

Farice ehf.  
Financial Statements 2016

Farice ehf.  
Smáratorgi 3  
201 Kópavogur

Reg. no. 511203-2950

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# Report of the Board of Directors and the CEO

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Farice ehf. is a transmission and data service provider. The Company plays an important role in Iceland's infrastructure to the greater good to public and economic life in Iceland. The Company operates two submarine cables between Iceland and Europe and connects Iceland to the world with backhaul agreements to other networks in major connecting points in Europe.

## Operations in the year 2016

The Company is delivering Operating Profit for the third year in a row. According to the Statement of Comprehensive Income the operating revenue amounted to EUR 13,9 million and the EBITDA EUR 7,2 million. Depreciation was EUR 7,2 million and operating profit EUR 25 thousand. According to the Statement of Financial Position the Company's assets amounted to EUR 83 million and the equity amounted to EUR 28,5 million, an equity ratio of 34,4%. The Financial Statements are prepared in accordance with International Financial Reporting Standards. Applicable legal provisions do not permit payment of dividend and equity is used to cover the loss of the year which amounted to EUR 11 million due extremely high calculated exchange loss on its loan in ISK.

In 2016 the company paid in advance the remaining balance of the loan with Nordic Investment Bank of amount of EUR 8,4 million. The present Public Service Agreement with the Icelandic State is valid until end of 2018 which reduces significantly the financial risk of the company. The purpose of the Agreement is to secure Iceland's continued international connectivity and sustainability of the Company.

## Share capital

At the end of 2016 the share capital was increased by EUR 6,2 million as explained in note 15. The three shareholders in Farice ehf. are Arion Bank (ID 581008-0150) with 38,35%, the Icelandic State (ID 540269-5459) with 27,06%, Landsvirkjun, The National Power Company (ID 420269-1299) with 33,16% and 1,43% belongs to the Company itself.

## Corporate governance

The Board is practicing good corporate governance based on provisions of law, the company's Articles of Association and guidelines in KPMG's handbook on corporate governance. The purpose of these rules is to ensure transparency and internal control and increase risk awareness. The Board consists of five members and two alternative members and the board hires the CEO. Internal audit and control systems are limited due to the fact that few people work for the Company. Three independent members form the audit committee that follows in detail the closing of the Financial Statements. The risk assessment mainly relates to an action plan if a disruption happens to the submarine cables.

In June 2016 the Parliament of Iceland approved extensive changes to the Financial Statements Act. Among the changes is a requirement regarding reporting of a non-financial statement. The Board refers to note 21 regarding non-financial information and the changes in the legislation.

## Risk management

The Board refers to note 17 in the financial statements, regarding information on the financial risk management.

## Performance

Protected service on Farice network delivered 100% availability in 2016 as in previous years. Backhaul in Iceland showed 99,87% to 100% availability depending on routes. Backhaul in UK connecting Farice-1 submarine cable to London showed 98,91% to 99,21% availability on each route. Backhaul on continental Europe connecting Danice submarine cable to Amsterdam and Copenhagen showed 99,48% to 100% availability depending on route. Reported availability is based on faults and planned outages. Submarine cables availability was 100% on both cables.

## Report of the Board of Directors and the CEO, Contd.:

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### Statement by the Board of Directors and the CEO

According to the Board of Directors' best knowledge, the Financial Statements comply with International Financial Reporting Standards as adopted by the EU and give a true and fair view of the Company's assets and liabilities, financial position as at 31 December 2016, operating performance and the cash flow for the year ended 31 December 2016 as well as describing the principal risk and uncertainty factors faced by the company. The report of the Board of Directors provides a clear overview of the development and achievements in the company's operations and its situation.

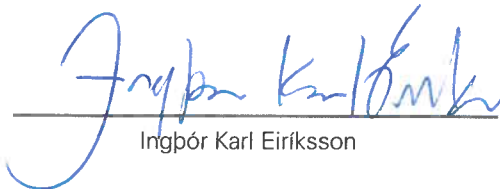
The Board of Directors and CEO of Farice ehf., hereby confirm the Financial Statements of Farice ehf., for the year 2016 with their signatures.

