price increases, the price mechanisms of 2016 were supply-driven. Moving into 2017, the question will be how supply will respond to the increasing market milk prices, and how fast this supply recovery will take place. Major regulatory factors such as EU phosphate regulation and other environmental regulations are likely to negatively impact the development of the supply and demand balance in 2017.

External experts now believe lower milk volumes will be a key driver of a more stable pricing environment versus what we saw during the second half of 2016. We do not currently foresee significant changes in global consumption trends or big shifts in global trade patterns during 2017.

Arla's revenue to grow in 2017

In 2017, Arla's revenue is expected to grow both in absolute as well as in qualitative terms. The relative revenue growth is expected to increase at single digit rates, primarily driven by year-on-year price increases. On the qualitative dimension, we expect 2017 to show continued growth of our strategic branded business and therefore the overall branded share of our business.

In 2017, we expect the member milk intake to be on relatively the same level as in 2016, however this remains uncertain due to the current market environment. With increases in milk prices into 2017, milk production is expected to respond positively, however the timing of potential supply increases are very difficult to predict.

Due to the lower expected milk intake, all of our volume driven growth metrics are expected to slow somewhat versus the strong 2016 levels. We continue to expect to see solid growth in our profitable and strategically important branded business, as well as our International business, measured as a share of our total revenue. In 2017, we will continue to invest more in our strategic branded positions, which underpin our long-term strategic ambition of building value through brands.

If we are to succeed in 2017, we need to deliver on both profitability and branded growth. To do so, we need to further raise prices and drive strong branded growth through focused innovation. In addition, we aim to secure efficiency gains and release cash in our business. The focus of our growth is to truly solidify and leverage our strong milk, yogurt and powder position, as well as grow new leadership positions in our International market segment.

Due to the lower milk intake and continued growth of our branded business, we expect to see the trading share of our business to remain below 20 per cent.

Costs remain a focus, but lower volumes might challenge performance

Going into 2017, we maintain our tight focus on delivering the cost agenda. 2016 and the previous years proved that a consistent and clear focus on improvements in cost measures delivers results. We regularly target a scalability ratio of two to one. This means volume driven revenue growth should increase at twice the rate of our capacity costs, i.e. fixed cost base. In 2017, given that we expect lower milk volume and lower overall growth rates, this will be a highly challenging measure to deliver. However, other cost measures, such as conversion and administrative costs, will become increasingly relevant.

In supply chain, we maintain our focus on delivering the planned cost programmes and the underlying core key performance indicator conversion costs at or below index 100.

Strong cash management to continue in 2017

For 2017, our cash outlook continues to be positive, and we expect to be able to build further on the positive development of recent years. We will continue our year-on-year focus of improving our working capital accounts and, despite strong international growth, enable the Group to

Financial outlook

	Actual 2016	Expectations 2017
Peer group performance (peer group index)	105*	103-105
Milk volume (bkg)	13.9	~13.9
Revenue (EURb)	9.6	10-10.5
Profit	3.6%**	2.8-3.2%
Leverage	2.4**	2.8-3.4
Strategic branded volume driven revenue growth	5.2%	1-3%
Brand share	44.5%	>45%
International share	18.0%	>20%
Trading share	20.1%	<20%

** Peer group performance index preliminary.*
*** Including gain from sale of Rynkeby.*

operate with a visibly lower working capital tie up.

We expect 2017 to be another year of improvement in financial leverage and other balance sheet and cash key performance indicators. Leverage will stay within the stated long-term target range of 2.8 to 3.4, calculated as the ratio of net interest-bearing debt to profitability, i.e. EBITDA.

Within these boundaries, we expect to see a significant increase in our capital expenditure in 2017. This follows two years of low investment levels due to the financial position. Our capital expenditure is planned to increase from EUR 263 million in 2016 to approximately EUR 335 million in 2017. Most of the investments focus on production upgrades that will increase profitability of products sold in markets like Germany, the UK, Denmark, Sweden, the Netherlands and Finland, as well as on production sites that supply high-quality dairy products to Arla's emerging markets outside the EU. Some examples include the following: Rødkærsbro which is one of the leading mozzarella sites in the world, Danmark Protein which is a protein, lactose and other highly value-added whey-based ingredients for the global food industry, a cream cheese dairy site in Holstebro introducing new, innovative packaging designs and lastly, investment in better energy efficiency across all sites. We will clearly show our commitment to deliver our strategy, Good Growth 2020, by investing in our strategic markets and product priorities. Our ability to make this significant increase in capital expenditure investments reflects the success of tight cash management in recent years, providing us the financial freedom to relentlessly pursue our long-term strategy.

Net profit expected within target range of 2.8 to 3.2 per cent

As we continue to focus on paying out the largest possible share of our profit via the prepaid milk price to our farmer owners, we continue to target a net profit share for 2017 in the range of 2.8 to 3.2 per cent. As in previous years, we expect to see seasonality in our operations impacting the 2017 half-year results. Our net profit target range is a full year target and therefore results at half-year 2017 may be either above or below the annual target range.

The Executive Management Team has presented seven essential business priorities for 2017, managing the dual responsibilities of delivering on current business objectives and creating growth opportunities for the future. Read more on page 29.

Five year financial review

	2016	2015	2014	2013	2012
Inflow of raw milk (mkg)					
Inflow from owners in Denmark	4,728	4,705	4,550	4,508	4,419
Inflow from owners in Sweden	1,909	1,995	2,035	2,016	2,059
Inflow from owners in Germany	1,758	1,741	1,526	1,332	685
Inflow from owners in the UK	3,210	3,320	3,088	1,254	286
Inflow from owners in Belgium	515	531	403	253	53
Inflow from owners in Luxembourg	144	130	119	111	27
Inflow from owners in the Netherlands	56	41	17	-	-
Inflow from others	1,554	1,729	1,832	3,202	2,881
Total inflow of raw milk	13,874	14,192	13,570	12,676	10,410
Number of owners					
Owners in Denmark	2,877	3,027	3,144	3,168	3,354
Owners in Sweden	2,972	3,174	3,366	3,385	3,661
Owners in Germany	2,461	2,636	2,769	2,500	2,911
Owners in the UK	2,485	2,654	2,854	2,815	1,584
Owners in Belgium	852	882	997	529	501
Owners in Luxembourg	218	221	228	232	245
Owners in the Netherlands	57	56	55	-	-
Total number of owners	11,922	12,650	13,413	12,629	12,256
Performance price					
EUR-cent/kg owner milk	30.9	33.7	41.7	41.0	36.9

Financial key figures (EURm)

	2016	2015	2014	2013	2012
Income statement					
Revenue	9,567	10,262	10,614	9,870	8,479
EBITDA*	839	754	681	737	597
EBIT	505	400	368	425	336
Net financials	-107	-63	-30	-88	-70
Profit for the year	356	295	320	300	255
Consolidation for the year					
Contributed capital	30	31	39	43	38
Common capital	193	141	171	131	63
Supplementary payment	124	113	104	121	149
Balance sheet					
Total assets	6,382	6,736	6,613	6,187	5,828
Non-current assets	3,714	3,903	3,774	3,427	3,273
Current assets	2,668	2,833	2,839	2,760	2,555
Equity	**2,192**	**2,148**	**1,874**	**1,708**	**1,463**
Total non-current liabilities	1,742	2,084	2,137	2,189	2,049
Total current liabilities	2,448	2,504	2,602	2,290	2,316
Net interest-bearing debt including pension liabilities	2,017	2,497	2,547	2,394	2,298
Net working capital	831	999	928	906	790
Cash flows					
Cash flow from operating activities	806	669	511	342	510
Cash flow from investing activities	-167	-402	-416	-470	-715
Free cash flow	639	267	95	-128	-204
Cash flow from financing activities	-624	-274	-93	110	235
Investments in property, plant and equipment	-263	-348	-429	-505	-444
Purchase of enterprises	-	-29	15	-	-39
Financial ratios					
EBIT margin	5.3%	3.9%	3.5%	4.3%	4.0%
Leverage*	2.4	3.3	3.7	3.2	3.9
Interest cover	11.4	13.2	8.2	11.1	11.5
Equity ratio	34%	31%	28%	28%	25%

Please refer to glossary inside the front flap.
** Including gain from sale of Rynkeby.*

Segment overview

Arla is the world's fourth largest dairy company based on milk intake. Our activities cover all continents and have been streamlined in 2016 to reflect our core business areas and strategic objectives. They are divided into three main business segments: Europe, International and Arla Foods Ingredients. Our business segments are organised to service different market needs in the best possible way sharing global synergies while respecting local differences.

**Trading and other revenue is not disclosed as a separate segment because it is related to sale of excess milk volume.*

Europe

“We made a strong start to Good Growth 2020 in Europe with significant branded growth and market share gains across most markets and categories. The yogurt business had a great year with award winning innovations for skyr and protein, delivering strong incremental category growth. Revenue was under pressure as a result of a depressed global dairy market during the first half of 2016.”

Peter Giørtz-Carlsen, Executive Vice President

Revenue split by country, 2016

	2016	2015
UK	35%	38%
Sweden	22%	21%
Germany	19%	19%
Denmark	15%	13%
Finland	5%	5%
Netherlands and Belgium	4%	4%

Key brands

Retail and foodservice volume driven revenue growth, 2016

1.3%

2015: 3.3%

Strategic branded volume driven revenue growth, 2016

3.2%

2015: 3.7%

Brand share, 2016

47.6%

2015: 46.3%

Revenue development, 2016

-6.9%

2015: -2.9%

In 2016, Northern Europe was characterised by positive volume driven revenue growth rates in a flat underlying market. In line with Good Growth 2020, the growth was driven by strategic brands across all major markets, especially within the butter, spreads and margarine (BSM) and cheese categories. Our BSM brands delivered impressive growth even against a backdrop of category declines, and our cheese business has grown across all markets with positive developments in most sub-categories.

The yogurt business had a great year, with award winning innovations for skyr and protein delivering strong growth. Lurpak® and value-added propositions in the UK delivered solid market share gains. In Germany, particularly in private label, prices were under considerable pressure due to historically tough market conditions until late summer. However, the Arla® brand performed strongly with close to a double digit volume driven revenue growth rate.

Growth in Sweden was driven by Arla® and Castello® in the cheese category, whereas the fresh milk category experienced a slight decline. In Denmark, 2016 was a very strong year, driven by positive branded growth rates and solid progress in the Arla Baby & Me® assortment.

International

"We have gained market shares in many of our key international markets, although facing challenging external factors such as low oil prices and currency constraints. In light of these circumstances, we are satisfied with our achievements in 2016."

Tim Ørting Jørgensen, Executive Vice President

Revenue split by region, 2016

	2016	2015
Middle East and North Africa	36%	39%
Americas	23%	24%
Russia and others	24%	22%
China and South East Asia	11%	9%
Sub-Saharan Africa	6%	6%

Retail and foodservice volume driven revenue growth, 2016

9.5%

2015: 6.9%

Strategic branded volume driven revenue growth, 2016

10.7%

2015: 6.2%

Brand share, 2016

81.4%

2015: 80.2%

Revenue development, 2016

5.9%

2015: 6.3%

Key brands

In 2016, volume driven revenue growth outside Europe increased by 9.5 per cent due to improvements in our International branded positions. In the Middle East and North Africa, underlying market growth was slow in 2016 due to the economic impact from continued low oil prices. However, we achieved volume driven growth of 3.8 per cent, mainly attributable to strong progress in the Puck® assortment, thereby winning market share in most markets.

Sub-Saharan Africa had a strong start to the year, with the newly established joint venture in Nigeria as the main driver of higher milk powder sales. However, the devaluation of the local Naira currency in June following scarce USD availability, limited growth in the second half of the year.

China and South East Asia continued the strong branded volume driven revenue growth journey in 2016, led by China, mainly in organic UHT. However, markets such as Bangladesh and the Philippines also showed solid progress.
The Americas delivered close to double-digit branded growth, further focusing on the Arla® brand within the important US market.

Furthermore, we established a joint venture with the largest cooperative in the world, Dairy Farmers of America.

Arla Foods Ingredients

"It is our ambition to discover and deliver all the wonders whey can bring to people's lives. In 2016, Arla's third party manufacturing activities were transferred to AFI. Furthermore, we completed our new state of the art hydrolysate plant and launched a major capacity expansion of our range of innovative whey proteins for premium infant nutrition."

Henrik Andersen, Group Vice President

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

AFI is a 100 per cent owned subsidiary of Arla and benefits tremendously from being part of the cooperative, in terms of controlling the quality of raw materials from cow to end product. The close connection between our milk supply, cheese production and whey processing provides unique opportunities to deliver on customers' expectations regarding product quality and food safety.

Arla Foods Ingredients' business areas

AFI covers two business areas: whey processing and third party manufacturing (TPM). AFI operates a business-to-business model with all customers being industrial.

AFI's objective is to turn whey, the by-product from cheese production, into ingredients for the food and nutrition industry. AFI produces whey proteins and lactose from what was once a waste product, and through forceful innovation, whey has become a valuable raw material in its own right creating new value-added whey ingredients for Arla and other industrial customers.

Advanced innovation, as well as research and development facilities in Nr. Virum, Denmark, focus on research-based product innovation and developing new ingredients proactively. Our two application centres in Denmark and Argentina have state of the art trial and development facilities, and AFI cooperates closely with several leading research institutes and universities on new product development.

Strategic ambition

AFI's strategic ambition is to become the leading global supplier of value added whey, by maximising value-add, increasing our raw material pool, growing an organisation with winning capabilities, and becoming a leading supplier of private label child nutrition products.

In 2016, highlights for AFI included the significant expansion of lactose capacities, both at Danmark Protein and at our joint venture ArNoCo, Germany, with both units now operating at full capacity. The transfer of Arla's third party manufacturing (TPM) to AFI realises synergies between the two units, mainly as both product categories address the same customer base. AFI's TPM business produces a range of organic and conventional child nutrition products and expects to grow its business further in the coming years. Finally, the new state of the art hydrolysate plant at Danmark Protein was completed in 2016.

Arla Foods Ingredients operates within four categories

Paediatric
High-quality ingredients for the infant segment, which are obtained from the filtration and fractionation of milk and whey. These products offer carbohydrates, lipids and proteins that children need to have a good start in life.

Functional solutions
Speciality milk proteins adapted for optimum functionality in a range of food products, such as fresh dairy, cheese, bakery, beverages, culinary and meat.

Health and performance
Medical, health and high-end sports nutrition. The Health and Performance team develops milk ingredients with unique benefits for patients with specific diseases, as well as athletes and other people looking for a healthier lifestyle.

General foods
Global leader in cost efficient solutions for the food industry, such as ice cream, sports products, confectionery, affordable food and feed.

Revenue development, 2016

5.0%

2015: 2.0%

Whey intake, 2016

6.6 billion kg

2015: 6.5 billion kg

Revenue split by region, 2016

545* million EUR

	2016	2015**
Europe, the Middle East and Africa	47%	51%
Asia	40%	37%
Americas	13%	12%

**A large part of Arla Foods Ingredients activities are carried out in joint ventures, which are not included in the consolidated financial statements. Revenue including joint ventures amounts to EUR 644 million.*
*** Revenue split is not comparable to prior year due to organisational structural changes in transferring Arla's third party manufacturing (TPM) activities to Arla Foods Ingredients.*

AFI produces a range of unique value added whey ingredients with advanced and innovative functionalities

Alpha-lactabumin *which is used in infant formula and may help reduce protein content in formula, which is believed to reduce the risk of obesity later in life. It also improves digestion and increases gastro-intestinal comfort.*

Osteopontin *which is used in infant formula and supports the development of a strong immune system in infants.*

Whey protein hydrolysates *which are used in sports nutrition and infant formula. Hydrolysates promote better absorption of protein in the stomach and may help reduce the risk of allergic reactions in babies allergic to milk.*

Whey protein isolate *which is used in clear drinks and great for clinical nutrition, functional foods and sports nutrition.*

Risk and opportunity

risk

Content

oppor tunity

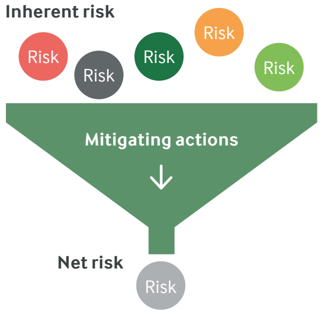
Risk and opportunity report: we promote risk awareness

The world is changing quickly and becoming increasingly volatile, presenting both new risks and new opportunities. The potential of our strategy, Good Growth 2020, is promising, but there are also a number of new initiatives that will see Arla continually facing increased risks and uncertainty in the pursuit of growth.

In Arla, we promote and support risk and opportunity awareness for braver decision-making, to seize key business opportunities and ensure more effective execution. We do this through our strategic risk management process.

Inside-out changes
Our strategy, Good Growth 2020, will expand our exposure to more risky world regions and product categories.

Outside-in changes
The exponentially changing world around Arla is presenting new risks and opportunities.



In Arla, risk assessment is based on net risks, which are the residual risks after mitigating actions.

Failure or breakdown of production facilities could adversely affect our business operations and constitutes a significant risk for Arla.

Strategic risk management defined

Being in control of the entire value chain from the cow to the consumer, is a major foundation for Arla being well positioned to manage many of our risks. However, being a truly global dairy company engaged in sales and production across the world, we are continuously exposed to uncertainties and change. Seizing growth opportunities in emerging markets is critical for the long-term success of Arla. At the same time, it is crucial to manage the potential risk exposure in order to secure the profitability of our activities. Furthermore, the increasing role of our branded business requires a higher risk awareness regarding reputational and social media impacts, in order to protect the brand value of our company. In 2016, we harmonised our efforts and principles regarding how we work with risks across the business, ensuring that this is performed according to a more common structure, assessment and understanding. We are planning to further grow our risk management capabilities during 2017.

Classification of risks and opportunities

In Arla we work with three major clusters of risks: emerging, strategic and operational risks. The differentiation between these three clusters allows us to apply different techniques and tools, and also helps us to identify and allocate primary ownership for the various risks in each cluster.

Emerging risks

Our focus on emerging risks is to enable a longer term outlook and ongoing consideration of risk and opportunities beyond the horizon of the current strategy, Good Growth 2020. The assessment of this risk cluster requires us to work closely with both internal and external stakeholders and to use many different sources as a mean to determine future trends and capture input. The insights captured are then transformed into relevant risks and opportunities that we can monitor or analyse in further detail.

Strategic risks

The strategic choices we make are based on a range of assumptions and naturally involve a level of uncertainty. As such, we ascertain risks in our strategic assumptions, as well as risks related to the strategic choices we make in executing our strategy, Good Growth 2020. These risks address the core of our business model and have the potential to harm our long-term ambitions.

Operational risks

Embedded in our everyday operations are a number of key risks that we need to manage. Our focus regarding the operational risk cluster is on the integration of existing processes, business areas and corporate functions. Based on clear ownership and accountability, operational management performs a set of activities to effectively prevent and mitigate these risks.

The overarching setup of our strategic risk management function is detailed in a framework of annual activities, roles and responsibilities for various stakeholders as well as the involvement of the Board of Directors and the Executive Management Team. All colleagues are responsible for the risks within their span of control and are overseen by Risk Owners, who are responsible for managing risks in major commercial and functional areas.

We aim to look more to the left

In order to operate successfully in an increasingly volatile environment, we need to anticipate developments and understand emerging trends, which can lead to new risks and opportunities, at an early stage. We call this 'looking left' and it means, wherever possible, we aim to take a proactive approach to strategic risk management instead of a more problem-solving reactive focus.

Our strategic risk management system provides a common framework across Arla, achieving a sound balance between continuously exploring opportunities and risk avoidance.

Our efforts in strategic risk management are primarily about building capabilities. This allows our colleagues to make brave decisions with an appropriate level of risk awareness so they can pursue the relevant opportunities. At the same time, our strategic risk management approach helps us proactively identify key risks and develop necessary action plans. Our strategic risk management function is focused on integrating risk efforts into existing processes through capability building, as well as developing harmonised methodologies and tools.

From identification to action

Clear decision-making structures, standardised guidelines and a common language facilitated by our strategic risk management function, form the foundation for efficient and effective governance in relation to risks and opportunities.

Successful risk management drives value

To create value, strategic risk management needs to balance the need for fast decision making with extensive analysis as needed. In 2016, we expanded our strategic risk management approach to involve all major areas within the organisation. Assigning Risk Owners with clear roles and responsibilities, we aim to take risks and seize opportunities successfully, subsequently also increasing profitability.

Risk and opportunity identification

At Arla, we continuously monitor the global market situation as well as internal processes, in order to identify risks and opportunities as early as possible to ensure proactive decision making.

The strategic risk management function identifies major risks in collaboration with leaders from all major areas across the Group. Further, certain expert functions such as Global Tax, Treasury, Legal and Procurement monitor their risk profile separately on a regular basis during the year.

During the annual business planning process, the Board of Directors and the Executive Management Team discuss risks that are most critical to the business. The Board of Directors and the Executive Management Team also identify opportunities with the biggest potential. As an incremental part of our annual business planning process, risk and opportunity identification are also embedded in the local activities of our business functions and commercial zones.

Risk and opportunity assessment

Risk and opportunity assessment is a core Risk Owner responsibility, supported and guided by the strategic risk management function in the evaluation process.

Once risks and opportunities have been identified, we assess them both individually and systematically, allowing adequate prioritisation and allocation of resources while creating a solid foundation for sound decision making.

Risks and opportunities are assessed on the basis of two dimensions:

- Potential financial impact on profit (mEUR) per incident. This includes quantitative but also qualitative measurements such as reputational exposure such as impairment to brand value, impact on market position and media coverage.
- The likelihood that a given risk or opportunity materialises within the next three to five years.

Based on this assessment, risks and opportunities are classified according to their relative significance. Risks and opportunities are assessed based on the net effect of the risk after all expected mitigating actions.

Risk and opportunity management

Working closely together with the strategic risk management function, Risk Owners develop and implement appropriate mitigating actions and explore opportunities within their business function or commercial zone.