Kópavogur, 1 February 2017

The Board of Directors of Farice ehf.



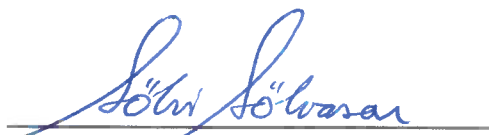
Martha Eiríksdóttir, Chairman



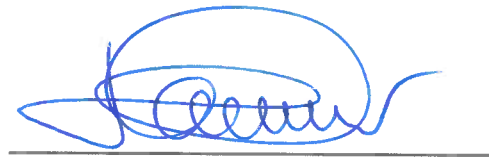
Ingþór Karl Eiríksson



Kristín Guðmundsdóttir



Sölvi Sölvason



Kristján Gunnarsson

Chief Executive Officer



Ómar Benediktsson

# Independent Auditors' Report

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To the Board of Directors and Shareholders of Farice ehf.

## Report on the Audit of the Financial Statements

### Opinion

We have audited the financial statements of Farice ehf. (the Company), which comprise the statement of financial position as at 31 December 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

### Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the Code of ethics for Icelandic auditors, which are based on the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have also fulfilled other ethical requirements of that rules. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

| Key audit matter | How the matter was addressed in the audit |
|------------------|---|
|------------------|---|

#### Impairment test of operating assets

Impairment test is performed annually in order to determine if carrying amount of the company's operating assets is greater than its estimated recoverable amount. As explained in note 12 is the test is based on management's assumptions about future growth of revenues, operating margin, and weighted average cost of capital. The impairment test is based on a five year forecast but with fixed income and margin for the period thereafter. The expected recoverable amount of operating assets is key audit matter in our audit due to the inherent uncertainty involved in forecasting and discounting future cash flows which are the basis of the impairment test.

We obtained the annual impairment test performed by management and critically evaluated the model and assumptions used by management in their calculations.

Our audit work included following procedures:

- Management forecasts were agreed with the forecasts approved by the Board and compared with historic amounts and growth rates.
- Detailed analysis was performed on key assumptions in the valuation model such as historic forecasts, long-term growth rates and EBIDTA.
- Inputs used for the calculation of weighted cost of capital were assessed and compared to current finance costs and market conditions.
- The model used for the impairment test was reviewed and validated.
- Review of the notes to the financial statements in order to confirm that all information regarding impairment test of the operating assets were provided.

## Independent Auditors' Report, cont.:

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### **Responsibilities of the Board of Directors and CEO for the Financial Statements**

The Board of Directors and CEO are responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as they determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Board of Directors and CEO are responsible for assessing the 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 unless they either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs 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 financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with The Board of Directors and the audit committee 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.

## Independent Auditors' Report, cont.:

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We also provide The Board of Directors and audit committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with The Board of Directors and the audit committee, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. bear on our independence, and where applicable, related safeguards.

### **Report on Other Legal and Regulatory Requirements**

Pursuant to the legal requirement under Article 104, Paragraph 2 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the financial statements.

The engagement partner on the audit resulting in this independent auditor's report is Árni Claessen.