The aim of strategic risk management is to use appropriate measures to reduce risk probability and to minimise their impact by implementing and driving mitigating actions, or by seizing available or emerging opportunities. This process is supported by a common language and a clear methodology for assessing risks and defining opportunities, using tools and processes tailored for operational, strategic and emerging risks.

Initiated in 2016, for the first time, the strategic risk management function works in close collaboration with Risk Owners, to monitor progress of planned mitigating actions and assess the viability of already implemented mitigating actions. The result is a one-page action plan that is updated quarterly for all material identified risks and opportunities.

Risk and opportunity monitoring and reporting

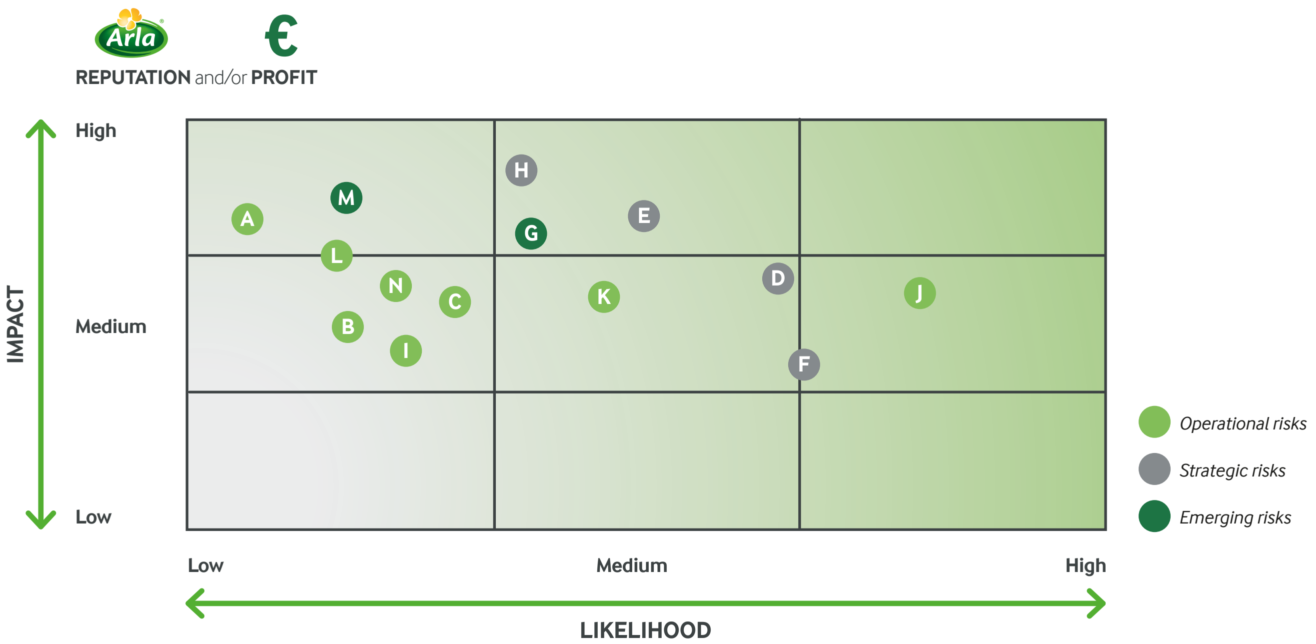
As both risks and opportunities are subject to constant change, Risk Owners not only monitor developments closely, they are also responsible for consistently ensuring the adequacy and effectiveness of our risk mitigation and resolution strategies.

We aim to increase the transparency of risks and opportunities for Arla. To avoid unnecessary bureaucracy and enable real value creation, risk and opportunity reporting is integrated into our existing and ongoing reporting procedures and management tools. This supports an effective escalation process. In 2017, a risk and opportunity report will be produced and presented to the Executive Management Team on a bi-annual basis, whilst risks and opportunities are formally reported to the Board of Directors annually.

Furthermore, a status update is disclosed to external stakeholders in this section within the annual report.

Our risk landscape in 2016

Arla's heatmap includes the top emerging, strategic and operational risks that we have identified in 2016. Our risk assessment is based on the potential impact for Arla's reputation and/or profit per incident and the likelihood of the risk to occur within the next three to five years.



Supply and production disruptions

Failure or breakdown of Arla's vital production facilities could adversely affect business operations and potentially cause colleagues injuries or infrastructure damage. Fire, chemical spills, explosions, sabotage and other hazard risks, as well as non-site-access due to strikes or quarantines could cause prolonged business interruption, making it difficult to deliver products to customers. The specialisation of dairies in general increases the level of exposure. However, an emergency programme exists across all production sites and lessons from historical incidents are continuously incorporated. Further mitigation measures include preventing and responding to fires, annual inspections, back-up facilities and safety inventories.

Guaranteeing food safety is also a key priority. A major product contamination incident could lead to a product recall and thereby to medium or long-term damage to our brands and positions. Besides clear and professional crisis management and recovery processes, our focus is on avoiding incidents through clear adherence to the Arlagården® farm assurance programme and a comprehensive quality, health, environment and safety model safeguarding the impeccability of all our products across the entire value chain.

Risk	Risk scenario	Trend
A	Major breakdown at key production site	↘
B	Major product recall	→
C	Failure of contract manufacturer that damages the Arla brand and image	→

Market risks and global instability

As a global dairy company with sales and production offices across the world, we are exposed to specific country risks and to any general increase in global instability. The global trend of more protectionist politics can increase the costs of international trade. Taking our ambition for profitable growth in emerging markets into account, terrorism, economic or political turmoil and civil unrest in some or several of these countries have the potential to jeopardise our strategic initiatives. A prolonged economic downturn in oil-exporting countries could, for example, negatively impact local spending power and availability of foreign currencies, thereby leading to lower demand in certain regions such as the Middle East and Sub-Saharan Africa. However, diversification across many international markets reduces the dependency on single markets.

Also in our core markets within Europe, political instability is currently on the rise. This ranges from the uncertainties about the final consequences of the UK leaving the EU, to a more general nationalistic and protectionist sentiments such as 'Buy National'. In an extreme but unlikely scenario, this could lead to a collapse of the EU in the light of further countries leaving. We have established a task force that permanently monitors Brexit negotiations, analyses the impact of different scenarios and develops proper strategic responses and lobbying activities for Arla.

Risk	Risk scenario	Trend
D	Political instability and economic turmoil in emerging markets	→
E	Consequences of Brexit and further EU exits and protectionism	↗

Changing consumer demands and digital disruption

Eating habits are differentiating and changing at a higher pace. For example, some consumers demand products that are produced locally, whilst others are focusing more on the functional aspects of their diet. There are also consumers for which the price level is of major concern. The way in which consumers are deciding to purchase grocery products is also evolving, from visiting the general retailer around the corner to e-commerce delivery at home, or ready-made convenient products consumed on-the-go. All of these consumer trends present new and exciting opportunities for Arla. By continuously listening to our consumers, we can ensure that we respond to these opportunities. To be equipped for this, we have strong international research and development, marketing and innovation teams that constantly monitor and explore new technologies, digital business models and products innovations.

Animal welfare concerns and the rising popularity of vegan diets are generally questioning the ways in which animal-based products are produced. Based on our quality assurance programme, Arlagården®, our focus on natural and healthy products and the big source of organic milk, as well as milk based on non-genetically modified feed, we are proactively positioning ourselves to the forefront of the increasing animal welfare requirements and the wish for healthy food.

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

Lack of milk supply and member dissatisfaction

Milk production increased significantly in Europe after the abolishment of the EU milk quota system in 2015. Together with the drop in demand from China and the Russian embargo for agricultural products from Europe, farmers experienced a sharp decline of milk prices and thereby a worsening financial situation. Due to the low milk prices, milk production growth started to slow down during the second half 2016. The new paradigm of milk price volatility and regional price differences could cause a fragmentation of the owner group. A prolonged decline of milk prices and an inability to pay a competitive milk price compared to competitors could lead to a loss of owners and lack of milk supply. Towards the end of 2016 milk prices started to increase again and the price outlook for 2017 confirms this positive price development, leading to a more sustainable financial situation for our owners. Our strategy focusses on value creation and on increasing the performance of our business to ensure our ability to pay a competitive milk price to our owners. This is accompanied by a new owner strategy that strengthens the democratic processes in Arla.

Risk	Risk scenario	Trend
H	Significant membership reduction	↘

Financial risks

Arla's main financial risks relate to exchange rates, tax disputes, interest rate changes and pension liability valuations. Within Europe, the majority of sales are in EUR, GBP, DKK and SEK. Due to the increasing size of our international business, the sales in USD and other foreign currencies have increased. To manage this risk, the Group hedges expected future cash flows for selected key currencies. Read more about on our currency exposure and corresponding risk on page 116 and page 123 for details about our pension liabilities.

The OECD Base Erosion and Profit Shifting (BEPS) project, completed in late 2015, has increased the focus of tax authorities worldwide on transfer pricing between affiliated companies. The BEPS project resulted in additional transfer pricing documentation requirements. Our focus is to adapt to this increased compliance burden. Read more on page 78 about our key tax principles.

Risk	Risk scenario	Trend
I	Taxation and transfer pricing risks	→
J	Currency, interest and pensions risks	→
K	Major cyber attack	↗

Business and legal risks

The breach of human rights, ethics, or fraud within Arla or on a supplier and partner level, would harm the reputation of Arla and our brands. In 2016, we have strengthened our programmes, processes and internal controls on fraud and human rights management. Further risks include the loss of intellectual property and customer or competitor intellectual property developments, especially within our ingredients business. These have the potential to limit our freedom to operate. Further legal risks are potential non-compliance with EU legislation on antitrust or the disclosure of private data. Legal, IT and Corporate Social Responsibility departments are well established within Arla and utilise clear and enforced policies supported by extensive training to ensure effective risk avoidance through mitigation. The loss of key personnel in strategic positions and the inability to identify, recruit and retain sufficient highly qualified and skilled people pose substantial risks to our business performance. In order to mitigate this risk, we create the right corporate culture and work environment, provide employees development and career opportunities and establish a global recruiting organisation.

Risk	Risk scenario	Trend
L	Major bribery, fraud and legal non-compliance	↘
M	Breach of human rights or ethics in Arla, among suppliers or partners	↘
N	Loss of key personnel in strategic positions and recruiting and retaining the best talent	→

How to do the right thing

In Arla, we consider compliance with the law as well as compliance with external and internal regulations as an imperative. All colleagues are required to act ethically and in compliance with the law and applicable regulations. However, knowing right from wrong goes beyond laws and regulations. Our compliance governance system plays a key role in helping us do the right thing.

Responsible business conduct comes from living our strong company values through a culture of openness and transparency, starting at the top of the organisation and spanning throughout our business zones and functions in the entire value chain. Arla's corporate directives and policies serve as the North Star of our company and establish a clear link between our values, the way we conduct our business and engage with stakeholders.

Our Code of Conduct reflects our values and embodies the essence of Arla's culture and provides guidance on our behaviour, governing how we act and engage. The Code of Conduct is applicable to all colleagues and management globally and is also available on our website.

Our policies address critical behavioral aspects of individual conduct. They are applicable to all colleagues and management globally and must be strictly adhered to. The policies contain statements on what to do in order to comply with specific regulations and requirements.

Our processes and procedures give details on how our policies should be implemented in practice and are applicable to relevant colleagues and management globally.

Our guidelines are detailed recommendations and provide guidance within certain areas for the everyday user. They are applicable to relevant colleagues globally in their day-to-day activities.

Compliance management

Identification of potential compliance risks is essential for our risk and opportunity governance system, as they form part of risk management. Compliance tells us how to deal with specific risks. The compliance management system delivers value by supporting the strategic priorities.

Our compliance management system is challenging the way the business thinks strategically about risks. It optimises functions or processes and integrates sustainable solutions throughout the organisation in order to prevent, detect and mitigate risks.

Prevention

Prevention includes our policies, training of colleagues and other compliance-related communication. In 2016, we have strengthened the policy framework further. All colleagues are regularly assigned an e-learning and our policies are readily available on company mobile devices. In 2016, 87 per cent of colleagues completed training on at least one policy. We have also launched a comprehensive compliance training programme for higher risk entities in Africa, the Middle-East and Asia.

Detection

To ensure timely detection of potential infringements of laws, regulations or internal guidelines we have implemented a whistleblower service to enable colleagues in all companies that are majority owned or controlled by Arla Foods amba to report information about possible irregularities and concerns over potential compliance violations. We also have a mandatory reporting system in place for gifts and hospitality, which ensures transparency and compliance with anti-bribery laws and internal entertainment policies. Furthermore, we perform data analysis to detect compliance issues, and carry out compliance visits to selected high-risk entities.

Response

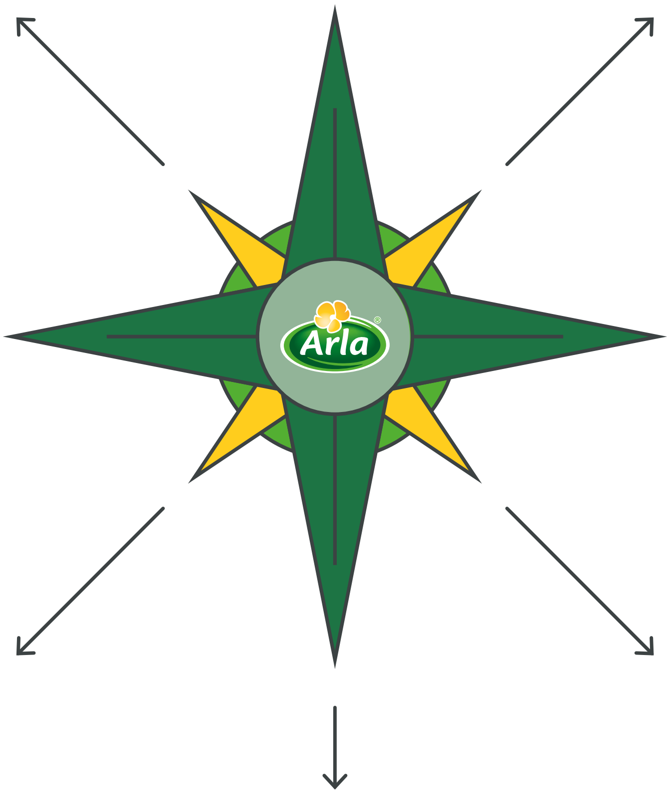
Adherence to our corporate directives and policies is monitored closely across the organisation and immediate action is taken to remedy non-compliance. Appropriate sanctions, for example, warnings or termination of employment, are used to react promptly to compliance violations, and experiences gathered are used to strengthen the internal control system.

The North Star

One of the cornerstones of our identity is acting responsibly. Our global policies are like the North Star of our company, guiding our behaviour and telling us how to act and work together in a responsible way.

Cyber security
Arla continuously assesses the threat from the online world to ensure that we have proper IT security and internal controls in place. Our colleagues are the first line of defence and we prioritise education in cyber-security.
In 2015, Arla launched a global campaign 'Are you cyber-safe?' for colleagues and vulnerable customers in international markets to increase the awareness of cyber risk. We have also described the general vulnerabilities within cyber-security and launched a roadmap to strengthen our resilience to cyber threats.

Fraud
Arla has a zero-tolerance approach to fraud and takes all forms of non-compliant transactions very seriously. We have a clear commitment to thoroughly investigate the validity of any credible allegations of fraud and to ensure that the appropriate actions are taken.



Good practice
We are a large cooperative and we rely on one another to act responsibly in accordance with our shared values. We are dedicated to managing our resources in the best possible way. We achieve this through a combination of policies and culture framing our behaviour. Behaviour is monitored actively and corrective action is taken if needed.

Bribery
It is our policy to conduct business in an honest and ethical manner. We take a zero-tolerance approach to corruption such as bribery and facilitation payments. We are committed to acting professionally, fairly and with integrity in all our business dealings and relationships, implementing and enforcing effective systems to counter corruption.

Internal controls
A strong internal control environment is a prerequisite for a 'no surprise' culture. We continuously strengthen and automate the internal controls in core transactional and reporting processes. Using a risk-based approach, the compliance maturity in Arla is monitored through various compliance activities and local compliance visits to ensure implementation of adequate risk mitigating measures. Continuously improving our internal control framework and anchoring it in the organisation is key for a strong second line of defence.

A 'no surprise culture' in financial reporting
For Arla, quality and efficiency in financial reporting is a fundamental objective. Our structured approach to internal control and risk over financial reporting provides reasonable assurance regarding the reliability of our external financial reporting, by ensuring compliance with the International Financial Reporting Standards (IFRS) as adopted by the EU, additional disclosures in the Danish Financial Statements Act, as well as relevant policies, procedures and guidelines.

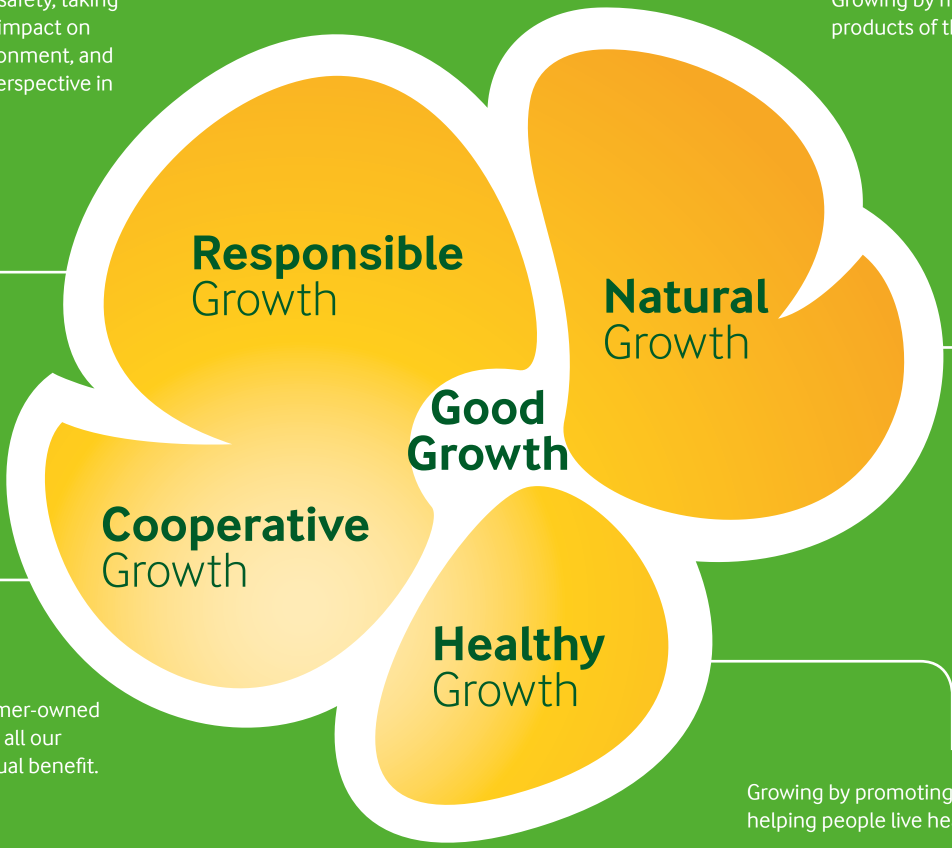
All group entities are required to comply with our finance manual. We aim to ensure compliance with the finance manual through continuous adherence to segregation of duties in accounting related processes. Furthermore, we have implemented minimum-level controls across Group entities in order to strengthen our controlling foundation and reduce the risk of fraud and error.

We have structured the internal controls and compliance activities according to the COSO framework, in order to identify and assess, as well as to limit and control risks identified in the consolidated financial reporting process, which might result in our consolidated financial statements not conforming with internal and external regulations.

Values and considerations

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

Growing by making natural products of the highest quality.



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

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

Good Growth is our corporate identity. It is at the centre of everything we do and describes who we are and how we are creating the future of dairy.

Content

Values and considerations

Arla is a farmer-owned democratic dairy cooperative with a history dating back to the 1880s. Our cooperative identity fuels our business and represents an important differentiator in the global dairy market. However, being a multi-national cooperative also presents a set of realities that need to be addressed.

Values

Insights show that modern consumers value traceability, food safety and high quality. They care about how the milk is produced at the farm and who is behind the Arla product. Integrated in our identity is the cooperative and responsible mindset founded in our cooperative roots which demonstrate to consumers that we care about sustainable growth. Furthermore, Arlagården® and our farmer-owned position provide clarity and build trust in our responsibility standards.

Our identity, Good Growth

Our company identity is defined by four principles helping to ensure we create Good Growth: responsible growth, healthy growth, cooperative growth and natural growth. They are at the centre of everything we do and guide how we develop our cooperative, products, markets and ways of working.

Read more on page 69.

The commercial value of Arlagården®

Arlagården® is the farm assurance programme that governs our farms to ensure food safety, traceability and quality of our raw milk. As a cooperative in control of the entire value chain, our farm assurance programme ensures milk of the highest quality. Food safety, animal welfare and sustainability are core to our farmers and their effort is Arla's license to operate in an increasingly transparent world.

Read more on page 75.

Being farmer-owned creates value among consumers

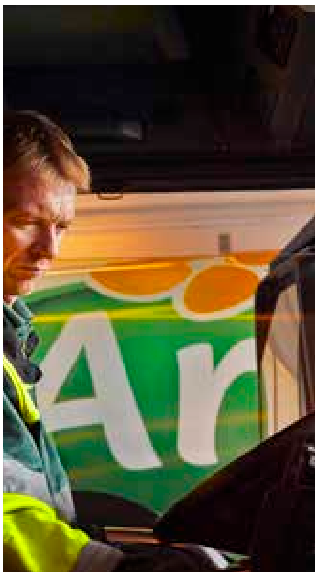
Knowing that Arla is owned by farmers instills more trust in our products and makes it easy to identify them as responsibly sourced. We introduced the farmer-owned marque to strengthen awareness of Arla being owned by farmers.

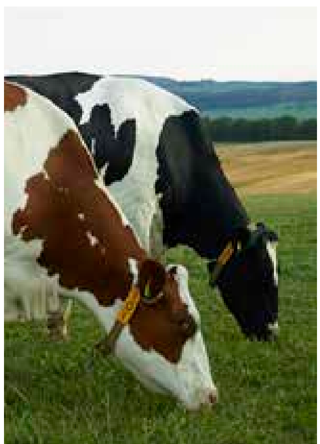
Read more on page 74.

Approaching sustainability

As we work to create the future of dairy, we keep our focus on corporate social responsibility to build long-term success for Arla. Acting responsibly towards the environment and the communities in which we operate will also benefit us commercially.

Read more on page 72.





Considerations

Working to compete in an increasingly global marketplace requires consideration of many factors. Despite the global reach of Arla's cooperative values, we continuously face the realities of local markets, local legislation and different political climates. As a result, the success of Arla is not determined by looking at local entities but at the Group holistically.

ONE milk pool

Consumers are demanding locally produced products that support local economies, and they tend to associate locally produced products with fresher, more nutritious and safer products. Arla's continued success depends on our ability to channel milk to the markets where the highest value can be added irrespective of the origin.

Read more on page 76.

Milk on the move

Earnings are higher in some legal entities than average while earnings in other legal entities are lower than average. Due to the principle of the cooperative, it is the average of all earnings that determines what Arla is paying farmer owners as the milk price for their raw milk deliveries.

Read more on page 77.

Our tax affairs

Operating under a cooperative tax scheme takes continuous consideration. Arla acknowledges the role that tax plays in society. As a cooperative based in Denmark, our activities are governed by the Danish tax rules for cooperatives. Our owners are also our suppliers, and earnings do not accrue in the company but go back to them in the form of the highest possible payment for their milk.

Read more on page 78.

Preparing the business for the potential impact of the Brexit vote

The outcome of the negotiations on the future trading relationship between the EU and the UK is uncertain following the Brexit vote. Arla is working with all relevant stakeholders both in the UK and across the EU to ensure that Brexit will have as little impact as possible on Arla. It is important that a trade agreement is reached that will not limit the free movement of dairy products for a prosperous future for dairy.

Read more on page 79.

Sustainability ambitions

As the population of the world continues to grow, along with the desire to create prosperity, the need for accessible and sustainable food options increases. We want to grow and respond to this need, and we care about how we do it. We operate our business in a sustainable and responsible manner in order to safeguard and develop Arla's reputation and profitability, while caring for people and delivering growth.

Our key principles

Responsible business
We act credibly and with integrity in all our operations. We manage our business in a responsible and cooperative way, promoting the financial interests of our owners. We have open and honest relationships with all of our stakeholders. We expect our suppliers to support us in our commitment to abide by our Code of Conduct.

Health and nutrition
We ensure that our products are safe, no matter where they are manufactured. We make healthy and natural dairy products available to consumers around the globe to enhance the quality of peoples' lives.

Sustainable dairy production
We care about the environment and climate and as a result we continually improve our environmental performance by applying sound and sustainable principles throughout our entire value chain. We maintain high animal welfare standards and support sustainable dairy farming.

Responsible relations
We have competent, committed and engaged colleagues, and we provide safe and healthy working conditions. We respect and support internationally recognised human rights and we engage in open, respectful and constructive community relations. No matter what our relationship is, we are committed to maintaining mutual respect and understanding.

Responsible behaviour

At Arla, we are dedicated to developing our business in a responsible manner. This is embedded in our identity, Good Growth. We believe sustainability and profitability go hand in hand, and that our commitment to being responsible will benefit us commercially. Our Code of Conduct strengthens the expectations we have of ourselves and those of our stakeholders, and further embeds responsibility in our culture.

Sustainable dairy

Delivering sustainable food products is the ultimate goal of our social responsibility and sustainability commitment. We progress towards this through leadership, innovation and research, and the development of pioneering products and brands that are defined by quality, food safety and environmental and social care.

Natural products without additives

The naturalness of our products has been our focus for many years. We continue to develop products without artificial additives, for example, a new cream cheese that we have successfully launched in several markets. We have various initiatives to communicate naturalness to our consumers in response to their increased interest in this area. For example, we have begun communicating to consumers that our Lurpak® butter is made from 100 per cent fresh milk.

Focus on research

Through research, we aim to increase our understanding of the role that dairy products play in a balanced and sustainable diet. We also want to have as much knowledge as possible about the link between the nutritional value of our products and consumers' health. We contribute to international research by being an active member of global networks and organisations, such as the Global Dairy Platform and the International Dairy Federation.

In 2015, Arla initiated a public-private partnership in nutrition research 'Arla Food for Health' in cooperation with Copenhagen and Aarhus universities. We want to enable fast and efficient translation of research into competence building and prototyping of future healthy products and solutions. The ongoing research projects are focused on cutting edge scientific knowledge about the health benefits of dairy and dairy-based ingredients.

Global perspective

As well as reflecting Arla's business priorities and value chain, our social responsibility and sustainability approach aims to address challenges in the global environment. Following analysis of global food trends and industry challenges, we have defined our list of focus areas. We linked these to the United Nations' Sustainable Development Goals (SDGs).

In our Corporate Responsibility Report, we demonstrate how we are developing our responsible business and adhering to our Code of Conduct. We are proud of our commitment and achievements in 2016, and look forward to highlighting further improvements.

Read more about how we meet our responsibilities in Arla's Corporate Responsibility Report on http://www.arla.com/company/responsibility/csr-reports/ in accordance with section 99a in the Danish Financial Statements Act.

“In Arla we are committed to growing our business responsibly, so that we can be part of solving the global challenges.”

Kjell Lundén Pettersson, Ph.D., Senior Manager Corporate Responsibility

Sustainable Development Goals defined

In September 2015, the United Nations adopted 17 new Sustainable Development Goals (SDGs) relevant for all countries. For the goals to become reality, all countries, businesses and organisations have been invited to embrace any necessary change. For Arla, the journey has already begun. The new sustainability goals include health, peace and equality alongside the original areas including poverty, education and climate. The aim is to create long-term resilient communities.

Our contribution to the Sustainable Development Goals

At Arla, we already have a clear sustainability agenda and linking our agenda to the SDGs can contribute to a better understanding of its importance. We continually monitor global challenges and analyse consumer megatrends and local variations to assess their impact on our Group and to pursue new business opportunities.

Our commitments cover our entire value chain from a social, economic and environmental perspective. Arla has chosen to focus on the SDGs on which we can have most impact. While supporting all SDGs, Arla will particularly contribute to goal 2, 8 and 12. Innovation, technology and sustainable production are important for progression on all goals. We have highlighted som examples of our actions in 2016.

17 Sustainable Development Goals defined

Adopted by the United Nations General Assembly in September 2015
Read more on sustainable development.un.org

Goal 2: Zero hunger

End hunger, achieve food security and improved nutrition and promote sustainable agriculture.

- Providing healthy, quality products for broad consumer needs, for example, high in protein; containing probiotics, vitamins and fibre; low-fat; reduced salt and added sugar; as well as lactose free.
- Teaming up with our owners to improve environmental performance and promote sustainable dairy farming.
- Supporting ‘Milky Way to Development’ in Western Africa, in collaboration with external stakeholders.

Goal 8: Decent work and economic growth

Promote inclusive and sustainable economic growth, employment and decent work for all.

- Local employment of diverse staff.
- On-the-job technical and food safety training; as well as a behaviour-based safety programme and preventative-tools and processes on more sites.
- Human rights assessment are included in market entrance and the business partner process.
- Arla supports open markets and promotes free trade. We are in favour of negotiating equivalence agreements with our trading partners, avoiding technical barriers to trade.

Goal 12: Responsible consumption and production

Ensure sustainable consumption and production patterns.

- Resource efficient production throughout the entire value chain, through increased use of renewable energy, increased water and energy efficiency and reduced waste, for example.
- Support research to find protein sources for cow feed replacing food sources for humans.
- Arla is the world’s largest producer of organic dairy products and growing.
- We support consumers to reduce food waste in several ways, for example, by optimising packaging sizes and providing shopping lists.

Being farmer-owned creates value among consumers

It is a global reality that consumers and customers are increasingly interested in what is happening on the farm, making Arla's farmer-owned DNA an important commercial differentiator. During 2016, we continued to strengthen the awareness of our cooperative roots among consumers with our farmer-owned campaign, that has responsibility and quality at its core. Knowing that Arla is owned by farmers instills more trust in our products and makes it easy to identify them as being sourced responsibly.

We introduced the farmer-owned marque to strengthen awareness of Arla being owned by farmers, and the underlying value that this creates for the consumer. Arla's farmer-owned DNA presents two key advantages to our consumers: They can rely on Arla® products being produced in a responsible manner and all profit flowing back to the farmer.

Enabling growth among owners

When consumers buy an Arla® product, the profit will be distributed back to the owners of Arla. This is fundamental to the structure of a cooperative. Our mission is to ensure a sustainable financial position for our owners enabling them to grow their business. We know that customers and consumers care more and more about who they are supporting when buying a product. As a result, it is particularly valuable and important to create awareness that when an Arla product is purchased, the profit goes to the dairy farmers, not a group of shareholders with little or no association with dairy farming. This is especially key at a time when many dairy farmers are under pressure as a result of volatility in the global market.

In control of all stages of production

Consumers can trust that Arla® products are made from high quality milk, as we are in control of all stages of the production chain - from cow to consumer. We know all of our owners and we work closely together to deliver product traceability and transparency of origin, which consumers are increasingly demanding. Arla's owners are committed to delivering natural and nutritious milk produced in a responsible manner, in line with our farm assurance programme, Arlagården®.

CARE IN EVERY STEP · FARMER OWNED · FROM COW TO YOU

A long-term worldwide initiative

Arla's farmer-owned marque on products was launched as part of the farmer-owned campaign in August 2015, and during 2016 the farmer-owned marque was rolled out in all markets worldwide. Throughout 2016, activities have included TV advertisements and social media campaigns, opening up farms to consumers, as well as farmers and colleagues teaming up to share the story of the cooperative. Campaign activities cover both our core markets, as well as international markets where European farmer-owned products are highly desired by the consumer.

The commercial value of Arlagården®

Our high food standards and commitment to animal welfare are at the core of our business and create growth for our products and brands and in turn, growth for our owners. Our farm assurance programme, Arlagården® ensures milk of high quality produced responsibly.

High quality is an important part of our strategy and key to creating Good Growth in the future. As high quality in our products starts on the farm, all of our 11,922 owners comply 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 high welfare standards for both animals and the environment. Our farmers are proud of how they farm and of Arla. It is a strength that 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 produced according to high standards.

Ensuring food safety, traceability and raw milk quality with 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 trained agricultural advisors to ensure compliance. As a farmer owned cooperative, Arla ensures that farmers who need support and guidance in implementing further improvements receive sufficient support from farm advisors.

- Milk composition: We strive to achieve a milk composition that ensures that our products live up to the needs and wishes of the consumer, compensating our owners according to the quality of the milk.
- Food safety: Starting at the farm, we provide consumers with safe milk-based products. Our owners treat the milk with care and respect to maintain its natural fresh taste and health benefits.
- Animal welfare: We strive to meet the animals' physiological and behavioural needs in order to improve their health and well-being, because healthy and happy cows produce more milk and milk of a higher quality.
- Environmental considerations: We strive to encourage environmentally sound milk production on the farm that is respectful of nature.

Developing Arlagården® Plus for the benefit of consumers and owners

More than ever it is important to tell the story about all the good we do on the farms every day, as consumers and customers become increasingly interested in how the raw milk is produced. It has become a commercial opportunity for Arla. Principles, facts and figures are vital to document that our farmers care for their cows and farms, thereby creating transparency for consumers and customers. As a result, an ambitious framework has been established in which Arla and farmer representatives collaborate in order to develop a digital blueprint of, for example, animal welfare on Arla farms.

ONE milk pool

With ONE milk pool, we are able to channel the milk to the markets where the highest value can be added, irrespective of the origin. It gives Arla the opportunity to create new growth for our owners, which is our company mission.

We constantly seek new opportunities for global growth in order to optimise the raw milk supplied by our owners. Until recently we handled the raw milk on a country by country basis. With the strategy, Good Growth 2020, we have taken a big step by establishing ONE European milk pool to ensure a more holistic use of our raw milk across Arla.

Over the past years, Arla's milk volume has grown to 13,822 million kg mainly through mergers and acquisitions, which means that the majority of the additional raw milk came with growing market positions. We have spent the past few years aligning the different companies into one and harvesting the synergies that the mergers created. Good Growth 2020 has taken this unity to the next level with the establishment of ONE milk pool.

Holistic use of Arla's raw milk

We anticipate that owners of Arla will grow their milk production by another two per cent leading up to 2020, providing Arla with more growth opportunities than ever before. However, our continued success depends on our ability to increase the value of the raw milk and develop profitable positions for the increasing milk volumes from our existing owners.

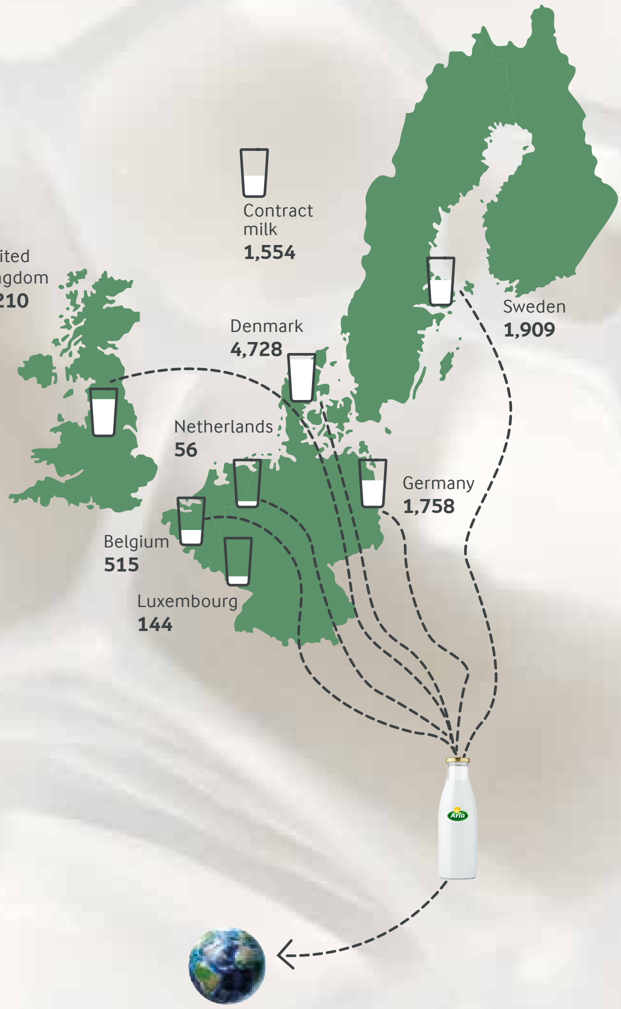
We want to create the maximum value for the increased volume of raw milk supported by ONE milk pool with the same quality requirements through our farm assurance programme, Arlagården®. This also creates a more efficient supply chain, enabling Arla to more easily balance the raw milk volumes in the most profitable way.

With ONE milk pool we can channel the milk to the markets where the highest value can be added, irrespective of origin. This gives Arla the opportunity to create new growth for our owners, which is our mission as a company.

Think global and act local

In order to succeed, we need to think globally whilst acting locally. Consumers are increasingly demanding locally produced products that support local economies and generate the best possible social impact. They tend to associate locally produced products with fresher, more nutritious and safer products, compared to products shipped in from afar. They are also increasingly willing to pay a price premium for locally produced products. We are acknowledging this reality as we continuously make local products available to the consumers seeking these options.

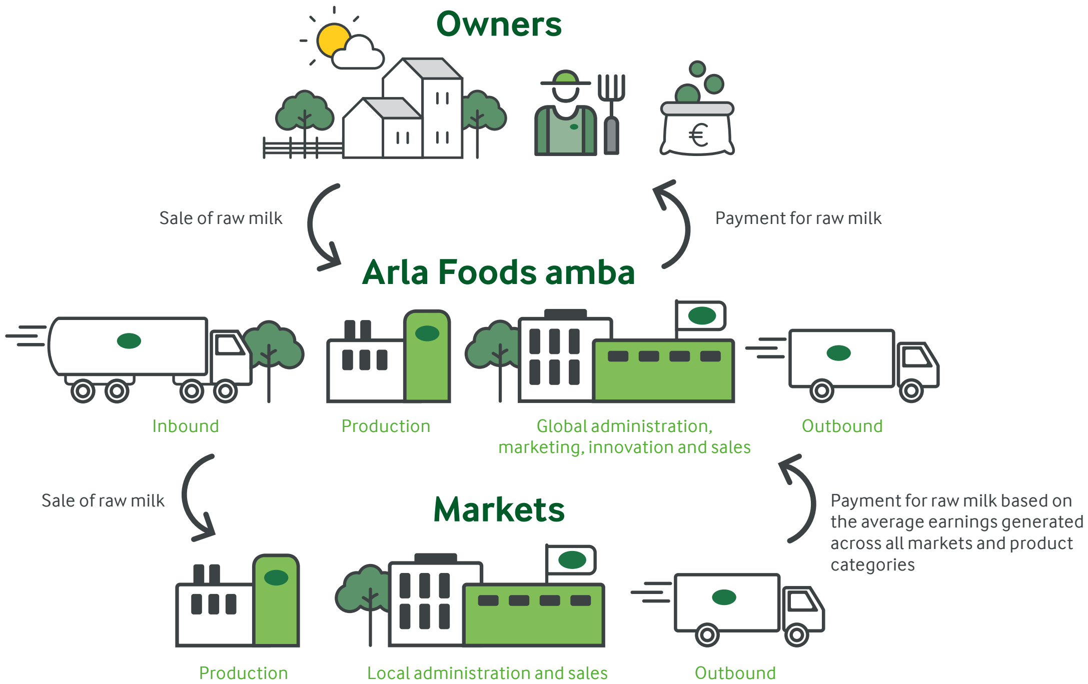
An example of how Arla responded to the increased demand for locally produced products, is the investment in locally produced milk from Gotland in Sweden, which is processed at Visby dairy. We launched Arla Ko® Gotlandsmjölk with packaging inspired by local landmarks in the area, clearly identifying that the milk comes from the 190 local Arla owners in Gotland.



Inflow of raw milk (mkg) to consumers around the world.

Milk on the move

As a dairy cooperative our primary raw material is the raw milk delivered by our owners. Arla pays the prepaid milk price for this raw milk during the year. Arla pays the same milk price to all owners, with the exception of limited transition periods following entry of new members. The prepaid milk price is set with the ambition to reach a targeted year-end result. As part of the annual profit appropriation, the farmer-owners receive a supplementary payment based on their annual milk volumes, subject to approval by the Board of Representatives.



In our cooperative all raw milk is weighed in by Arla Foods amba, the parent company. Subsequently, Arla Foods amba sells the raw milk to various Group entities at a price based on the average earnings generated across all markets and product categories. This means that legal entities in the Group with a full dairy value chain acquire the raw milk at the same price, irrespective of where the milk originates from.

Global activities forming ONE milk price

Arla's dairy activities are global and earnings are different in individual markets and across product categories. Earnings in some markets and legal entities are higher than average, while earnings in other entities are lower than average. However, due to the principle of the cooperative, it is the average of all earnings that determines what Arla is paying farmer-owners as the milk price for their raw milk deliveries.

The profitability of the Group entities may differ significantly between markets and from year to year, but all entities still contribute positively to our cooperative.

Our tax affairs

At Arla we are dedicated to developing our business in a responsible way and we believe that a responsible approach to tax is essential for the sustainability of our business in the countries in which we operate. Our approach to taxes conforms with Arla's global Code of Conduct 'Our Responsibility' and is founded on a set of key tax principles approved by the Board of Directors. We aim to ensure full compliance and support transparency. Our goal is to proactively manage tax in order to identify, mitigate and report our tax risks.

Our key tax principles

Arla's strategic ambition is to act as a good partner in all tax matters, achieving a balance between managing tax costs, driving efficiencies and ensuring optimisation in a responsible way.

Our key tax principles are aligned with this ambition and are the cornerstones for all tax-related matters in Arla. The principles apply to both Arla Foods amba and all other controlled Group entities. Our key tax principles are:

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

Accountability and governance

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

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

Operating under a cooperative tax scheme

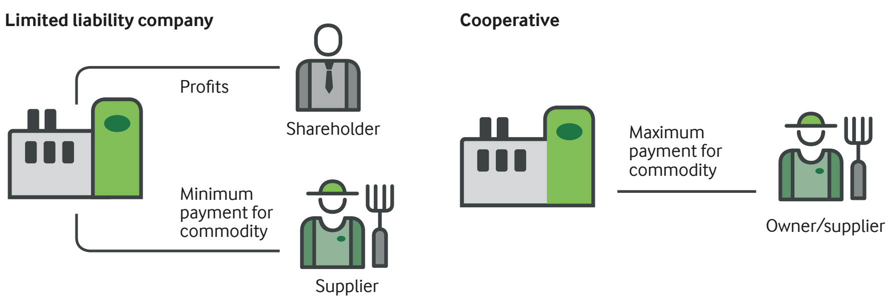
Arla acknowledges the role that tax plays in society. As a cooperative based in Denmark our activities are governed by the Danish tax rules for cooperatives. Danish cooperative tax rules are based on the fact that the cooperative acts as its owners' extended arm. Our owners are also our suppliers, and earnings do not accrue in the company but go back to them in the form of the highest possible payment for their milk. The company's earnings can therefore be viewed as the owners' personal income.

This means that our owners pay income tax on the amount of milk they have delivered in a year multiplied by the milk price, prepaid as well as any supplementary payment, under the applicable rules in their countries. It also means that Arla as a cooperative pays income tax in Denmark based on its assets (equity). This income tax can be viewed as interest on the tax of the portion of earnings retained in the company.

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

Guide to cooperative taxes

Danish cooperative tax rules take into account the fact that Arla's suppliers are also Arla's owners and that earnings do not accrue to the company, but are paid to its owners in the form of the highest possible milk price.



Preparing the business for the potential impact of the Brexit vote

Following the EU referendum on 23 June 2016, the UK is expected to initiate exit negotiations for the country to leave the EU in March 2017. The outcome of the negotiations on the future trading relationship between the EU and the UK is uncertain.