Reykjavík, 1 February 2017

**KPMG ehf.**



# Statement of Comprehensive Income for the year ended 31 December 2016

|   | Notes | 2016                 | 2015                |
|---|-------|----------------------|---------------------|
| Sale of bandwidth .....                                   | 5     | 10.920.225           | 12.254.252          |
| Income from Public Service Contract .....                 | 6     | 2.948.168            | 2.717.089           |
|   |       | <u>13.868.393</u>    | <u>14.971.341</u>   |
| Operating expenses .....                                  | 7     | 5.742.122            | 5.865.780           |
| Administrative expenses .....                             | 8     | 914.810              | 784.466             |
|   |       | <u>6.656.933</u>     | <u>6.650.246</u>    |
| <b>Profit before depreciation and finance items</b> ..... |       | 7.211.460            | 8.321.095           |
| Depreciation .....  | 12    | ( 7.185.898)         | ( 7.334.241)        |
| <b>Operating profit</b> .....                             |       | 25.562               | 986.854             |
| Finance income .....                                      |       | 25.441               | 3.986               |
| Interest and indexation expenses .....                    | 11    | ( 3.964.085)         | ( 3.551.097)        |
| Exchange rate differences .....                           |       | ( 7.076.925)         | ( 3.523.339)        |
| <b>Net finance cost</b> .....                             |       | <u>( 11.015.569)</u> | <u>( 7.070.450)</u> |
| <b>Total comprehensive loss for the year</b> .....        |       | <u>( 10.990.007)</u> | <u>( 6.083.596)</u> |

Notes on pages 12 to 27 are an integral part of these financial statements.



# Statement of Financial Position 31 December 2016

|   | Notes | 31.12.2016    | 31.12.2015    |
|---|-------|---------------|---------------|
| <b>Assets</b>                               |       |               |               |
| Operating assets .....                      | 12    | 80.152.640    | 87.267.113    |
| Prepaid expenses .....                      | 13    | 1.547.063     | 1.636.316     |
| Non-current assets                          |       | 81.699.703    | 88.903.429    |
| Trade receivables .....                     |       | 239.615       | 358.142       |
| Other receivables .....                     |       | 418.778       | 268.891       |
| Cash and cash equivalents .....             |       | 599.365       | 802.938       |
| Current assets                              |       | 1.257.758     | 1.429.971     |
| <b>Total assets</b>                         |       | 82.957.462    | 90.333.400    |
| <b>Equity</b>                               |       |               |               |
| Share capital .....                         | 15    | 59.615.031    | 53.372.575    |
| Other paid in capital .....                 | 15    | 0             | 2.549.061     |
| Accumulated deficit .....                   |       | ( 31.058.538) | ( 18.826.075) |
| Total equity                                |       | 28.556.493    | 37.095.561    |
| <b>Liabilities</b>                          |       |               |               |
| Loans and borrowings .....                  | 16    | 45.329.796    | 42.397.605    |
| Deferred income .....                       | 3f    | 3.000.000     | 0             |
| Non-current liabilities                     |       | 48.329.796    | 42.397.605    |
| Loans and borrowings .....                  | 16    | 3.329.225     | 9.473.101     |
| Trade payables .....                        |       | 465.880       | 438.463       |
| Deferred income and other liabilities ..... | 3f    | 2.276.068     | 928.670       |
| Current liabilities                         |       | 6.071.173     | 10.840.234    |
| Total liabilities                           |       | 54.400.969    | 53.237.839    |
| <b>Total equity and liabilities</b>         |       | 82.957.462    | 90.333.400    |

Notes on pages 12 to 27 are an integral part of these financial statements.

# Statement of Changes in Equity for the year ended 31 December 2016

|   | Notes | Share capital     | Other paid<br>in capital | Accumulated<br>deficit | Total<br>equity   |
|---|-------|-------------------|--------------------------|------------------------|-------------------|
| <b>2015</b>                                 |       |                   |                          |                        |                   |
| Equity as at 1 January 2015 .....           |       | 53.372.575        | 2.549.061                | ( 12.742.479)          | 43.179.157        |
| Total comprehensive loss for the year ..... |       |                   |                          | ( 6.083.596)           | ( 6.083.596)      |
| Equity as at 31 December 2015 .....         | 15    | <u>53.372.575</u> | <u>2.549.061</u>         | <u>( 18.826.075)</u>   | <u>37.095.561</u> |
| <b>2016</b>                                 |       |                   |                          |                        |                   |
| Equity as at 1 January 2016 .....           |       | 53.372.575        | 2.549.061                | ( 18.826.075)          | 37.095.561        |
| Other paid in capital .....                 |       |                   | 2.450.939                |                        | 2.450.939         |
| New share capital .....                     |       | 6.242.456         | ( 5.000.000)             | ( 1.242.456)           | 0                 |
| Total comprehensive loss for the year ..... |       |                   |                          | ( 10.990.007)          | ( 10.990.007)     |
| Equity as at 31 December 2016 .....         | 15    | <u>59.615.031</u> | <u>0</u>                 | <u>( 31.058.538)</u>   | <u>28.556.493</u> |

Notes on pages 12 to 27 are an integral part of these financial statements.