As a dairy company with 11,922 owners in seven EU member states and with approximately 80 per cent of our total revenue generated in the EU, it is essential that our products can move freely across the markets in which we operate to optimise the utilisation of our ONE milk pool. With 2,485 owners based in the UK, the country is Arla's biggest single market accounting for approximately 26 per cent including Arla Foods Ingredients of the total revenue with approximately 75 per cent based on local milk and the remaining share from sales of imported products. As well as being our largest market, the UK is a critical and significant focus for our European business. For our branded business in the UK, Lurpak® has the potential to be most impacted by the Brexit vote.

Up to, and immediately following the Brexit vote, the exchange rate between GBP and EUR was highly volatile. Compared to the average exchange rate in 2015, the GBP decreased by more than 10 per cent. However, as a result of Arla's hedging strategy, the profit for 2016 was not significantly affected by the volatile exchange rates.

Arla will focus on minimising any potential negative impact of Brexit and utilise potential opportunities for the business as a result of the Brexit vote. For Arla it is important that a trade agreement is reached that will not limit the free movement of dairy products for a prosperous future for dairy. We are working with all relevant stakeholders both in the UK and across the EU to ensure that Brexit has as little impact as possible on Arla.

Despite these new challenges, this will not change the importance of the UK market for Arla.

In order to support Arla's activities in relation to the upcoming Brexit negotiation, Arla has established a senior management taskforce to analyse and monitor the possible consequences as well as prepare the business to deal with the developments following the Brexit. The taskforce will regularly inform the Executive Management Team and the Board of Directors on progress.

Consolidated financial statements

Content

Consolidated income statement 1 January - 31 December

(EURm)	Note	2016	2015	Development
Revenue	1.1	9,567	10,262	-7%
Production costs	1.2	-7,177	-7,833	-8%
Gross profit		**2,390**	**2,429**	**-2%**
Sales and distribution costs	1.2	-1,642	-1,597	3%
Administration costs	1.2	-435	-417	4%
Other operating income	1.3	91	37	146%
Other operating costs	1.3	-29	-74	-61%
Gain from sale of enterprise	3.6	120	-	
Share of results after tax in joint ventures and associates	3.4	10	22	-55%
Earnings before interest and tax (EBIT)		**505**	**400**	**26%**
Specification:				
EBITDA excluding gain from sale of enterprise		719	754	-5%
Gain from sale of enterprise	3.6	120	-	
Depreciation, amortisation and impairment losses	1.2	-334	-354	-6%
Earnings before interest and tax (EBIT)		**505**	**400**	**26%**
Financial income	4.1	7	14	-50%
Financial costs	4.1	-114	-77	48%
Profit before tax		**398**	**337**	**18%**
Tax	5.1	-42	-42	0%
Profit for the year		**356**	**295**	**21%**
Minority interests		-9	-10	-10%
Arla Foods amba's share of profit for the year		**347**	**285**	**22%**

Basis for profit appropriation

(EURm)	**2016**	**2015**
Profit for the year	356	295
Minority interests	-9	-10
Arla Foods amba's share of net profit for the year	**347**	**285**
Proposed profit appropriation:		
Supplementary payment for milk	121	110
Interest on contributed capital	3	3
Total supplementary payment	**124**	**113**
Transferred to equity:		
Reserve for special purposes	193	141
Contributed capital	30	31
Total transferred to equity	**223**	**172**
Appropriated profit	**347**	**285**

Impacts on profit for the year

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 owners. The performance price is calculated as the prepaid milk price, included in production costs, plus the result for the year attributable to owners of Arla Foods amba, divided by milk volume supplied. The performance price in 2016 was 30.9 EUR-cent per kg owner milk, compared to 33.7 EUR-cent per kg owner milk in 2015. For more detail, please refer to the financial review on page 45.

The market situation within the dairy industry and on financial markets has significantly impacted the income statement. Despite our efforts improving the quality of our sales, the difficult market situation has resulted in a decrease in revenue of 7 per cent compared to last year. For more detail refer to Note 1.

In general, the income statement was significantly impacted by effects from currencies. Revenue was negatively impacted by EUR 357 million, while operational costs reduced by EUR 260 million. Positive effects from hedging were included in other operating income, while financial costs were adversely impacted by foreign exchange adjustments.

The year-end result is significantly impacted by a number of one-off effects which were unique to the 2016 financial year. The main one-offs recognised in the year include a gain on the divestment of Rynkeby, an unfavourable impact from the associate company Mengniu in China, as well as currency availability and devaluations which occurred in Nigeria.

Net profit of the Group was EUR 356 million compared to EUR 295 million in 2015 corresponding to a 21 per cent increase. Net profit allocated to the owners of Arla Foods amba amounted to EUR 347 million, which constitutes 3.6 per cent of revenue compared to 2.8 per cent achieved last year. This exceeded our target range of 2.8 to 3.2 per cent. Net profit as a percentage of revenue (excluding the divestment) represented 2.4 per cent in 2016, compared to 2.8 per cent in 2015.

The proposed supplementary payment for 2016 is EUR 124 million corresponding to EUR-cent 1 per kg owner milk after adjustments in accordance wtih merger agreements.

Consolidated statement of comprehensive income 1 January - 31 December

(EURm)	Note	2016	2015
Profit for the year		**356**	**295**
Other comprehensive income			
Items that will not be reclassified to the income statement:			
Actuarial gains and losses on defined benefit plans	4.7	-132	34
Income tax on actuarial gains and losses on defined benefit plans		21	-13
Items that may be reclassified subsequently to the income statement:			
Deferred gains and losses on cash flow hedges arising during the period		-23	-49
Value adjustments of hedging instruments reclassified to other operating income and costs		-34	53
Value adjustments of hedging instruments reclassified to financial items		17	20
Value adjustments of hedging instruments reclassified to production costs		18	12
Value adjustments of financial assets for the period classified as held for sale		-2	-
Foreign exchange adjustments of foreign entities		-40	41
Income tax on items that may be reclassified to profit or loss		-5	-1
Other comprehensive income, net of tax		**-180**	**97**
Total comprehensive income		**176**	**392**
Allocated as follows:			
Owners of Arla Foods amba		169	380
Minority interests		7	12
Total		**176**	**392**

Consolidated balance sheet 31 December

(EURm)	Note	2016	2015	Development
Assets				
Non-current assets:				
Intangible assets	3.1	825	873	-5%
Property, plant and equipment	3.3	2,310	2,457	-6%
Investments in associates	3.4	434	434	0%
Investments in joint ventures	3.4	51	50	2%
Deferred tax	5.1	74	64	16%
Other non-current assets		20	25	-20%
Total non-current assets		**3,714**	**3,903**	**-5%**
Current assets:				
Inventories	2.1	950	1,007	-6%
Trade receivables	2.1	876	910	-4%
Derivatives		31	75	-59%
Current tax		1	1	0%
Other receivables		222	202	10%
Securities		504	509	-1%
Cash and cash equivalents		84	70	20%
Total current assets excluding assets held for sale		**2,668**	**2,774**	**-4%**
Assets held for sale		-	59	-100%
Total current assets		**2,668**	**2,833**	**-6%**
Total assets		**6,382**	**6,736**	**-5%**
Equity and liabilites				
Equity:				
Equity excluding proposed supplementary payment to owners		2,033	2,000	2%
Proposed supplementary payment to owners		124	113	10%
Equity attributable to the parent company's owners		**2,157**	**2,113**	**2%**
Minority interests		35	35	0%
Total equity		**2,192**	**2,148**	**2%**
Liabilities				
Non-current liabilities:				
Pension liabilities	4.7	369	294	26%
Provisions	3.5	12	8	50%
Deferred tax	5.1	80	65	23%
Loans	4.2	1,281	1,717	-25%
Total non-current liabilities		**1,742**	**2,084**	**-16%**
Current liabilities:				
Loans	4.2	947	1,076	-12%
Trade payables	2.1	995	918	8%
Provisions	3.5	13	19	-32%
Derivatives		168	158	6%
Current tax		18	5	260%
Other current liabilities		307	298	3%
Total current liabilities excluding liabilities regarding assets held for sale		**2,448**	**2,474**	**-1%**
Liabilities regarding assets held for sale		-	30	-100%
Total current liabilities		**2,448**	**2,504**	**-2%**
Total liabilities		**4,190**	**4,588**	**-9%**
Total equity and liabilities		**6,382**	**6,736**	**-5%**

Consolidated statement of changes in equity 1 January - 31 December

	Common capital		Individual capital			Other equity accounts					
(EURm)	Capital account	Reserve for special purposes	Delivery-based owner certificates	Contributed capital	Proposed supplementary payment to owners	Reserve for value adjustment of hedging instruments	Available for sale reserve	Reserve for foreign exchange adjustments	Total	Minority interests	Total equity
Equity at 1 January 2016	**909**	**573**	**94**	**422**	**113**	**-95**	**5**	**92**	**2,113**	**35**	**2,148**
Suplementary payment for milk	-	-	-	-	121	-	-	-	121	-	121
Interest on contributed capital	-	-	-	-	3	-	-	-	3	-	3
Reserve for special purposes	-	193	-	-	-	-	-	-	193	-	193
Contributed capital	-	-	-	30	-	-	-	-	30	-	30
Minority interests	-	-	-	-	-	-	-	-	-	9	9
Profit for the year	**-**	**193**	**-**	**30**	**124**	**-**	**-**	**-**	**347**	**9**	**356**
Other comprehensive income	-111	-	-	-	-	-27	-2	-38	-178	-2	-180
Total comprehensive income	**-111**	**193**	**-**	**30**	**124**	**-27**	**-2**	**-38**	**169**	**7**	**176**
Capital issued to new owners	-	-	-	5	-	-	-	-	5	-	5
Payments to owners	-	-	-6	-16	-	-	-	-	-22	-	-22
Dividend to minority shareholders	-	-	-	-	-	-	-	-	-	-8	-8
Disposal of non-controlling interests	-	-	-	-	-	-	-	-	-	1	1
Supplementary payment to owners	-	-	-	-	-108	-	-	-	-108	-	-108
Foreign exchange adjustments	31	-	-1	-25	-5	-	-	-	-	-	-
Total transactions with owners	**31**	**-**	**-7**	**-36**	**-113**	**-**	**-**	**-**	**-125**	**-7**	**-132**
Equity at 31 December 2016	**829**	**766**	**87**	**416**	**124**	**-122**	**3**	**54**	**2,157**	**35**	**2,192**
Equity at 1 January 2015	**901**	**432**	**99**	**387**	**104**	**-131**	**5**	**54**	**1,851**	**23**	**1,874**
Suplementary payment for milk	-	-	-	-	110	-	-	-	110	-	110
Interest on contributed capital	-	-	-	-	3	-	-	-	3	-	3
Reserve for special purposes	-	141	-	-	-	-	-	-	141	-	141
Contributed capital	-	-	-	31	-	-	-	-	31	-	31
Minority interests	-	-	-	-	-	-	-	-	-	10	10
Profit for the year	**-**	**141**	**-**	**31**	**113**	**-**	**-**	**-**	**285**	**10**	**295**
Other comprehensive income	21	-	-	-	-	36	-	38	95	2	97
Total comprehensive income	**21**	**141**	**-**	**31**	**113**	**36**	**-**	**38**	**380**	**12**	**392**
Capital issued to new owners	-	-	-	5	-	-	-	-	5	-	5
Payments to owners	-	-	-6	-12	-	-	-	-	-18	-	-18
Dividend to minority shareholders	-	-	-	-	-	-	-	-	-	-10	-10
Disposal of non-controlling interests	-	-	-	-	-	-	-	-	-	10	10
Supplementary payment to owners	-	-	-	-	-105	-	-	-	-105	-	-105
Foreign exchange adjustments	-13	-	1	11	1	-	-	-	-	-	-
Total transactions with owners	**-13**	**-**	**-5**	**4**	**-104**	**-**	**-**	**-**	**-118**	**-**	**-118**
Equity at 31 December 2015	**909**	**573**	**94**	**422**	**113**	**-95**	**5**	**92**	**2,113**	**35**	**2,148**

Understanding the 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 is explained in detail below:

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 below determines that the account can not 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 on this account.

Individual capital

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

Other equity accounts

Other equity accounts include accounts prescribed by IFRS that shall be disclosed separately and cannot be used for payment to owners. This includes *reserve for value adjustment of hedging instruments, available for sale reserve* and *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 despite significantly losses on pension liabilities

During 2016, equity increased by EUR 44 million compared to 31 December 2015.

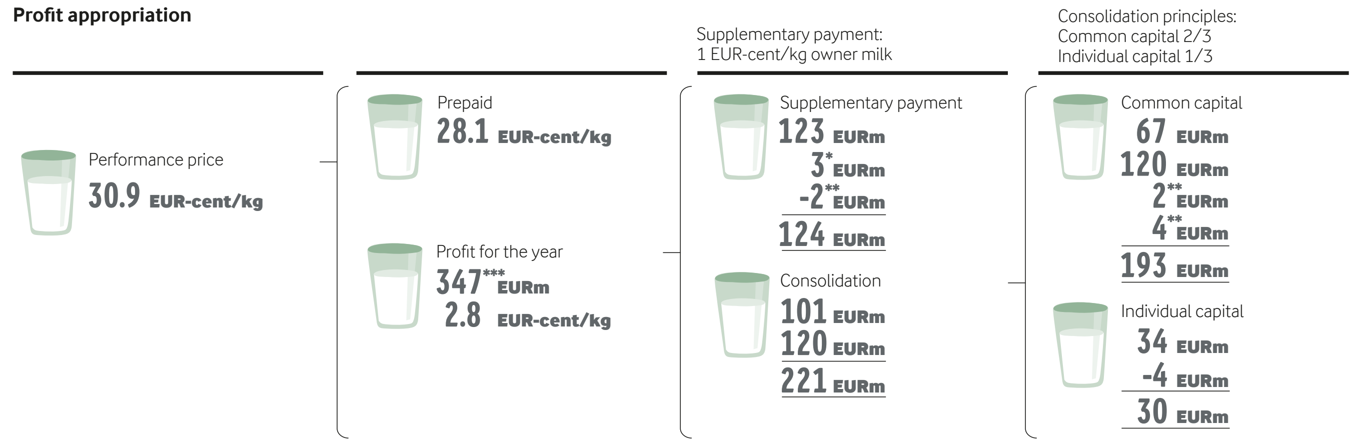
Profit appropriation
Basis for proposed supplementary payment is EUR 123 million, corresponding to EUR-cent 1 per kg owner milk. As set out in previous years merger agreements, EUR 2 million of the supplementary payment is transferred separately to the reserve for special purposes. Interest on consolidated contributed capital amounts to EUR 3 million, which gives rise to a supplementary payment of EUR 124 million. This is an increase of EUR 11 million, primarily due to a lower impact in 2016 from merger agreements. The average supplementary payment of EUR-cent 1 per kg owner milk is unchanged compared to last year.

The gain on the divestment of Rynkeby, amounting to EUR 120 million, has been transferred to the reserve for special purposes in accordance with the consolidation policy approved by the Board of Representatives. The basis for consolidation after adjusting for the gain on divestment is EUR 101 million. This is split into 1/3 contributed capital, amounting to EUR 34 million, and 2/3 reserve for special purposes, amounting to EUR 67 million. As set out in merger agreements, EUR 4 million of the contributed capital is transferred to the reserve for special purposes.

Other comprehensive income
Other comprehensive income amounting to a loss of EUR 180 million is primarily attributable to actuarial losses on pension liabilities, adverse value adjustments on hedging instruments and net assets measured in foreign currencies.

Payments to and from owners
A supplementary payment relating to 2015 totalling EUR 108 million was paid out in March 2016. Additionally, EUR 22 million was paid out to owners resigning or retiring from the cooperative. It is expected that EUR 22 million will be paid out in 2017 to owners resigning or retiring.

Profit appropriation



** Interest on contributed capital: 0.03 EUR-cent/kg owner milk ** According to merger agreements *** Based on profit allocated to owners of Arla Foods amba*

Regulations according to Articles of Association and IFRS

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

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

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

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

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

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

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

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

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

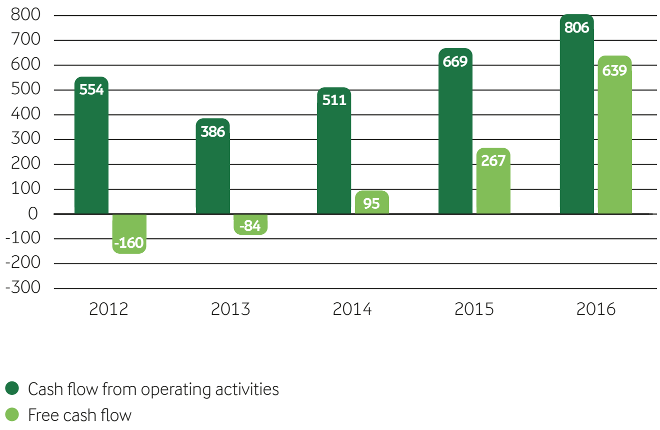
Non-impairment clause
Under the Article of Association, no payment may be made by Arla Foods amba to owners that impair the sum of the capital account and equity accounts prescribed by law and IFRS. The non-impairment clause is assessed on the basis of the most recent annual report presented under IFRS.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

Minority interests
Subsidiaries are fully recognised in the consolidated financial statements. Minority interests' share of the results for the year and of the equity in the subsidiaries that are not wholly owned are recognised as part of the consolidated results and equity, respectively, but are listed separately. On initial recognition, minority interests are measured at either the fair value of the equity interest or the proportional share of the fair value of the acquired companies identified assets, liabilities and contingent liabilities. The measurement of minority interests is selected on a transactional basis, and disclosure is made in the note pertaining to business combinations.

Consolidated cash flow statement 1 January - 31 December

(EURm)	Note	2016	2015
EBITDA		839	754
Gain from sale of enterprise	3.6	-120	-
EBITDA excluding gain from sale of enterprise		719	754
Share of results in joint ventures and associates	3.4	-10	-22
Change in working capital	2.1	138	-23
Change in other working capital		-3	10
Other operating items without cash impact		22	11
Dividends received, joint ventures and associates		12	8
Interest paid		-59	-56
Interest received		5	6
Tax paid	5.1	-18	-19
Cash flow from operating activities		**806**	**669**
Investment in intangible fixed assets	3.1	-58	-70
Investment in property, plant and equipment	3.3	-263	-348
Sale of property, plant and equipment	3.3	16	8
Operating investing activities		**-305**	**-410**
Free operating cash flow		501	259
Acquisition of enterprises	3.6	-	-29
Sale of enterprises	3.6	138	37
Financial investing activities		**138**	**8**
Cash flow from investing activities		**-167**	**-402**
Free cash flow		639	267
Supplementary payment regarding the previous financial year		-108	-105
Paid in funds from new owners		-	5
Paid out from equity regarding terminated membership contracts		-22	-18
Loans obtained, net	4.2	-400	-173
Payment to pension liabilities		-45	-70
Change in current liabilities		-54	37
Net change in marketable securities		5	50
Cash flow from financing activities		**-624**	**-274**
Net cash flow		**15**	**-7**
Cash and cash equivalents at 1 January		70	81
Exchange rate adjustment of cash funds		-8	3
Transferred to asset held for sale		7	-7
Cash and cash equivalents at 31 December		**84**	**70**

Development in cash flow
(EURm)



Delivering improved cash flow

Cash flow from operating activities improved by EUR 137 million, to EUR 806 million in 2016 from EUR 669 million in 2015. The change was attributable to changes in working capital, as our ongoing efforts to reduce working capital continue to release cash.

Cash flow from investing activities were EUR -167 million, compared to EUR -402 million in 2015. Cash flow from operating investment activities mainly related to facilities in Upahl and Pronsfeld in Germany, Aylesbury in the UK, Linköping and Falkenberg in Sweden and a global innovation center in construction in Denmark. Cash flow from financing investment activities reflected the divestment of Rynkeby Foods. Free cash flow totalled EUR 639 million in 2016, compared to EUR 267 million in 2015. These are calculated as cash flow from operating activities less cash flow from investment activities.

Cash flow from financing activities were EUR -624 million, compared to EUR -274 million last year. The movement was mainly affected by the supplementary payment relating to 2015, paid out in 2016, as well as significant loan repayments.

Combined cash and cash equivalents as at 31 December 2016 were EUR 84 million, compared to EUR 70 million in prior year.

Accounting policies

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

Note 1

Operating profit

Note 1.1 Revenue

Improved quality of sales

Revenue decreased by 6.8 per cent to EUR 9.567 million, compared to EUR 10.262 million in 2015. This is a direct result of lower sales prices due to higher milk volumes in the first half of 2016, as well as unfavourable exchange rates. The lower sales prices contributed to a EUR 500 million or 4.9 per cent decline in revenue, particularly in Germany and Finland. The effect of currency development resulted in a EUR 357 million decline in revenue largely based on the GBP currency, as the UK represents approximately 25 per cent of revenue.

Following divestment of Rynkeby in May 2016 revenue was reduced. This was more than offset by improved sales volumes within retail and foodservice. The full year effect of the Rynkeby divestment will be visible in 2017.

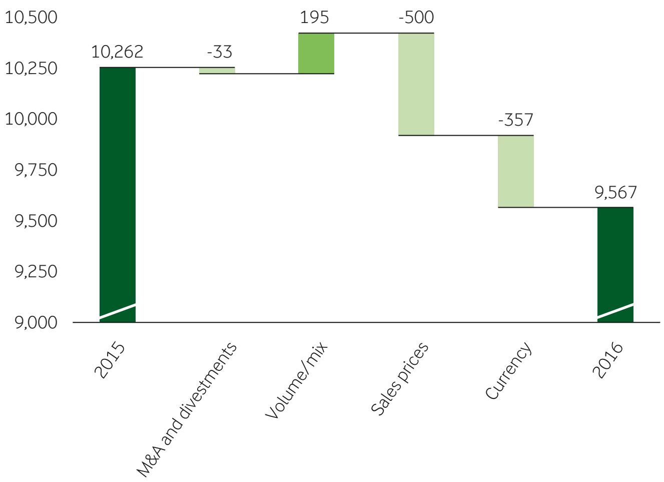
Despite challenging market conditions, volume driven revenue growth in branded positions was 5.2 per cent, demonstrating that we have improved the quality of our revenue. Branded sales now total 44.5 per cent of total sales, increasing 25 percentage points compared to 2015.

Year-on-year, milk intake from owners and contract suppliers totalled 13.9 billion kg compared to 14.2 billion kg in 2015, representing a decline of 2.2 per cent.

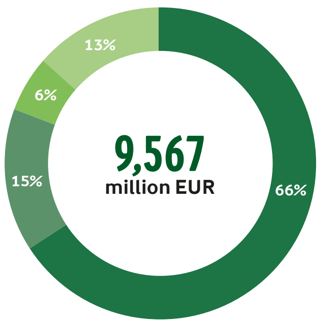
Europe is our largest commercial segment, comprising 66 per cent of total revenue, followed by International 15 per cent, Arla Foods Ingredients 6 per cent and other (including trading activities) 13 per cent. We have achieved a volume driven revenue growth of 2.7 per cent in retail and food service. This was achieved despite an overall decline in milk intake. Europe contributed to a volume driven revenue growth of 1.3 per cent. Our International segment achieved a growth rate of 9.5 per cent, primarily due to increased sales in Sub-Saharan Africa, China and South East Asia.

Revenue split by category remains largely unchanged compared to last year. The milk, yogurt, powder and cooking category is by far the largest category.

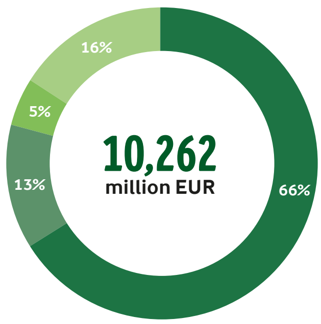
Development in revenue
(EURm)



Revenue split by commercial segment 2016



Revenue split by commercial segment 2015



(EURm)	2016	2015
Europe	6,321	6,793
International	1,428	1,348
AFI	545	519
Trading and other	1,273	1,602

Table 1.1 Revenue split by country
(EURm)

	2016	2015
UK	2,532	2,968
Sweden	1,463	1,517
Germany	1,302	1,370
Denmark	1,061	1,100
Netherlands	373	389
Finland	329	348
Saudi Arabia	246	247
China	202	174
Belgium	197	261
USA	180	179
Other*	1,682	1,709
Total	**9,567**	**10,262**

Other countries include Canada, Oman, UAE, Spain, France, Australia, Nigeria and Russia.

2016 revenue in per cent split by country

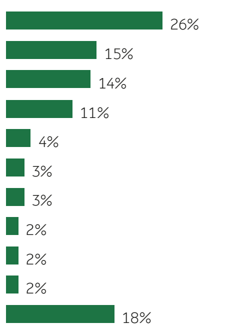


Table 1.1 represents the total revenue by country and includes all sales that occur in the countries, irrespective of the commercial segment where they are generated. Therefore, the figures cannot be compared to our market review on page 52 to 55.

Revenue by category

	Milk, yogurt, powder and cooking (MYPC)	Cheese	Butter, spreads and margarine (BSM)	Other
2016	45%	26%	14%	15%
2015	45%	25%	13%	17%

Accounting policies

Revenue from the sale of dairy and other food products is recognised in the income statement when delivery and risk of the products have passed to the buyer, the amount of revenue can be measured reliably, and collection is probable. Revenue comprises invoiced sales for the year less sales rebates, cash discounts, VAT and duties. Revenue by business group/market and product category is based on the Group's internal financial reporting.

Note 1.2 Costs

Tight control on costs

Operational costs for 2016 were EUR 9,254 million compared to EUR 9,847 million in 2015, representing a decrease of 6.0 per cent. Excluding the cost of raw milk, total costs have decreased by 1.4 per cent, partially due to currency effects. We have maintained a tight grip on costs, delivering scalability above 2.0 and a conversion cost index of 99.2.

Production costs (excluding cost of raw milk) decreased by 4.2 per cent due to a continuous focus on cost reduction and currency. The cost efficiency programme focusing on delivering savings, primarily within supply chain, has delivered savings amounting to EUR 100 million in 2016. This has been offset by the effects from inflation, planned salary increases and development in inventory levels.

Sales and distribution costs have increased by 2.8 per cent, mainly due to increased marketing spend to support major branded sales initiatives. Research and development spend incurred amounted to EUR 43 million, consistent with the prior year. EUR 22 million was capitalised in relation to internal hours and costs related to development activities.

Administration costs increased by EUR 18 million, primarily as a result of extraordinary redundancy and salary costs attributed to the 2016 restructure.

Cost of raw milk
The cost of raw milk decreased by EUR 519 million or 11.4 per cent. This was driven by lower prices, volumes and currency effects mainly attributed to the development in the GBP.

Owner milk
Costs related to owner milk decreased by EUR 415 million or 10,6 per cent. A lower prepaid milk price reduced the costs by EUR 246 million, while lower volumes attributed to a reduction of EUR 39 million. Currency effects amounted to EUR 130 million.

Other milk
Costs relating to other milk decreased by EUR 104 million, whereof currency effects amounted to EUR 26 million. Other milk consists of speciality milk and other contract milk acquired to meet local market demands. Volumes decreased by 10.1 per cent, as a result of an active focus to drive a reduction.

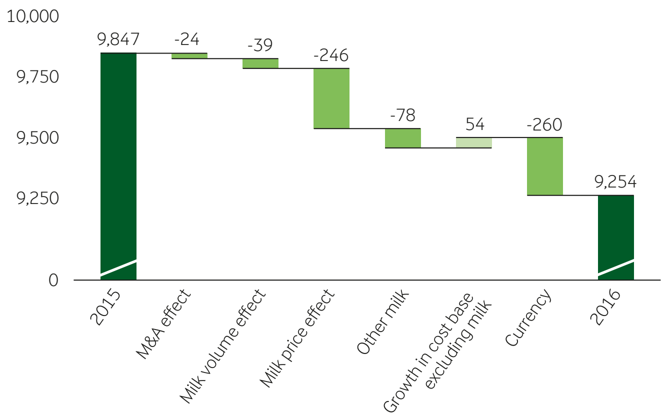
Staff costs
Staff costs decreased to EUR 1,223 million in 2016 from EUR 1,225 million in 2015. The development in staff costs was positively impacted by currency effects and the divestment of Rynkeby, despite one-off redundancy costs related to the restructure.

To deliver the strategy, Good Growth 2020, a restructure was designed and implemented during 2016. The key driver of the new organisation is to drive a more global agenda in Arla and to strengthen collaboration, synergies and efficiencies across countries. As a result, more than 500 white collar employees were made redundant. The full year effect of the reduction in full time employees will be realised in 2017, as well as the resulting cost savings.

Marketing spend
Marketing costs increased 9.2 per cent to EUR 309 million in 2016 from EUR 283 million in 2015. This represents an increase of EUR 37 million excluding currency effects. We centralised marketing departments into one global marketing team, enabling us to harvest significant synergies across markets and to negotiate better marketing contracts.

Major marketing initiatives for the year included investment in yogurt and milk in the UK (skyr, protein product ranges, organic and Best of Both milk), milk and powder in China (Milex and Baby and Me), milk, powder and cheese in South East Asia (launching cheese spread in the Philippines and Dano milk in Bangladesh), as well as an Arla brand campaign in the US. The increased marketing spend is in line with our strategy, Good Growth 2020, focusing on growing our brands. Read more about significant marketing events on page 12.

Development in operational cost
(EURm)



Depreciation, amortisation and impairment
Depreciation, amortisation and impairment amounted to EUR 334 million, corresponding to a decrease of EUR 20 million compared to last year. Useful lives of fixed assets are assessed annually. The useful lives of major production buildings were revised in the current year, extending the useful lives of buildings from 20 to 30 years to better reflect the actual lifetime. The re-evaluation has reduced the depreciation by EUR 18 million.

Table 1.2.a Operational costs split by function

(EURm)	2016	2015
Production costs	7,177	7,833
Sales and distribution costs	1,642	1,597
Administration costs	435	417
Total	**9,254**	**9,847**
Specification:		
Cost of raw milk	4,028	4,547
Other production materials*	1,463	1,435
Staff costs	1,223	1,225
Transportation costs	1,010	1,044
Marketing costs	309	283
Depreciation, amortisation and impairment	334	354
Other costs**	887	959
Total	**9,254**	**9,847**

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

Table 1.2.b Cost of raw milk

	2016		2015	
	Weighed in mio. kg.	EURm	Weighed in mio. kg.	EURm
Owner milk	12,320	3,503	12,463	3,918
Other milk	1,554	525	1,729	629
Total	**13,874**	**4,028**	**14,192**	**4,547**

Table 1.2.c Staff costs

(EURm)	2016	2015
Wages, salaries and remuneration	1,038	1,043
Pensions - defined contribution plans	73	70
Pensions - defined benefit plans	3	5
Other social security costs	109	107
Total staff costs	**1,223**	**1,225**
Staff costs relate to:		
Production costs	668	676
Sales and distribution costs	346	355
Administration costs	200	182
Staff costs recognised as inventory or fixed assets	9	12
Total staff costs	**1,223**	**1,225**
Average number of full time employees	18,765	19,025

Table 1.2.d Depreciation, amortisation and impairment losses

(EURm)	**2016**	**2015**
Intangible assets, amortisation	42	34
Property, plant and equipment, depreciation	292	320
Total depreciation, amortisation and impairment losses	**334**	**354**
Depreciation, amortisation and impairment losses relate to:		
Production costs	269	287
Sales and distribution costs	32	31
Administration costs	33	36
Total depreciation, amortisation and impairment losses	**334**	**354**

Accounting policies

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

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

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

Note 1.3 Other operating income and costs

Hedging gains drive increase in net operating income

Other operating income and costs consist primarily of the following items: gains and losses relating to divestment of intangible assets, property, plant and equipment, gains and losses relating to financial instruments, and compensation from insurance contracts. Net other operating income for 2016 constituted EUR 62 million, compared to a net other operating costs of EUR 37 million last year. This is mainly a result of gains on financial instruments used for hedging of future sales, which have increased by EUR 86 million due to fluctuations in GBP and USD.

Other operating income and costs include items related to the sale of surplus power from condensation plants.

Note 2

Net working capital

Note 2.1 Net working capital

Strong net working capital improvement

To secure long-term earnings for our owners, we optimise our operational cash flow to fund new activities and investments. One way to release cash is by reducing the net working capital. The Group has a constant focus on improving our net working capital position. Processes are continuously being improved to optimise payment terms, the accuracy of inventory forecasting and internal planning.

In 2016, net working capital improved by EUR 168 million (17 per cent), to EUR 831 million in 2016 compared to EUR 999 million in 2015. The movement in net working capital, adjusted for owner milk, represents an improvement of EUR 195 million. Currency effects contributed EUR 41 million of the improvement in net working capital. These currency effects are mainly caused by the decreased value of the GBP and SEK.

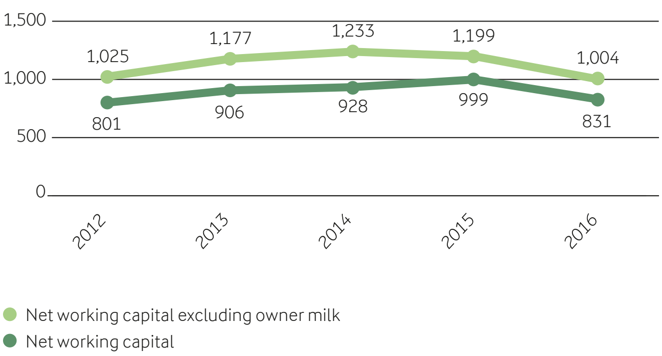
Inventory
Inventory decreased to EUR 950 million in 2016 from EUR 1,007 million in 2015. The majority of the decrease is attributed to currency development as a result of the decrease in the value of the GBP and SEK. The remainder of the decrease in inventory EUR 16 million was due to reduced volumes at year-end, combined with a lower milk price compared with 2015.

Trade receivables
Trade receivables decreased to EUR 876 million in 2016 from EUR 910 million in 2015. The net movement, excluding currency effects, is a decrease of EUR 4 million compared to 2015. The main drivers for the reduction in trade receivables include the lower sales price and our continued focus on cash collection.

Exposure to credit risk on trade receivables is managed locally in the operating entities. Credit limits are set based on the customer's financial position and the current market conditions. Generally, the Group 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 is 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 2016. Overdue above 90 days on trade receivables amounted to 1.5 per cent (2015: 1.8 per cent).

Trade payables
Trade payables improved to EUR 995 million in 2016 from EUR 918 million in 2015. The movement in trade payables, excluding owner milk and currency effects, was an improvement of EUR 134 million. The increase was driven by focus on payments terms, including launch of a new supply chain financing programme in 2016. Owner milk decreased by EUR 27 million, mainly as a result of a new aligned settlement structure.

Net working capital
(EURm)



Development in net working capital
(EURm)

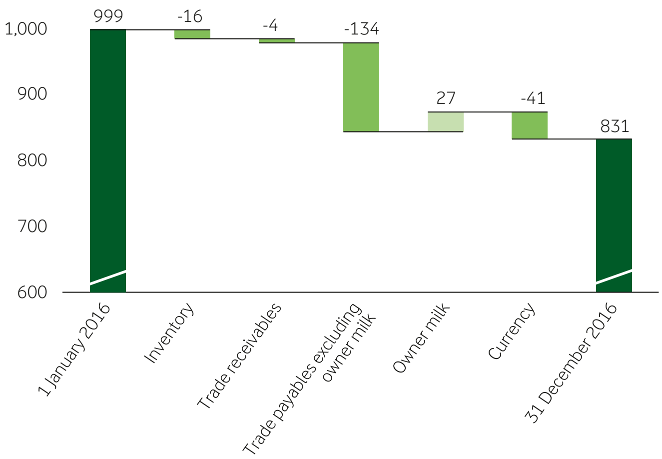


Table 2.1.a Net working capital
(EURm)

	2016	2015
Inventories	950	1,007
Trade receivables	876	910
Trade payables	-995	-918
Net working capital	**831**	**999**
Payables for owner milk	173	200
Net working capital excluding owner milk	**1,004**	**1,199**

Table 2.1.b Inventory

(EURm)	2016	2015
Inventory	969	1,036
Write-downs	-19	-29
Total inventory	**950**	**1,007**
Raw materials and consumables	257	224
Work in progress	292	294
Finished goods and goods for resale	401	489
Total inventory	**950**	**1,007**

Table 2.1.c Trade receivables

(EURm)	2016	2015
Trade receivables before provision for bad debts	887	922
Write-downs for bad debts	-11	-12
Total trade receivables	**876**	**910**

Accounting policies

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

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

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

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

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

Uncertainties and estimates

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

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

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

Receivables
Receivables are written down based on individual assessment if signs of impairment regarding customers' insolvency are present and insolvency is anticipated. Furthermore, a mathematical computation is used based on several parameters including number of days overdue.
The financial uncertainty associated with write-downs for bad debt losses is usually considered to be limited. However, if a customer's ability to pay deteriorates in the future, further write-downs may be necessary.

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

Note 3

Capital employed

Note 3.1 Intangible assets

Intangible assets reduction driven by currency

Intangible assets amounted to EUR 825 million at 31 December 2016, representing a decrease of EUR 48 million compared to last year, primarily related to effects of changes in currencies.

Goodwill
Carrying value of goodwill amounted to EUR 615 million at year-end, compared to EUR 678 million in 2015. EUR 488 million hereof was allocated to activities in the UK, compared to EUR 550 million last year. This decrease in goodwill relates to exchange rate adjustments. For details on the impairment test refer to Note 3.2.

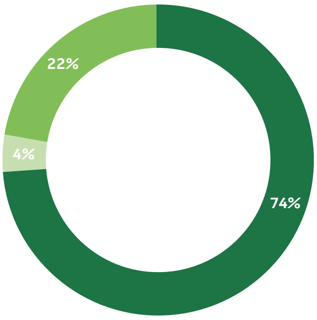
Licences and trademarks
Licences and trademarks recognised at a total carrying amount of EUR 30 million include Cocio®, Anchor® and Hansano®. Other brands including the strategic brands, Arla®, Lurpak®, Castello® and Puck® are not recognised on the balance sheet.

IT and other development projects
The Group continues to invest in the development of IT. During 2016, the integration of seven UK cheese sites, as well as Finland, Upahl in Germany and Falbygden in Sweden, into the Arla IT platform was completed. Similar integration was started in the Netherlands and Westbury in the UK. Other capitalised development costs related to innovation activities attributed to the development of new products.

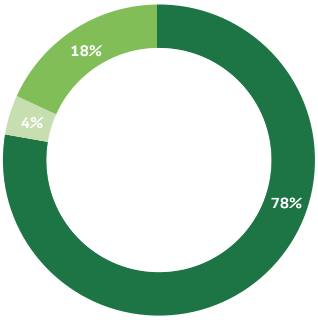
Table 3.1 Intangible assets
(EURm)

	Goodwill	Licenses and trademarks	IT and other development projects	Total
2016				
Cost at 1 January	678	102	281	1,061
Exchange rate adjustments	-63	1	-1	-63
Additions	-	-	58	58
Reclassification	-	-	-1	-1
Disposals	-	-3	-10	-13
Cost at 31 December	**615**	**100**	**327**	**1,042**
Amortisation and impairment at 1 January	-	-65	-123	-188
Exchange rate adjustments	-	-1	2	1
Amortisation for the year	-	-6	-36	-42
Amortisation on disposals	-	2	10	12
Amortisation and impairment at 31 December	**-**	**-70**	**-147**	**-217**
Carrying amount at 31 December	**615**	**30**	**180**	**825**
2015				
Cost at 1 January	645	103	206	954
Exchange rate adjustments	26	-2	-	24
Additions	-	-	70	70
Mergers and acquisitions	10	2	-	12
Reclassification	-3	-	13	10
Disposals	-	-1	-8	-9
Cost at 31 December	**678**	**102**	**281**	**1,061**
Amortisation and impairment at 1 January	-	-60	-103	-163
Exchange rate adjustments	-	1	-	1
Amortisation for the year	-	-6	-28	-34
Amortisation on disposals	-	-	8	8
Amortisation and impairment at 31 December	**-**	**-65**	**-123**	**-188**
Carrying amount at 31 December	**678**	**37**	**158**	**873**

Intangible assets 2016



Intangible assets 2015



Goodwill
Licences and trademarks
IT and other development projects

Accounting policies

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

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

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

Note 3.2 Impairment tests

Goodwill supported by the Good Growth 2020 strategy

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

Applied estimates
The impairment test is based on expected future cash flow derived from forecast and targets supporting the Good Growth 2020 strategy. The impairment tests do not include growth in the terminal value, as the growth rate has been set to the expected inflation rate.

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

Test results
Impairment testing showed that there was no need for impairment in 2016. In that regard, sensitivities to changes in milk prices and discount rates were calculated. The discount rate could rise by 4 percentage points before the need for impairment arises.

Table 3.2 Impairment tests
(EURm)

		Applied key assumptions	
2016	Carrying amount, goodwill	Discount rate, net of tax	Discount rate, before tax
UK	488	7.1%	8.9%
Finland	40	6.2%	7.6%
Sweden	23	6.4%	8.3%
Other	64	6.2%	6.9%
Total carrying amount at 31 December	**615**		
2015			
UK	550	7.2%	9.1%
Finland	40	6.1%	7.8%
Sweden	24	6.3%	8.3%
Other	64	6.3%	6.9%
Total carrying amount at 31 December	**678**		

Accounting policies

Impairment occur when the carrying amount of an asset is greater than its recoverable amount through either use or sale. For impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use (cash-generating unit) that are largely independent of the cash inflows of other assets or cash-generating units. The cash-generating units are determined based on the management structure and the internal financial reporting. The cash-generating units are reassessed each year.

The carrying amount of goodwill is tested for impairment together with the other non-current assets in the cash-generating unit to which the goodwill is allocated. The recoverable amount of goodwill is recognised as the present value of the expected future net cash flows from the cash-generating unit to which the goodwill is linked, 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 on a separate line in the income statement and cannot be reversed. The carrying amount of other non-current assets is assessed annually to determine whether there is any indication of impairment. The assets are measured on the balance sheet at the lower value of the recoverable amount and the carrying amount.

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

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

Uncertainties and estimates

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

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

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

Anticipated future free cash flows
The anticipated future free cash flows are based on current forecasts and targets set in the strategy period 2017-2020 within Good Growth 2020 strategy. These are based on management's best estimates and expectations, which are judgmental by nature. They include expectations in strategy period on revenue growth, EBIT margins and capital expenditures. This includes moving milk intake into value-added products, more profitable markets and cost reduction initiatives. The growth rate beyond the strategy period has been set to the expected inflation rate in the terminal period.

Following the Brexit vote, expected cash flows relating to goodwill in the UK are inherently more uncertain. Read more about the Brexit on page 79.

Discounts rates
A discount rate (WACC) is applied for the specific business areas based on assumptions regarding interest rates, tax rates and risk premiums. Changes in the future cash flow or discount rate estimates used may result in materially different values.

Note 3.3 Property, plant and equipment

Focused capital expenditure

The Group's main tangible assets are located in Denmark, the UK, Germany and Sweden. The carrying value decreased by EUR 147 million to EUR 2,310 million in 2016, mainly driven by currency and depreciation.

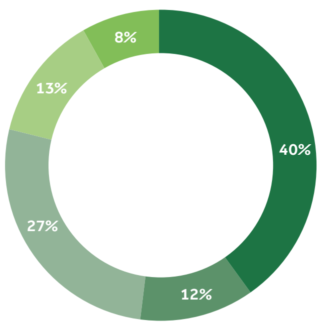
Capital expenditure at Arla decreased by 25 per cent to EUR 263 million from EUR 350 million in 2015. This reflected our ability to utilise our production capacity at existing sites more efficiently which allowed us to temporarily reduce capital expenditure.

Significant investments for the year included Navita, our global innovation centre in Denmark, increased capacity in Upahl and a milk separation facility in Pronsfeld in Germany. Furthermore, capacity was expanded at our dairies in Aylesbury in the UK, as well as Linköping and Falkenberg in Sweden.