# Statement of Cash Flows for the year ended 31 December 2016

|  | Notes | 2016                | 2015                |
|--|-------|---------------------|---------------------|
| <b>Cash flow from operating activities</b>                       |       |                     |                     |
| Loss for the year .....  |       | ( 10.990.007)       | ( 6.083.596)        |
| Adjustments for:   |       |                     |                     |
| Depreciation .....   | 12    | 7.185.898           | 7.334.241           |
| Net finance cost .....   |       | 11.015.569          | 7.070.450           |
|  |       | <u>7.211.460</u>    | <u>8.321.095</u>    |
| Changes in current assets and liabilities .....                  |       | 4.877.561           | ( 828.047)          |
| Cash generated from operating activities before interest         |       | <u>12.089.021</u>   | <u>7.493.048</u>    |
| Interest received .....  |       | 25.441              | 3.986               |
| Interest paid .....  |       | ( 3.060.907)        | ( 1.774.142)        |
| Net cash from operating activities                               |       | <u>9.053.555</u>    | <u>5.722.892</u>    |
| <b>Cash flows from investing activities</b>                      |       |                     |                     |
| Acquisition of property and equipment .....                      | 12    | ( 71.425)           | ( 254.941)          |
| Net cash used in investing activities                            |       | <u>( 71.425)</u>    | <u>( 254.941)</u>   |
| <b>Cash flows from financing activities</b>                      |       |                     |                     |
| Other paid in capital .....                                      | 15    | 2.450.927           | 0                   |
| Repayment of long-term loans .....                               |       | ( 11.556.342)       | ( 5.020.829)        |
| Net cash used in financing activities                            |       | <u>( 9.105.415)</u> | <u>( 5.020.829)</u> |
| <b>Net (decrease) increase in cash and cash equivalents.....</b> |       | ( 123.285)          | 447.122             |
| <b>Cash and cash equivalents at 1 January .....</b>              |       | 802.938             | 355.816             |
| <b>Effect of exchange rate fluctuations on cash held .....</b>   |       | ( 80.288)           | 0                   |
| <b>Cash and cash equivalents at 31 December .....</b>            |       | <u>599.365</u>      | <u>802.938</u>      |

Notes on pages 12 to 27 are an integral part of these financial statements.

# Notes

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## 1. Reporting entity

Farice ehf. is a limited liability company domiciled in Iceland. The Company's registered office address is Smáratorg 3, Kópavogur, Iceland. The principal activities of the Company are to insure safe telecommunications between Iceland and its neighbour countries by submarine cables.

The company has operations in Iceland, the Faroe Islands, Denmark and the United Kingdom. The income and expenses originate in Iceland and neighbouring countries.

## 2. Basis of preparation

### a. Statement of compliance

The Company's financial statements are prepared according to International Financial Reporting Standards (IFRS) as adopted by the EU and additional Icelandic disclosure requirement in accordance with the Icelandic financial statement act no. 3/2006.

These financial statements were authorized for issue by the Board of Directors on 1 February 2017.

### b. Going concern

Management has evaluated whether the Company is a going concern. It is the opinion of the management that the Company's ability to meet its obligations in the foreseeable future has been ensured. Therefore, the financial statements are presented based on the assumption that the Company is a going concern.

### c. Basis of measurement

The financial statements have been prepared on the historical cost basis.

### d. Presentation and functional currency

These financial statements are presented in euro (EUR), which is the Company's functional currency.