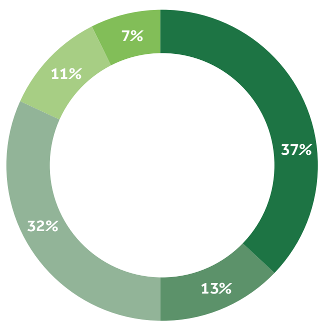
Table 3.3 Property, plant and equipment
(EURm)

	Land and buildings	Plant and machinery	Fixture and fitting, tools and equipment	Assets in course of construction	Total
2016					
Cost at 1 January	1,466	2,547	519	255	4,787
Exchange rate adjustments	-64	-84	-34	-7	-189
Additions	2	41	12	208	263
Transferred from assets in course of construction	37	227	28	-292	-
Disposals	-11	-67	-25	-	-103
Cost at 31 December	**1,430**	**2,664**	**500**	**164**	**4,758**
Depreciation and impairment at 1 January	-553	-1,402	-375	-	-2,330
Exchange rate adjustments	20	45	22	-	87
Depreciation for the year	-43	-204	-45	-	-292
Depreciation on disposals	3	62	22	-	87
Depreciations and impairment at 31 December	**-573**	**-1,499**	**-376**	**-**	**-2,448**
Carrying amount at 31 December	**857**	**1,165**	**124**	**164**	**2,310**
Of which assets held under finance lease	37	13	1	-	51
2015					
Cost at 1 January	1,382	2,368	472	286	4,508
Exchange rate adjustments	48	36	24	1	109
Additions	18	97	16	219	350
Acquisitions	2	2	-	-	4
Transferred from assets in course of construction	65	154	31	-250	-
Reclassification	-24	-43	-6	-1	-74
Disposals	-25	-67	-18	-	-110
Cost at 31 December	**1,466**	**2,547**	**519**	**255**	**4,787**
Depreciation and impairment at 1 January	-500	-1,273	-336	-	-2,109
Exchange rate adjustments	-15	-12	-16	-	-43
Depreciation for the year	-72	-203	-45	-	-320
Reclassification	13	22	5	-	40
Depreciation on disposals	21	64	17	-	102
Amortisation and impairment at 31 December	**-553**	**-1,402**	**-375**	**-**	**-2,330**
Carrying amount at 31 December	**913**	**1,145**	**144**	**255**	**2,457**
Of which assets held under finance lease	44	21	4	-	69

Property, plant and equipment by country 2016

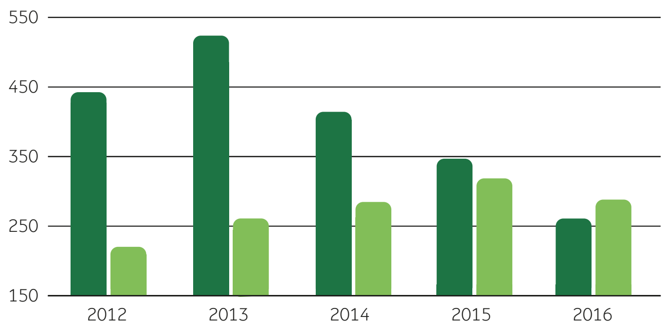


Property, plant and equipment by country 2015



- Denmark
- Sweden
- UK
- Germany
- Other

Investments and depreciation property, plant and equipment (EURm)



- Investments property, plant and equipment
- Depreciation property, plant and equipment

Accounting policies

Property, plant and equipment are measured at cost less accumulated depreciation and impairment. 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. 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 such time as 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). 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
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 anticipated useful life.

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

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

Uncertainties and estimates

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

Useful life of buildings
The Group revaluates the useful lives of fixed assets annually. During the year, management reassessed the useful lives of major production buildings, prolonging these from 20 to 30 years to better reflect the actual lifetime. This has reduced the Group's depreciation by EUR 18 million in 2016.

Note 3.4 Joint ventures and associates

Financial comments

COFCO Dairy Holdings Limited (China) and China Mengniu Dairy Company Limited
The Group has a 30 per cent investment in COFCO Dairy Holdings Limited (China), which is considered an associated company based on a cooperation agreement extending significant influence, including right of board representation. The cooperation agreement with COFCO also entitles Arla to representation on the board of China Mengniu Dairy Company Limited, a Hong Kong listed dairy company controlled by COFCO. It has been agreed that Arla and China Mengniu Dairy Company Limited cooperate regarding the exchange of technical dairy knowledge and expertise, and that Arla grants intellectual rights to China Mengniu Dairy Company Limited. Based on the underlying agreements, it has been determined that Arla has significant influence in China Mengniu Dairy Company Limited. Currently, COFCO Dairy Holdings Limited holds no other investments.

As at 31 December 2016, the Group's proportionate share of the net asset value of COFCO Dairy Holdings Limited, including China Mengniu Dairy Company Limited, is EUR 309 million, compared to EUR 325 million last year. The carrying amount of the investment in COFCO Dairy Holdings Limited includes goodwill amounting to EUR 160 million, compared to EUR 158 million last year.

The fair value of the indirect share in China Mengniu Dairy Company Limited equals EUR 383 million, compared to EUR 311 million last year.

The investment in COFCO Dairy Holdings Limited is part of the China business unit and is currently managed in China together 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 of the China business unit.

Impairment testing showed that there was no indication of impairment need in 2016. Impairment risks could include substantial and long-term reductions in leading stock indexes in Asia, issue of import restrictions on dairy products in China, or an adverse and permanent reduction in the expected performance of China Mengniu Dairy Company Limited.

Lantbrukarnas Riksförbund, Sweden (LRF)
The Group has an ownership interest of 23 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, the representation on the Board of Directors; historically a member of Arla's Board of Directors has represented the Swedish dairy industry at the Board of Directors in LRF.

Vigor Alimentos S.A., Brazil
The Group holds an 8 per cent investment in Vigor Alimentos S.A., which is considered an associated company based on a cooperation agreement extending significant influence, including the right to representation on the board.

In July 2016, Vigor Alimentos S.A was delisted from the stock exchange and is no longer a publicly-held company.

Joint ventures
Carrying value of joint ventures amounted to EUR 51 million at year-end compared to EUR 50 million last year. The carrying value includes no goodwill.

Table 3.4.a Associates

Reconciliation of recognised value of associates (EURm)	**2016**	**2015**
Share of equity in material associates	149	167
Goodwill in material associates	160	158
Share of equity in non-material associates	125	109
Recognised value	**434**	**434**

Table 3.4.b Material associates

Financial information for associates that are considered material to the Group (EURm)	**COFCO Dairy Holdings Limited, China 2016**	**COFCO Dairy Holdings Limited, China 2015**
Revenue	15	10
Results after tax	15	10
Other comprehensive income	-	-
Non-current assets	789	722
Current assets	-	-
Non-current liabilities	-	-
Current liabilities	-	-
Dividends received	4	4
Ownership share	30%	30%
Group share of result after tax	-6	21
Recognised value	309	325

Table 3.4.c Transactions with joint ventures and associates

(EURm)	**2016**	**2015**
Sales of goods to joint ventures	9	4
Sales of goods to associates	21	155
Total sale of goods to joint ventures and associates	**30**	**159**
Purchase of goods from joint ventures	52	60
Total purchase of goods from joint ventures and associates	**52**	**60**
Trade receivables joint ventures*	26	-
Trade receivables associates*	9	2
Total trade receivables joint ventures and associates	**35**	**2**
Trade payables joint ventures**	7	3
Total trade payables joint ventures and associates	**7**	**3**

* Included in other receivables
** Included in 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 the Group's accounting policies. The proportionate share of unrealised intra-group profits and the carrying amount of goodwill are added. Whereas the proportionate share of unrealised intra-group losses is deducted. Dividends received from associates and joint ventures reduce the value of the investment.

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

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

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

Uncertainties and estimates

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

Note 3.5 Provisions

Financial comment

Provisions for 2016 totalled EUR 25 million, compared to EUR 27 million last year. Provisions primarily pertain to insurance provisions for insurance incidents that occurred but have not been reported, restructuring provisions, and onerous contracts.

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

In March 2016, a restructure of Arla Foods was communicated. As a consequence of the restructure, a provision for indemnity payments of EUR 5 million was recognised as at 31 December 2016 as a short-term provision.

Uncertainties and estimates

Provisions are particularly associated with estimates on restructuring and insurance provisions. The scope and size of onerous contracts, as well as employee and other liabilities related to the restructure are also estimated. Insurance provisions are assessed based on historical records of, among other things, the number of insurance events and related costs considered.

Note 3.6 Purchase and sale of business or activities

Divestment of Rynkeby Foods A/S

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

Divestments in 2015 related to Walhorn and K/S Danske Immobilen, a divestment of EUR 37 million.

No purchases were made in 2016.

Purchases in 2015 related to Falbygden Ost, an investment of EUR 29 million.

Table 3.6 Sale of business or activities

(EURm)	2016	2015
Selling price on divestment of enterprise	145	37
Cash transferred as part of the transaction	-7	-
Net cash received	138	37
Other assets transferred	-52	-37
Liabilities transferred	34	-
Gain on divestment of enterprises in the income statement	**120**	**0**

Accounting policies

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

Note 4
Funding

Note 4.1 Financial items

Increased financial cost due to currencies

Net financial cost increased by EUR 44 million to EUR 107 million in 2016, mainly due to currency adjustments.

Net interest cost amounted to EUR 63 million, representing a decrease of EUR 7 million compared to last year. Net interest cost decreased due to a lower level of net interest-bearing debt, while the average interest cost, excluding pension liabilities, totalled 3.0 per cent compared to 2.6 per cent last year.

The average interest cost increased due to the increase in committed liquidity reserves and a higher relative proportion of fixed interest on debt.

Exchange rate losses relate primarily to the devaluation in the Nigerian currency, which amounted to EUR 28 million, as well as other costs related to effects from functional currency and costs of converting funding currencies into currencies with funding needs.

Table 4.1 Financial income and financial costs

(EURm)	**2016**	**2015**
Financial income:		
Interest securities, cash and cash equivalents	5	5
Fair value adjustments and other financial income	2	9
Total financial income	**7**	**14**
Financial costs:		
Interest on financial instruments measured at amortised cost	-60	-65
Net exchange rate losses	-48	-6
Interest on pension liabilities	-8	-9
Interest on transferred to property, plant and equipment	7	8
Fair value adjustments and other financial costs	-5	-5
Total financial costs	**-114**	**-77**
Net financial costs	**-107**	**-63**

Accounting policies

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

Capitalisation of interest has been performed by using an interest rate of 3 per cent, matching the Group's average external interest rate in 2016.

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

Note 4.2 Interest-bearing debt

Strong cash flow resulted in improved leverage

Net interest-bearing debt, excluding pension liabilities, decreased by EUR 555 million to EUR 1,648 million as at 31 December 2016. This was a result of a strong cash flow in the underlying business, including the effects from an improved working capital position, reduced capital expenditure and the divestment of Rynkeby.

The leverage ratio decreased by 0.9 to 2.4 as at 31 December 2016, including the effect from the divestment of Rynkeby. This surpassed the Group's long-term target range of 2.8-3.4, underpinning the Group's strong financial position. Leverage, excluding the gain form the divestment of Rynkeby, ended at 2.8 for the financial year 2016.

Pension liabilities at the end of 2016 increased by EUR 75 million to EUR 369 million and were adversely affected by the significant decrease in long-term interest rates, partly offset by a weaker GBP. As a result, net interest-bearing debt, including pension liabilities, amounted to EUR 2,017 million as at 31 December 2016 compared to EUR 2,497 million last year.

The average maturity of the interest bearing borrowings increased by 1.5 years to 5.9 years at 31 December 2016. The average maturity is impacted by a lapse of time to maturity, refinancing of committed facilities, new bond issue and the level of net interest-bearing debt.

The equity ratio measured 34 per cent at year end, compared to 31 per cent in 2015.

Funding

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

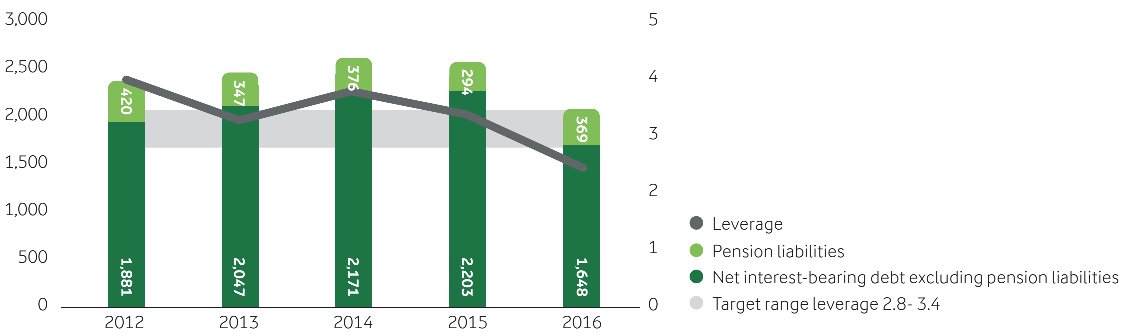
A diverse funding strategy includes diversification of markets, currencies, instruments, banks, lenders and maturities in order to secure access to funding to ensure that the Group is independent of any one creditor or any one market. All funding opportunities are measured against EURIBOR 3 months and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

The credit facilities contain financial covenants on equity/total assets and minimum equity, as well as standard non-financial covenants. The Group did not default on or fail to fulfil any loan agreements in 2016.

During 2016, the Group raised the following mix of funding:

- Bank and credit institutions: exercised extension options in our revolving credit facilities for an amount of EUR 682 million, increasing maturity by 1 year.
- Mortgage credit institutions: obtained new UK mortgage debt amounting to DKK 700 million (EUR 94 million). The mortgage loans are governed by the Danish Mortgage Act with mandatory security in land and buildings.
- EMTN bond programme: given Arla's commitment to be a repeating issuer in the Swedish bond market, Arla issued a new bond issue on SEK 1 billion (EUR 105 million) to partly refinance a SEK 1.5 billion (EUR 157 million) bond issue that matured in 2016.
- Commercial papers: the Group has a commercial paper program in Sweden denominated in SEK and EUR. The average utilization in 2016 was EUR 170 million. For the first time, Arla was able to obtain debt with a negative interest including the credit margin.
- Repo: the Group entered into a sale and repurchase arrangement based on its investment in listed AAA-rated Danish Mortgage Bonds. This sale and repurchase agreement is described in further detail in Note 4.6.

Net interest-bearing debt and leverage
(EURm)



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

Leverage in 2012 was influenced by mergers with Milk Union Hocheifel, Germany and Milk Link in the UK, and the acquisition of a minority interest in the Mengniu Dairy Group, China.

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

	2016	2015
Securities, cash and cash equivalents	-588	-579
Other interest-bearing assets	-12	-24
Long-term borrowings	1,281	1,717
Short-term borrowings	967	1,089
Net interest-bearing debt excluding pension liabilities	**1,648**	**2,203**
Pension liabilities	369	294
Net interest-bearing debt including pension liabilities	**2,017**	**2,497**

Table 4.2.b Borrowings
(EURm)

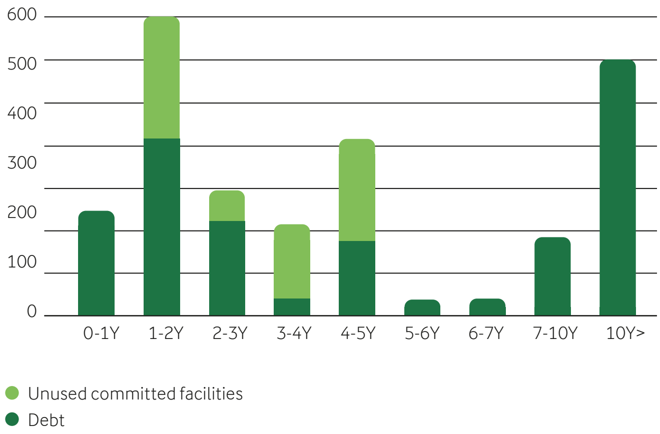
	2016	2015
Long-term borrowings:		
Issued bonds	419	330
Mortgage credit institutions	798	700
Bank borrowings	52	657
Finance lease liabilities	12	27
Other non-current liabilities	-	3
Total long-term borrowings	**1,281**	**1,717**
Short-term borrowings:		
Issued bonds	-	164
Commercial papers	115	115
Mortgage credit institutions	1	1
Bank borrowings	815	778
Finance lease liabilities	16	18
Other current liabilities	20	13
Total short-term borrowings	**967**	**1,089**
Total interest-bearing borrowings	**2,248**	**2,806**

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

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

December 31, 2015	Total	2016	2017	2018	2019	2020	2021	2022	2023-2025	After 2025
DKK	794	75	38	12	21	28	30	30	118	442
SEK	679	317	-	198	164	-	-	-	-	-
EUR	229	34	76	32	30	30	6	2	12	7
GBP	434	6	40	127	3	252	3	3	-	-
Other	67	57	10	-	-	-	-	-	-	-
Total	**2,203**	**489**	**164**	**369**	**218**	**310**	**39**	**35**	**130**	**449**

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



Maturity of net interest-bearing debt excluding pension liabilities at 31 December 2015
(EURm)

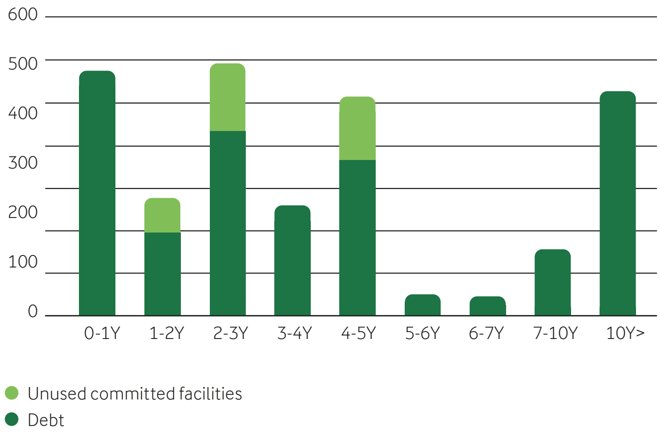
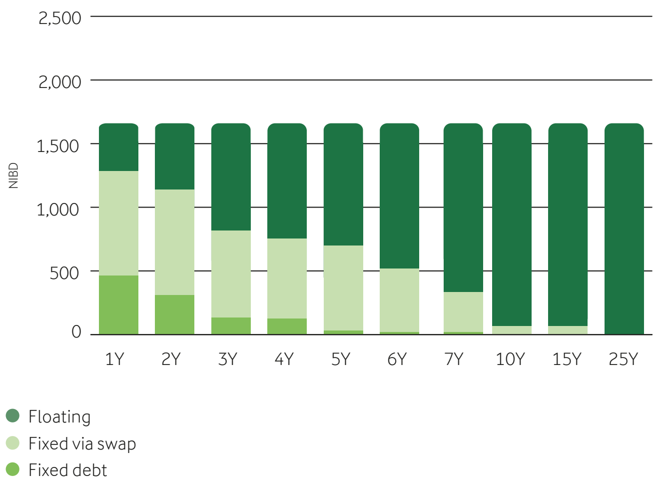


Table 4.2.d Interest rate risk at 31 December (EURm)	**Interest rate**	**Average interest rate**	**Fixed for**	**Carrying amount**	**Interest rate risk**
2016					
Issued bonds:					
SEK 500m maturing 04.06.2018	Fixed	3.25%	1-2 years	52	Fair value
SEK 800m maturing 28.05.2019	Fixed	2.63%	2-3 years	84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

	Interest Rate	Average Interest rate	Fixed for	Carrying Amount	Interest Rate risk
2015					
Issued bonds:					
SEK 1.150m maturing 22.06.2016	Fixed	5.00%	0-1 years	126	Fair value
SEK 500m maturing 04.06.2018	Fixed	3.25%	2-3 years	57	Fair value
SEK 800m maturing 28.05.2019	Fixed	2.63%	3-4 years	87	Fair value
SEK 350m maturing 22.06.2016	Floating	1.40%	0-1 years	38	Cash flow
SEK 1.000m maturing 04.06.2018	Floating	1.27%	0-1 years	109	Cash flow
SEK 700m maturing 28.05.2019	Floating	0.73%	0-1 years	77	Cash flow
Commercial papers	Fixed	0.08%	0-1 years	115	Fair value
Total issued bonds		**2.14%**		**609**	
Mortgages credit institutions:					
Floating-rate	Floating	0.70%	0-1 years	701	Cash flow
Total mortgages credit institutions		**0.70%**		**701**	
Bank borrowings:					
Fixed-rate	Fixed	0.01%	0-1 years	498	Fair value
Floating-rate	Floating	1.25%	0-1 years	953	Cash flow
Total bank borrowings		**0.82%**		**1,451**	
Other borrowings:					
Finance leases	Fixed	4.85%	0-4 years	10	Fair value
Finance leases	Floating	2.25%	0-1 years	35	Cash flow
Other borrowings	Floating	2.37%	0-1 years	31	Cash flow
Total other borrowings		**2.81%**		**76**	

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



Interest profile for net interest-bearing debt excluding pension liabilities at 31 December 2015
(EURm)

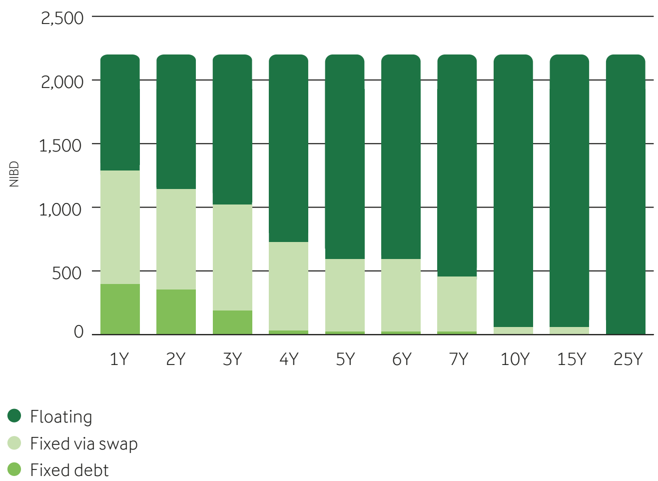


Table 4.2.e Currency profile of net interest-bearing debt excluding pension liabilities
(EURm)

Currency profile of net interest-bearing debt excluding pension liabilities before and after derivative financial instruments	Original principal	Effect of swap	After swap
2016			
DKK	872	-	872
SEK	558	-470	88
EUR	175	261	436
GBP	37	209	246
Other	6	-	6
Total	**1,648**	**-**	**1,648**
2015			
DKK	794	-	794
SEK	679	-546	133
EUR	229	273	502
GBP	434	273	707
Other	67	-	67
Total	**2,203**	**-**	**2,203**

Accounting policies

Financial instruments
Financial instruments are recognised at the date of trade.

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

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

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

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

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

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

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

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

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

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

Note 4.3 Financial risks

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

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

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

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

Note 4.3.1 Liquidity risk

Very strong liquidity reserves

The strong cash generation in 2016 positively influenced the liquidity reserves by reducing the utilisation of loan and credit facilities. Liquidity reserves increased by EUR 423 million to EUR 937 million as at 31 December 2016.

Ensuring availability of sufficient operating liquidity and credit facilities for operations is a primary goal of managing liquidity risk. According to the liquidity model inspired by the rating agencies, the Group's current liquidity reserves covering the next 12 months of expected cash flow is more favourable than required. However, given the relatively low cost required to maintain current facilities these will remain in place.

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

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

Table 4.3.1.a Liquidity reserves
(EURm)

	2016	2015
Cash and cash equivalents	84	70
Securities (free cash flow)	7	8
Unutilised committed loans facilities	666	333
Unutilised other loan facilities	180	103
Total	**937**	**514**

Table 4.3.1.b Gross financial liabilities
(EURm)

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

Table 4.3.1.b Gross financial liabilities *(continued)*
(EURm)

		Non-discounted contractual cash flows									
2015	**Carrying amount**	**Total**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023-2025**	**After 2025**
Issued bonds	494	492	164	-	164	164	-	-	-	-	-
Mortgage credit institutions	701	720	2	1	10	20	20	28	31	135	473
Credit institutions	1,551	1,541	845	142	220	34	283	10	7	-	-
Finance lease liabilities	45	45	19	15	10	1	-	-	-	-	-
Other non-current liabilities	15	15	13	2	-	-	-	-	-	-	-
Interest expense - interest bearing debt	-	113	22	19	15	11	7	5	5	12	17
Trade payable	918	918	918	-	-	-	-	-	-	-	-
Derivative instruments	158	158	71	18	16	14	7	6	6	8	12
Total	**3,882**	**4,002**	**2,054**	**197**	**435**	**244**	**317**	**49**	**49**	**155**	**502**

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

Risk mitigation

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

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

			Policy	
	2016	**2015**	**Minimum**	**Maximum**
Average maturity, gross debt	5.9 years	4.4 years	2 years	-
Maturity < 1 year, net debt	0%	5%	-	25%
Maturity > 2 year, net debt	94%	86%	50%	-

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

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

Note 4.3.2 Currency risk

Significant currency fluctuations

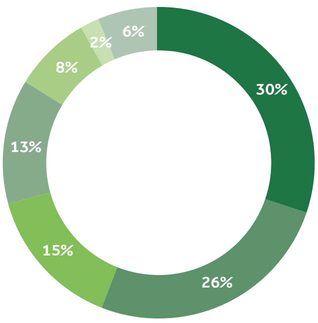
Compared to recent years, the USD was relatively stable in 2016, whereas the GBP weakened significantly from an average rate of 0.72 EUR/GBP in 2015 to 0.82 EUR/GBP in 2016. Our hedging strategies helped to mitigate the majority of the impact from the movement in the GBP in 2016. The hedging activities delivered a gain of EUR 35 million in 2016, compared to a loss of EUR 51 million in 2015. The result of hedging activities classified as hedge accounting is recognised in other income and other cost.

The Group is increasingly involved in emerging markets where efficient hedging is not possible, either due to currency regulations or illiquid financial markets. These markets are mainly Nigeria, Ivory Coast, Senegal, Egypt and Bangladesh.

Access to foreign currency in Nigeria and Egypt was very challenging in 2016, which limited Arla's possibilities to grow in these markets. The Nigerian currency devalued by 40 per cent in 2016. The devaluation, in combination with unavailability of a market for attractive hedging, triggered a loss of EUR 28 million recognised under financial cost.

The business in Saudi Arabia is a large part of the Group's export to MENA. The Saudi Arabia currency (SAR) has been pegged to USD since 1986, however, given the low oil price and increased uncertainty regarding the Saudi Arabia economy, we have chosen to significantly increase our hedge of SAR within the limits of our treasury and funding policy.

Revenue split by currency in 2016



Revenue split by currency in 2015

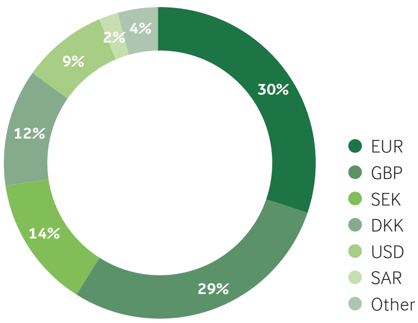


Table 4.3.2 Currency exposure
(EURm)

	EUR/DKK	USD/DKK*	GBP/DKK	SEK/DKK	SAR/DKK
2016					
External exposure:					
Financial liabilities	-191	-26	-35	-710	-15
Financial assets	148	190	204	39	80
Derivatives	-362	-593	-538	499	-198
Net external exposure	**-405**	**-429**	**-369**	**-172**	**-133**
Internal exposure:					
Financial liabilities	-24	-	-	-4	-
Financial assets	303	-	257	-	15
Derivatives	-	-	-	216	-
Net internal exposure	**279**	**-**	**257**	**212**	**15**
Net exposure	**-126**	**-429**	**-112**	**40**	**-118**
The net exposure relates to:					
Hedging of expected commercial cash flow that qualify for hedge accounting	-	-357	-152	-	-95
Hedging of expected commercial cash flow where hedge accounting is not used	-126	-72	-	-	-23
Exposure not hedged	-	-	40	40	-
Applied sensitivity	1%	5%	5%	5%	5%
Impact on profit or loss	-1	-4	2	2	-1
Impact on other comprehensive income	-	-18	-8	-	-5

* Incl. AED

Table 4.3.2 Currency exposure *(continued)*

(EURm)	EUR/DKK	USD/DKK*	GBP/DKK	SEK/DKK	SAR/DKK
2015					
External exposure:					
Financial liabilities	-238	-17	-494	-690	-
Financial assets	176	183	577	38	69
Derivatives	-393	-616	-901	490	-111
Net external exposure	**-455**	**-450**	**-818**	**-162**	**-42**
Internal exposure:					
Financial liabilities	-23	-24	-	-2	-
Financial assets	228		616	252	15
Derivatives	-	-	-	-	-
Net internal exposure	**205**	**-24**	**616**	**250**	**15**
Net exposure	**-250**	**-474**	**-202**	**88**	**-27**
The net exposure relates to:					
Hedging of expected commercial cash flow that qualify for hedge accounting	-	-421	-203	-	-51
Hedging of expected commercial cash flow where hedge accounting is not used	-250	-53	-	-	
Exposure not hedged	-	-	1	88	24
					-
Applied sensitivity	1%	5%	5%	5%	5%
Impact on profit or loss	-2	-3	-	4	1
Impact on other comprehensive income	-	-21	-10	-	-3

* Incl. AED

Risk mitigation

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

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

Assumptions for sensitivity analysis

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

Risk

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

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

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

Income statement

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

Balance sheet

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

Policy

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

How we act and operate

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

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

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

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

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

Note 4.3.3 Interest rate risk

Limited hedging activities due to decreased debt levels

The average duration of the Group's interest on interest-bearing debt, including derivatives but excluding pension liabilities, has increased by 1.0 to 4.5 as at 31 December 2016. The duration is positively impacted by reduced levels of interest-bearing debt, partly offset by matured interest rate hedges and a reduction in time to maturity on the remaining hedges.

Even though interest rates were extremely low in 2016, our hedging activity was limited due to the decrease in net interest-bearing debt.

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

			Potential accounting impact	
	Carrying value	**Sensitivity**	**Income statement**	**Other comprehensive income**
2016				
Financial assets	-600	1%	4	-2
Derivatives	-	1%	7	57
Financial liabilities	2,248	1%	-17	-
Net interest-bearing debt excluding pension liabilities	**1,648**		**-6**	**55**
2015				
Financial assets	-603	1%	4	-2
Derivatives	-	1%	12	63
Financial liabilities	2,806	1%	-22	-
Net interest-bearing debt excluding pension liabilities	**2,203**		**-6**	**61**

Risk mitigation

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

Fair value sensitivity
A change in interest rates will impact the fair value of the Group's interest-bearing assets, interest rate derivative instruments and debt instruments measured at either fair value through the income statement, or through other comprehensive income. The table above 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 reverse effect.

Cash flow sensitivity
A change in interest rates will impact interest rate payments on the Group's unhedged floating rate debt. The table above 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 2016. A decrease in the interest rate would have the reverse 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	
	2016	**2015**	**Minimum**	**Maximum**
Duration of net-interest bearing debt	4.5	3.5	1	7

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

The Group actively uses derivative financial instruments to reduce risks related to fluctuations in the interest rate and to manage the interest profile of the interest-bearing debt. By having a portfolio approach and using derivatives, the Group can 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 provides the Group with the opportunity to use derivatives like interest rate swaps and options, in addition to interest conditions embedded in the loan agreements. At present, no options have been utilised to the portfolio.

Note 4.3.4 Commodity price risk

Limited hedging activities in accordance with strategy

In order to strengthen the focus on procurement and risk management, the decision was made in 2016 to centralise energy hedging within the treasury department. Thereby procurement can concentrate on selecting the right suppliers, measured by quality, price and other relevant parameters. The supply contracts are predominately related to a floating official price index. The treasury department then uses financial derivatives to centrally hedge commodity price risk. This secures full flexibility to change suppliers without having to take future hedging into consideration.

The hedging activities concentrate on the most significant risks, including electricity, natural gas and diesel in Denmark, Germany, Sweden and the UK. The total energy commodity spend, excluding taxes and distribution costs, amounts to approximately EUR 90 million a year.

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

In 2016, hedged volumes decreased due to contracts expiring. As at 31 December 2016, 24 per cent of the energy spend for 2017 was hedged. A 5 per cent increase in commodity prices would negatively impact profit by approximately EUR 4 million. Conversely, other comprehensive income would be positively impacted by EUR 1 million.

Table 4.3.4 Hedged commodities
(EURm)

			Potential accounting impact	
	Sensitivity	**Contract value**	**Income statement**	**Other comprehensive income**
2016				
Diesel / natural gas	5%	2	-3	1
Electricity	5%	1	-1	-
2015				
Diesel / natural gas	5%	-12	-1	1
Electricity	5%	-7	-	1

Risk mitigation

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

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

Policy
According to the Risk Management Policy- Utilities, the risk on electricity, natural gas and diesel can be hedged for up to 24 months of the net forecasted consumption.

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

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

The energy exposure and hedging is managed as a portfolio across energy type and country. Not all energy commodities can effectively be hedged by matching the underlying costs, but Arla aims to minimise the base risk.

The Group started hedging price risk on selected milk commodity products for an insignificant value in the still relatively undeveloped dairy derivative markets in the EU and New Zealand. The dairy derivative market is evolving and will likely play a role in the future, in relation to managing fixed price commodity contracts with customers.

Note 4.3.5 Credit risk

Limited losses

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

For financial counterparties, the credit risk is minimised by only entering into new derivative transactions with those that have a credit rating of at least A-/A-/A3 from either S&P, Fitch or Moody's. All financial counterparties had satisfactory credit ratings at year-end. In some geographies which are not serviced by our relationship banks and where financial counterparties with a satisfying credit rating do not operate, the Group might deviate from the rating requirement. The risk is however limited. According to the treasury and funding policy, credit ratings are not required from lenders, however, only in one case has a credit facility been obtained from a counterparty with a lower credit rating than A-/A-/A3.

Other counterparties, customers and suppliers, are subject to an continous monitoring of the fulfilment of their contractual obligations and their 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 2.1c.

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
In order to manage financial counterparty risk, the Group uses master netting agreements when entering into derivative contracts with counterparties.

Table 4.3.5 shows the counterparty exposure for those agreements covered by entering into netting agreements.

Table 4.3.5 External rating of financial counterparties
(EURm)

	Assets	Qualifying for netting	Net assets	Liabilities	Qualifying for netting	Net liabilities
2016						
AA-	12	11	1	64	11	53
A+	11	11	-	20	11	9
A	7	7	-	71	7	64
A-	1	1	-	13	1	12
Total	**31**	**30**	**1**	**168**	**30**	**138**
2015						
AA-	32	32	-	42	32	10
A+	9	9	-	17	9	8
A	14	14	-	60	14	46
A-	2	1	1	1	1	-
Total	**57**	**56**	**1**	**120**	**56**	**64**

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

Risk mitigation

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

Policy
Financial counterparties must be approved by a member of the Executive Board and the CFO of Arla Foods amba, and have a credit rating of a least A-/A-/A3 by S&P, Fitch or Moody's in order for the financial counterparty to have a liability towards Arla. 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 these 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

Financial comments

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

Hedging of net investments
As at 31 December 2016, the Group hedged an insignificant part of currency exposure relating to investments in subsidiaries, joint ventures and associated companies, using loans and derivatives.

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

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

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

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

	Carrying value	**Fair value recognised in other comprehen-sive income**	**2016**	**2017**	**2018**	**2019**	**Later than 2019**
2015							
Currency contracts	8	8	8	-	-	-	-
Interest rate contracts	-85	-85	-15	-14	-13	-11	-32
Commodity contracts	-19	-19	-19	-	-	-	-
Hedging of future cash flow	**-96**	**-96**	**-26**	**-14**	**-13**	**-11**	**-32**

Accounting policies

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

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

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

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

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

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

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

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

Note 4.5 Financial instruments

Table 4.5.a Categories of financial instruments

(EURm)	2016	2015
Available for sale financial assets	504	509
Loans and receivables	911	949
Financial assets measured at fair value through profit or loss	50	100
Derivatives	168	158
Financial liabilities measured at amortised cost	3,243	3,658

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

Table 4.5.b Fair value hierarchy - carrying amount

(EURm)	Level 1	Level 2	Level 3	Total
2016				
Financial assets:				
Bonds	504	-	-	504
Shares	13	-	-	13
Derivatives	-	31	-	31
Total financial assets	**517**	**31**	**-**	**548**
Financial liabilities:				
Issued bonds	-	419	-	419
Mortgage credit institutions	798	-	-	798
Derivatives	-	168	-	168
Total financial liabilities	**798**	**587**	**-**	**1,385**
2015				
Financial assets:				
Bonds	509	-	-	509
Shares	14	-	-	14
Derivatives	-	75	-	75
Total financial assets	**523**	**75**	**-**	**598**
Financial liabilities:				
Issued bonds	-	494	-	494
Mortgage credit institutions	701	-	-	701
Derivatives	-	158	-	158
Total financial liabilities	**701**	**652**	**-**	**1,353**

Risk mitigation

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

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

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

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

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

Note 4.6 Transfer of financial assets

Financial comments

The Group has invested in mortgage bonds underlying its mortgage debt. The reason for investing in mortgage bonds is that the Group is able to achieve a lower interest rate than current market interest rates on mortgage debt by entering into a sale and repurchase agreement on the listed Danish mortgage bonds. The net interest rate payable, by raising financing through this kind of sale and repurchase agreement, is the interest rate inherent in the sale and repurchase agreement and the contribution to the mortgage institute.

Due to the repurchase agreement, the risks and rewards arising from the ownership of transferred mortgage bonds have been retained by the Group. These mortgage bonds have been classified as available for sale with value adjustments recognised through other comprehensive income. The received proceeds create a repurchase obligation which has been recognised within short-term loans.

Table 4.6 Transfer of financial assests (EURm)	**Carrying value**	**Notional amount**	**Fair value**
2016			
Mortgage bonds	496	508	496
Repurchase liability	-496	-507	-496
Net position	**-**	**1**	**-**
2015			
Mortgage bonds	501	513	501
Repurchase liability	-498	-513	-498
Net position	**3**	**-**	**3**

Note 4.7 Pension liabilities

Lower interest rate causes higher pension deficit

In 2016, responsibility for the Group's defined benefit pension plans was centralised to the treasury department and is thereby managed as an integrated part of the Group's external debt.

Pension liability consists primarily of defined benefit plans in the UK and Sweden. The defined benefit plans provide pension disbursements to participating employees based on seniority and final salary. Net pension liabilities on 31 December 2016 were recognised at EUR 369 million, an increase of EUR 75 million compared to last year. The carrying value of defined benefit plans increased primarily in the UK due to actuarial losses related to lower discount rates. This was partly offset by payments to the schemes and currency translation effect.

Pension plans in Sweden
The defined benefit plan in Sweden does not currently require the Group to make cash contributions. The recognised net liability stood at EUR 185 million on 31 December 2016, the same level as last year. An actuarial loss of EUR 11 million, resulting from a decrease in the discount rate, was offset by a foreign exchange rate adjustment of EUR 9 million.

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

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

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

At 31 December 2016 the recognised net liability was EUR 150 million, representing an increase of EUR 73 million compared to last year. The value of the liability totalled EUR 1,425 million, an increase of EUR 61 million compared to last year. The increase in the net pension liability is primarily related to actuarial losses of EUR 119 million due to lower discount rates, partly offset by payments into the plans amounting to EUR 34 million, and a foreign exchange rate adjustment of EUR 14 million.

These pension plans are defined benefit final salary schemes. The schemes are closed to both new entrants and future accrual. 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 sectionalised pension schemes. The Group has limited control over the operation of the plans and their investments. The trustees of the scheme set the investment strategy and have established a policy on asset allocation to best match the assets to the liabilities of the scheme. The trustees appoint an independent external advisor to the schemes who is responsible for advising on the investment strategy and investing the assets.

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

Table 4.7.a Pension liabilities recognised on the balance sheet

(EURm)	Sweden	UK	Other	Total
2016				
Present value of funded liabilities	196	1,425	45	1,666
Fair value of plan assets	-11	-1,275	-24	-1,310
Deficit of funded plans	**185**	**150**	**21**	**356**
Present value of unfunded liabilities	-	-	13	13
Net pension liabilities recognised on the balance sheet	**185**	**150**	**34**	**369**
Specification of total liabilities:				
Present value of funded liabilities	196	1,425	45	1,666
Present value of unfunded liabilities	-	-	13	13
Total liabilities	**196**	**1,425**	**58**	**1,679**
2015				
Present value of funded liabilities	194	1,364	39	1,597
Fair value of plan assets	-11	-1,287	-18	-1,316
Deficit of funded plans	**183**	**77**	**21**	**281**
Present value of unfunded liabilities	-	-	13	13
Net pension liabilities recognised on the balance sheet	**183**	**77**	**34**	**294**
Specification of total liabilities:				
Present value of funded liabilities	194	1,364	39	1,597
Present value of unfunded liabilities	-	-	13	13
Total liabilities	**194**	**1,364**	**52**	**1,610**

Table 4.7.b Development in defined benefit pension liabilities

(EURm)	2016	2015
Present value of liability at 1 January	1,610	1,563
Reclassification	-	15
Current service cost	4	3
Interest cost	52	55
Actuarial gains/losses from changes in financial assumptions (other comprehensive income)	282	-51
Benefits paid	-59	-65
Curtailments and settlements	-3	-
Exchange rate adjustment	-207	90
Present value of pension liability at 31 December	**1,679**	**1,610**

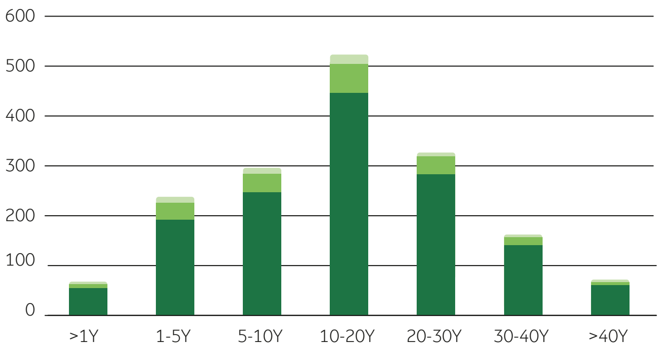
Table 4.7.c Development in fair value of plan assets
(EURm)

	2016	2015
Fair value of plan assets at 1 January	1,316	1,187
Reclassification	-	16
Interest income	44	46
Return on plan assets excluding interest income (other comprehensive income)	150	-17
Contributions to plans	34	70
Benefits paid	-48	-57
Administration expenses	-2	-2
Exchange rate adjustments	-184	73
Fair value of plan assets at 31 December	**1,310**	**1,316**

The Group expects to contribute EUR 36 million to the plan assets in 2017 and EUR 136 million in 2018-2021.