### e. Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements is included in the following notes:

- Note 12 - operating assets

Information about assumptions and estimates that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:

- Note 12 - key assumptions used in discounted cash flow projections

## 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

## Notes, contd.:

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### **3. Significant accounting policies, contd.:**

#### **a. Foreign currencies**

##### **(i) Transactions in foreign currencies**

Transactions in foreign currencies are translated to the functional currency of the Company at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the year. Foreign currency differences arising on translation are recognized in profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

#### **b. Financial instruments**

##### **(i) Financial assets and financial liabilities**

The Company's financial assets and liabilities comprise cash and cash equivalents, trade and other receivables, borrowings and trade and other short-term payables.

Financial instruments are initially recognised at fair value. They are recognised at the transaction date, which is the date the Company becomes a party to the contractual provisions of the instrument. All direct transaction costs are taken into account upon initial recognition.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The Company classifies financial assets and financial liabilities into the following categories: loans and receivables and other financial liabilities

##### ***Loans and receivables***

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

##### ***Cash and cash equivalents***

Cash and cash equivalents comprise cash balances and call deposits with maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Company in the management of its short-term commitments.

##### ***Other financial liabilities***

Financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method. Financial liabilities comprise loans and borrowings and trade and other payables.

##### **(ii) Share capital**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognized as a deduction from equity, net of any tax effects.

## Notes, contd.:

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### **3. Significant accounting policies, contd.:**

#### **b. Financial instruments, contd.:**

#### **c. Operating assets**

##### **(i) Recognition and measurement**

Items of operating assets are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use and capitalized borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When operating assets consist of parts which have different useful lives, the parts are separated and depreciated based on the useful life of each part.

The gain on sale of operating assets, which is the difference between their sale proceeds and carrying amount, is recognised in the income statement among other operating income and the loss on sale among administrative expenses.

##### **(ii) Subsequent costs**

Costs of replacing single components of property and equipment is capitalised when it is considered likely that the benefits associated with the asset will flow to the Company and the costs can be measured reliably. The carrying amount of the replaced component is expensed. All other costs are expensed in the income statement as they are incurred.

##### **(iii) Depreciation**

Depreciation is calculated based on the depreciable amount, which is the cost less estimated residual value. Depreciation is calculated on a straight line basis over the estimated useful lives of each component of property and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. Estimated useful lives are specified as follows:

|                              |              |
|------------------------------|--------------|
| Point of Presence (PoP)..... | 10 years     |
| Backhaul.....                | 10 years     |
| Cable stations.....          | 20 years     |
| Wet section.....             | 20 years     |
| Common items.....            | 5 - 10 years |

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

## Notes, contd.:

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### **3. Significant accounting policies, contd.:**

#### **d. Impairment**

##### **(i) Non-derivative financial assets**

A financial asset not classified as at fair value through profit or loss, including an interest in an equity-accounted investee, is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset, and that loss event(s) had an impact on the estimated future cash flows of that asset that can be estimated reliably.

In assessing collective impairment, the Company uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

##### **(ii) Non-financial assets**

The carrying amounts of the Company's non-financial assets, other than deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

Impairment is recognized if the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. 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 amortization, if no impairment loss had been recognized.

#### **e. Employee benefits**

##### **(i) Defined contribution plans**

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in profit or loss in the periods during which services are rendered by employees. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in future payments is available.

#### **f. Revenue**

##### **(i) Sale of bandwidth**

Revenue from the sale of bandwidth is recognized in profit and loss based on recorded measurement of delivery during the period. Prepaid revenues are deferred and recognized in income statement based on delivery over the lifetime of the contract.

##### **(ii) Income from Public Service Contract**

Income from Public Service Contract is recognised in profit or loss when the income becomes receivable.

## Notes, contd.:

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### **3. Significant accounting policies, contd.:**

#### **g. Leases**

##### **(i) Leased assets**

Assets held by the Company under leases which transfer to the Company substantially all of the risks and rewards of ownership are classified as finance leases. On initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Assets held under other leases are classified as operating leases and are not recognised in the statement of financial position.