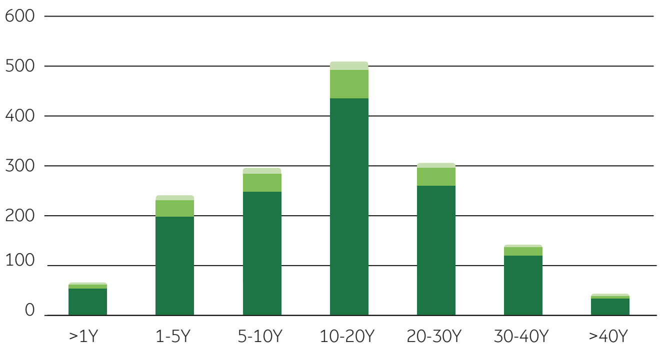
	2016	2015
Actual return on plan assets:		
Calculated interest income	44	46
Return excluding calculated interest	150	-17
Actual return	**194**	**29**

Maturity of pension liability at 31 December 2016
(EURm)



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

Maturity of pension liability at 31 December 2015
(EURm)



	Total	>1Y	1-5Y	5-10Y	10-20Y	20-30Y	30-40Y	>40Y
UK	1,364	54	198	248	435	260	120	49
Sweden	194	9	33	36	57	36	17	6
Other	52	2	10	12	17	7	3	1
Total	1,610	65	241	296	509	303	140	56

Table 4.7.d Sensitivity of defined benefit liabilities to key assumptions

(EURm)	2016	2016	2015	2015
Impact on defined liabilities at 31 December 2016	+	-	+	-
Discount rate +/- 10bps	-25	25	-27	26
Salary increases +/- 10bps	2	-2	15	-15
Life expectancy +/- 1 year	66	-66	47	-47
Inflation +/- 10 bps	18	-18	44	-44

Table 4.7.e Pension assets recognised on the balance sheet

(EURm)	2016	%	2015	%
Diversified Growth Funds	486	37%	503	38%
Liability-Driven Investments	246	19%	175	13%
Absolute Return Bonds	198	15%	199	15%
Equity instruments	154	12%	200	15%
Properties	130	10%	154	12%
Bonds	11	1%	10	1%
Other assets	85	6%	75	6%
Total assets	**1,310**	**100%**	**1,316**	**100%**

Pension assets are invested in a diversified portfolio including equity and debt instruments, structured investment products, as well as properties. Structured investments include the following:

Diversified Growth Funds are pooled funds invested in a range of return-seeking asset classes, including equity and debt instruments. Liability-Driven Investments is a method of investing where the portfolio of assets is built with the objective of its value moving in line with the respective scheme's liabilities, which is typically invested in government bonds and swaps. Absolute Return Bonds are pooled funds, which aim to provide a positive return in different market conditions, using mainly bond-type assets or derivatives to obtain exposure that matches the bond markets.

Table 4.7.f Recognised in the income statement for the year

(EURm)	2016	2015
Current service cost	4	3
Administration cost	2	2
Curtailments and settlements	-3	-
Recognised as staff costs	**3**	**5**
Interest cost on obligations	52	55
Interest income on plan assets	-44	-46
Recognised as financial (gains)/losses	**8**	**9**
Total amount recognised in the income statement	**11**	**14**

Table 4.7.g Recognised in other comprehensive income

(EURm)	2016	2015
Accumulated actuarial gains/(losses) at 1 January	-155	-189
Actuarial gains/(losses) for the year	-132	34
Accumulated actuarial gains/(losses) at 31 December	**-287**	**-155**

Table 4.7.h Assumptions for the actuarial calculations at the balance sheet date are:	2016	2015
Discount rate, Sweden	2.8%	3.4%
Discount rate, UK	2.7%	3.8%
Expected payroll increase, Sweden	2.2%	2.4%
Expected payroll increase, UK	4.5%	4.3%
Inflation (CPI), UK	2.2%	2.0%
Inflation (CPI), Sweden	1.7%	1.5%

Accounting policies

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

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

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

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

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

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

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

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

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

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

Uncertainties and estimates

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

Note 5
Other areas

Note 5.1 Tax

Financial comment

Tax in the income statement
The 2016 tax cost is EUR 42 million and on the same level as last year. Of the total tax cost, EUR 10 million, compared to EUR 8 million in 2015, relates to cooperative tax and EUR 16 million compared to EUR 11 million in 2015, to corporate tax. The effect of higher current taxes in 2016 has been offset by a reduced deferred tax cost. Read more about our tax affairs on page 78.

Deferred tax
The net deferred tax liability increased to EUR 6 million in 2016 from EUR 1 million in 2015.

Deferred tax assets are primarily based on temporary differences on property, plant and equipment together with pension liabilities. Deferred tax liabilities mainly relate to provisions and other temporary differences on property, plant and equipment.

The 2016 increase is explained through the utilisation of tax losses carried forward and temporary differences arising from other liabilities, as well as differences in accounting and tax depreciation on property, plant and equipment.

Net deferred tax liability amounted to EUR 6 million, of which EUR 45 million related to accumulated movements recognised as net income in other comprehensive income and EUR 51 million as net cost in the income statement.

A deferred tax asset of EUR 154 million was not recognised, as the Group does not expect to be able to utilise it within the near future. In 2015 the unrecognised deferred tax asset amounted to EUR 110 million.

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

	2016	2015
Cooperative tax	10	8
Current tax	16	11
Deferred tax	8	14
Change in deferred tax resulting from a change in the tax rate	-	2
Adjustment regarding previous years, actual tax	3	6
Adjustment regarding previous years, deferred tax	5	1
Total tax in the income statement	**42**	**42**

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

	2016	2015
Statutory corporate income tax rate in Denmark	22.0%	23.5%
Net deviation in foreign subsidiaries' tax rates compared with the Danish tax rate	-3.7%	-2.9%
Adjustment for cooperative tax	-13.1%	-23.3%
Net non-taxable income less non-tax-deductible costs	-5.0%	3.5%
Change in tax percentage	0.1%	0.5%
Adjustment regarding previous years	2.0%	2.1%
Other adjustments	8.2%	9.0%
Effective tax rate	**10.5%**	**12.4%**

Table 5.1.c Deferred tax
(EURm)

	Intangible assets	Property, plant and equipment	Financial assets	Current assets	Provisions	Other liabilities	Tax loss carry-forwards	Other category	Total
2016									
Net deferred tax asset/liability at 1 January	-1	1	2	-3	26	5	10	-41	-1
Income/charge to the income statement	-	-2	-5	-	-8	3	-3	2	-13
Income/charge to other comprehensive income	-	-	-	-	21	-4	-	-1	16
Change in tax rate	-	-2	-	-	2	-	-	-	-
Exchange rate adjustment	-1	-3	-	-	-3	-	-1	-	-8
Other adjustments	-	14	-	-	-11	-3	-	-	-
Net deferred tax asset/liability at 31 December	**-2**	**8**	**-3**	**-3**	**27**	**1**	**6**	**-40**	**-6**
Specification:									
Deferred tax asset at 31 December	-	39	-	-	28	1	6	-	74
Deferred tax liability at 31 December	-2	-31	-3	-3	-1	-	-	-40	-80
2015									
Net deferred tax asset/liability at 1 January	-	-10	11	-	40	2	13	-30	26
Income/charge to the income statement	-	6	2	-	-20	-1	-2	-	-15
Income/charge to other comprehensive income	-	-	-	-1	-13	-	-	-	-14
Change in tax rate	-	-3	-	-	2	-	-1	-	-2
Exchange rate adjustment	-	-	-	-	4	-	-	-	4
Other adjustments	-1	8	-11	-2	13	4	-	-11	-
Net deferred tax asset/liability at 31 December	**-1**	**1**	**2**	**-3**	**26**	**5**	**10**	**-41**	**-1**
Specification:									
Deferred tax asset at 31 December	-	32	-	-	17	5	10	-	64
Deferred tax liability at 31 December	-1	-31	2	-3	9	-	-	-41	-65

Accounting policies

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

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

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

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

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

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

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

Uncertainties and estimates

Deferred tax
Deferred tax reflects assessments of actual future tax due for items in the financial statements, taking into account 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 as a result of 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)	2016	2015
Statutory audit	1.3	1.2
Other assurance engagements	0.1	-
Tax assistance	1.4	1.1
Other services	1.4	1.6
Total fees to auditors	**4.2**	**3.9**

Note 5.3 Management remuneration and transactions

Financial comment

The remuneration of the Executive Board is proposed by the Chairmanship and approved by the Board of Directors. Principles applied to management remuneration are described on page 34. Remuneration for the Board of Directors is approved by the Board of Representatives. Remuneration is negotiated on an annual basis. Related parties exercising significant influence comprise the Board of Directors and Executive Board. Members of the Board of Directors are paid for milk supplies to Arla Foods amba on equal terms with other owners of the company.

Table 5.3.a Management remuneration

(EURm)	2016	2015
Board of Directors		
Wages, salaries and remuneration	1.3	1.4
Total	**1.3**	**1.4**
Executive Board		
Fixed compensation	2.2	2.1
Pension	0.3	0.3
Other benefits	0.1	0.1
Short-term variable incentives	0.6	0.5
Long-term variable incentives	0.2	0.3
Total	**3.4**	**3.3**

Table 5.3.b Transactions with the Board of Directors

(EURm)	2016	2015
Purchase of goods	10.7	10.7
Supplementary payments received regarding previous years	0.3	0.3
Total	**11.0**	**11.0**
Trade payables	0.7	0.6
Owner accounts	2.3	2.1
Total	**3.0**	**2.7**

Note 5.4 Contractual commitments and contingent 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 impact the Group's financial position beyond what is already recognised in the balance sheet and/or disclosed in the financial statements.

As security for mortgage debt based on the Danish Mortgage Act with a nominal value of EUR 817 million, compared with EUR 720 million at 31 December 2015, the Group provided security in property as security for the debt.

Contingent assets

The Finnish Supreme Administrative Court ruled on 29 December 2016, that the Finnish dairy company Valio violated the applicable competition law rules by its predatory pricing on the fresh liquid milk market in Finland. The decision is final. The violations by Valio have led to losses for Arla in previous years, for which Arla has raised a claim for damages of approximately EUR 58 million. This civil claim for damages is being pursued by Arla before the Helsinki District Court in Finland. We expect the court proceedings to continue throughout the course of 2017.

Table 5.4 Contractual commitments and contingent liabilities

(EURm)	2016	2015
Guarantee commitments	**5**	**5**
0-1 years	58	65
1-5 years	126	118
Over 5 years	32	43
Operating rent and lease commitments	**216**	**226**
Commitments in relation to agreements on the purchase of intangible assets	-	6
Commitments in relation to agreements on the purchase of property, plant and equipment	92	139
Total commitments in relation to agreements	**92**	**145**

Uncertainties and estimates

The Group has entered into a number of lease agreements. Management assesses the substance of the agreements in order to classify the lease agreements as either financial or operating leases. The Group has 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.

Note 5.5 Events after the balance sheet date

No events with a significant impact on the business have occurred after the balance sheet date.

Note 5.6 General accounting policies

Consolidated financial statements

The consolidated financial statements included in this Annual report have been prepared in accordance with the 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 21 February 2017 and presented for approval by the Board of Representatives on 1 March 2017.

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, liabilities together with items included in the equity of subsidiaries are aggregated and presented on a line-by-line basis in the consolidated financial statements. 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 in order 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 controlling influence are considered to be 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 (i.e. profits arising from sales to joint ventures or associates, whereby the customer pays with funds partly owned by the Group) from transactions with joint ventures and associates 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 way as unrealised gains, 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, e.g. property, plant and equipment which are measured based on historical cost in a foreign currency, are translated into the functional currency on 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. Repayment of outstanding balances considered part of the net investment is not in itself considered to be a partial divestment of the subsidiary.

Alternative performance measures

The Group presents a range of financial measures in the consolidated annual report that are not defined according to IFRS. The Group believes that these measures provide valuable information to external stakeholders and management and enable better evaluation of overall performance and trends. The financial measures should not be considered as a replacement for performance measures as defined under IFRS, but rather as supplementary information.

Adoption of new or amended IFRSs

The Group has implemented all new standards and interpretations effective in the EU from 2016. None of these newly adopted standards and interpretations have had or are expected to have an impact on the consolidated financial statements of Arla.

IASB has issued a number of new or amended and revised accounting standards and interpretations that have not yet come into effect. Arla expect to incorporate the new standards when they become mandatory.

In November 2016, the EU endorsed IFRS 9 "Financial Instruments" which is effective for annual periods beginning on or after 1 January 2018. A preliminary assessment has been performed which shows that the new standard would not have any material impact on classification of Group financial assets. Furthermore it is not expected that the new three-step expected loss model for trade receivables or the change in hedge accounting will have a material impact on recognition or measurement in the Group figures.

IFRS 15 was issued in May 2014 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 to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The standard is endorsed by EU in October 2016 and will be effective for annual periods beginning on or after 1 January 2018. The standard will apply for all industries, where there is revenue from contracts with customers.

The Group performed a preliminary assessment of IFRS 15 including a high-level analysis of the most complex contracts with complex price structures like variable considerations, right of returns etc. This high level analysis indicates that the new standard would not have any material impact on Group figures. The impact will continuously be analysed and the Group expects to adopt the new standard on 1 January 2018.

In January 2016, the IASB issued the final version of IFRS 16 "Leases". The standard, which is effective for annual periods beginning on or after 1 January 2019, brings significant changes to the treatment of leasing contracts currently treated as operating leases. At the moment, no in-depth analysis of the impact of the new standard has been performed. The standard is expected to have some impact on the consolidated financial statements, as a significant part of the Group's operating leases will be required to be recognised on the balance sheet.

Other new or revised accounting standards and implementations are not expected to have a material impact on the consolidated financial statements of the Group.

Note 5.7 Group companies

Company name	Country	Currency	Group Equity interest (%)
Arla Foods amba	**Denmark**	**DKK**	
Arla Foods Ingredients Group P/S	Denmark	DKK	100
Arla Foods Ingredients Energy A/S	Denmark	DKK	100
Arla Foods Ingredients KK	Japan	JPY	100
Arla Foods Ingredients Inc.	USA	USD	100
Arla Foods Ingredients Korea, Co. Ltd.	Korea	KRW	100
Arla Foods Ingredients Trading (Beijing) Co. Ltd.	China	CNY	100
Arla Foods Ingredients S.A. *	Argentina	USD	50
Arla Foods Ingredients Singapore Pte. Ltd.	Singapore	SGD	100
Arla Foods Ingredients S.A. de C.V.	Mexico	MZN	100
AFI Partner ApS	Denmark	DKK	100
Cocio Chokolademælk A/S	Denmark	DKK	50
CBI P/S	Denmark	DKK	100
CBI GP ApS	Denmark	DKK	100
Andelssmør A.m.b.a.	Denmark	DKK	98
Aktieselskabet J. Hansen	Denmark	DKK	100
J.P. Hansen Inc.	USA	USD	100
Mejeriforeningen	Denmark	DKK	91
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 Finance Ltd	UK	GBP	100
Arla Foods Holding Co. Ltd	UK	GBP	100
Arla Foods UK Services Ltd	UK	GBP	100
Arla Foods Naim Limited	UK	GBP	100
Arla Foods Limited	UK	GBP	100
Milk Link Holdings Ltd.	UK	GBP	100
Milk Link Processing Ltd.	UK	GBP	100
Milk Link (Crediton No 2) Limited	UK	GBP	100
Milk Link Investments Ltd.	UK	GBP	100
The Cheese Company Holdings Ltd.	UK	GBP	100
The Cheese Company Ltd.	UK	GBP	100
Cornish Country Larder Ltd.	UK	GBP	100
The Cheese Company Investments Ltd.	UK	GBP	100
Westbury Dairies Ltd.	UK	GBP	100
Arla Foods (Westbury) Ltd.	UK	GBP	100
Arla Foods Cheese Company Ltd. UK	UK	GBP	100
Arla Foods Ingredients UK Ltd.	UK	GBP	100
MV Ingredients Ltd. *	UK	GBP	50
Arla Foods UK Property Co. Ltd.	UK	GBP	100
Arla Foods B.V.	Netherlands	EUR	100
Arla Foods Ltda	Brazil	BRL	100
Danya Foods Ltd.	Saudi Arabia	SAR	75
AF A/S	Denmark	DKK	100
Arla Foods Finance A/S	Denmark	DKK	100
Kingdom Food Products ApS	Denmark	DKK	100
Ejendomsanpartsselskabet St. Ravnsbjerg	Denmark	DKK	100
Arla Insurance Company (Guernsey) Ltd	Guernsey	DKK	100
Arla Foods Energy A/S	Denmark	DKK	100
Arla Foods Trading A/S	Denmark	DKK	100
Arla DP Holding A/S	Denmark	DKK	100
Arla Foods Investment A/S	Denmark	DKK	100
Arla Senegal SA.	Senegal	XOF	100
Tholstrup Cheese A/S	Denmark	DKK	100
Tholstrup Cheese USA Inc.	USA	USD	100
Arla Foods Belgium A.G.	Belgium	EUR	99
Walhorn Verwaltungs GmbH	Germany	EUR	100
Arla Foods Ingredients (Deutschland) GmbH	Germany	EUR	100
Arla Tagatose Holding 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

Company name	Country	Currency	Group Equity interest (%)
Arla Foods Kuwait Company LLC	Kuwait	KWD	49
Arla Kallassi Foods Lebanon S.A.L.	Lebanon	USD	50
Arla Foods Qatar WLL	Qatar	QAR	40
AFIQ WLL **	Bahrain	BHD	25
Arla Foods Trading and Procurement Ltd.	Hong Kong	HKD	100
Arla Foods Sdn. Bhd.	Malaysia	MYR	100
Arla Foods Panama S.A.	Panama	USD	100
Dofo Cheese Inc.	Philippines	PHP	100
Arla Foods Limited	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 Milk Link Limited	UK	GBP	100
Arla Foods AB	Sweden	SEK	100
Boxholm Mejeri AB	Sweden	SEK	100
Arla Oy Ab	Finland	EUR	100
Ranuan Meijeri Oy	Finland	EUR	99
Massby Facility & Services Oy	Finland	EUR	60
Osuuskunta MS tuottajapalvelu **	Finland	EUR	39
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
L&L International AB	Sweden	SEK	100
Milko Sverige AB	Sweden	SEK	100
Videbæk Biogas A/S **	Denmark	DKK	33
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 SA	Poland	PLN	100
COFCO Dairy Holdings Limited **	Hong Kong	HKD	30
Arla Foods Inc.	Canada	CAD	100
Arla Global Financial Services Centre Sp. Z.o.o.	Poland	PLN	100
Arla National Foods Products LLC	UAE	AED	40
Arla Foods FZE	UAE	AED	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 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
Arla Foods Agrar Service Luxemburg GmbH	Luxembourg	EUR	100
Arla Foods Agrar Service Belguim AG	Belgium	EUR	100
Hansa Verwaltungs und Vertriebs GmbH	Germany	EUR	100
Arla Foods Logistics GmbH	Germany	EUR	100
Vigor Alimentos S.A. **	Brazil	BRL	8
Arla Foods Srl	Italy	EUR	100
Arla Foods S.a.r.l.	France	EUR	100
Arla Foods AS	Norway	NOK	100
Arla Foods S.A.	Spain	EUR	100
Arla Foods Hellas S.A.	Greece	EUR	100
Svensk Mjölk Ekonomisk förening **	Sweden	SEK	73
Lantbrukarnas Riksförbund upa **	Sweden	SEK	23
Arla Foods UK Farmers JV Company Limited	UK	GBP	100
Arla Côte d'Ivoire	Ivory Coast	XOF	51
Arla Foods Mayer Australia Pty, Ltd.	Australia	AUD	51
Arla Foods S.R.L.	Dominican Republic	DOP	100
Arla Foods Bangladesh Ltd.	Bangladesh	BDT	51
Arla Foods Dairy Products Technical Service (Beijing) Co. Ltd.	China	CNY	100
Dofo Cheese Eksport K/S	Denmark	DKK	100
Dofo Inc.	USA	USD	100
Marygold Trading K/S	Denmark	DKK	100
Arju For Food Industries S.A.E.	Egypt	EGP	49
Arla Foods Mexico S.A. de C.V.	Mexico	MXN	100

** Joint ventures ** Associates *** Joint operation*
The Group also owns a number of entities without material commercial activities.

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 2016, which comprise income statement, statement of comprehensive income, balance sheet, statement of changes in equity, statement of cash flow and notes, including a summary of significant accounting policies, for the Group as well as for 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 disclosure 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 2016 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 2016 in accordance with International Financial Reporting Standards as adopted by the EU and additional disclosure requirements of the Danish Financial Statements Act.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs) and the 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" section of our report. 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. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Statement on Management's review

Management is responsible for the Management's review.

Our opinion on the consolidated financial statements and the parent company 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 consolidated financial statements and the parent company 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 consolidated financial statements or the parent company 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 consolidated financial statements and the parent company 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 consolidated financial statements and the parent company 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 disclosure requirements of the Danish Financial Statements Act, and for such internal control as Management determines is necessary to enable the preparation of consolidated financial statements and parent company financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements and the parent company 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 consolidated financial statements and the parent company 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 consolidated financial statements and the parent company financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements and the parent company 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 these consolidated financial statements and parent company financial statements.

As part of an audit conducted in accordance with ISAs and additional requirements applicable in Denmark, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements and the parent company 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 consolidated financial statements and the parent company 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 consolidated financial statements and the parent company financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusion is 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 consolidated financial statements and the parent company financial statements, including the disclosures, and whether the consolidated financial statements and the parent company 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, 21 February 2017

Ernst & Young
Godkendt Revisionspartnerselskab
CVR no. 30 70 02 28

Jesper Ridder Olsen
State Authorised Public Accountant

Morten Friis
State Authorised Public Accountant

Statement by the Board of Directors and the Executive Board

Today, the Board of Directors and the Executive Board discussed and approved the annual report of Arla Foods amba for the financial year 2016. The annual report has been 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 2016 and of the results of the Group's and the parent company's activities and cash flows for the financial year 1 January – 31 December 2016.

In our opinion, the 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 flows, 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, 21 February 2017

Peder Tuborgh CEO	Povl Krogsgaard Vice CEO	Åke Hantoft Chairman	Jan Toft Nørgaard Vice Chairman
Viggo Ø. Bloch	Palle Borgström	Jonas Carlgren	Manfred Graff
Heléne Gunnarson	Markus Hübers	Bjørn Jepsen	Thomas Johansen
Steen Nørgaard Madsen	Torben Myrup	Jonathan Ovens	Johnnie Russell
Manfred Sievers	Haakan Gillström Employee representative	Ib Bjerglund Nielsen Employee representative	Harry Shaw Employee representative

Corporate calendar

Financial reports and major events

1 – 2 March 2017	Board of Representatives meeting in Sweden
2 March 2017*	Publication of consolidated annual report for 2016
23 May 2017	Board of Representatives meeting in Denmark
25 August 2017	Publication of consolidated half-year report for 2017
11 – 12 October 2017	Board of Representatives meeting in Sweden

** Dependent on Board of Representatives approval.*

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