##### **(ii) Lease payments**

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

#### **h. Finance income and finance expenses**

Finance income comprises interest income on investments. Interest income is recognised in the income statement as it accrues based on effective interest.

Finance expenses comprise interest expenses on borrowings and inflation indexation. Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognised in the income statement using the effective interest method.

Foreign currency gains and losses on financial assets and financial liabilities are reported on a net basis as either finance income or finance cost depending on whether foreign currency movements are in a net gain or net loss position.

#### **i. Income tax**

Income tax expense comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to operating items recognised directly in equity or in other comprehensive income, in which case the income tax is recognised together with those items.

Current tax is the income tax estimated to be payable or receivable next year in respect of the taxable income or loss for the year, based on the tax rate at the reporting date, in addition to adjustments to tax payable in respect of previous years, if any.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.



## Notes, contd.:

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### 3. Significant accounting policies, contd.:

#### j. Segment reporting

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Company's other components. All operating segments' operating results are reviewed regularly by the Company's management to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available. The Company's management considers the Company to have one segment.

#### k. New standards and interpretations not yet effective

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2017, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Company.

### 4. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

#### (i) Trade and other receivables

The fair value of trade and other receivables, which is only determined for disclosure purposes, is the estimated future cash flows discounted at the market interest rate at the reporting date. Short-term receivables are however not discounted as the difference between their fair value and their carrying amount is insignificant.

#### (ii) Financial liabilities

The fair value of payables and long term loans, which is only determined for disclosure purposes, is the estimated future cash flows discounted at the market interest rate at the reporting date. Short-term payables are however not discounted as the difference between their fair value and their carrying amount is insignificant.

### 5. Sale of bandwidth

Four customers account for 63,3% of the revenues from sale of bandwidth of the Company (2015: 73,1%). 51,5% of the revenue from sold bandwidth comes from the domestic market (2015:57,8%).

### 6. Public service contract

In April 2012 The Company and The Telecommunications Fund entered into a Public Service Contract concerning electronic communication connectivity between Iceland and Europe. The purpose of the contract is that the parties acknowledge that submarine electronic communications cables, providing international connectivity to the territory of Iceland are part of an essential infrastructure. The parties furthermore acknowledge that Farice is the only undertaking in possession of submarine cables connecting Iceland and other parts of Europe.

The Telecommunication Fund undertakes to compensate Farice for discharging the public service in as much as revenue is not sufficient to cover the cost of providing the public service taking into account a reasonable rate of return. The contract was extended in December 2015 and the extended expiration date is 31 December 2018.

### 7. Operating expenses

|  | 2016             | 2015             |
|--|------------------|------------------|
| Backhaul .....   | 2.972.015        | 3.079.782        |
| Cable stations and submarine cable maintenance support ..... | 1.392.205        | 1.281.006        |
| Other operating expenses .....                               | 1.377.903        | 1.504.992        |
| Total operating expenses .....                               | <u>5.742.122</u> | <u>5.865.780</u> |

Notes, contd.:

| <b>8. Administrative expenses</b>          | <b>2016</b> | <b>2015</b> |
|--|-------------|-------------|
| Salaries and salary-related expenses ..... | 631.512     | 518.423     |
| Office rent .....                          | 85.554      | 77.154      |
| Auditing and accounting support .....      | 71.169      | 39.881      |
| Other administrative expenses .....        | 126.575     | 149.008     |
| Total administrative expenses .....        | 914.810     | 784.466     |

| <b>9. Fee to auditors</b>                    | <b>2016</b> | <b>2015</b> |
|--|-------------|-------------|
| Audit of financial statements .....          | 25.030      | 22.727      |
| Review of interim financial statements ..... | 8.718       | 8.425       |
| Other services .....                         | 5.695       | 1.746       |
|  | 39.443      | 32.898      |

**10. Salaries and salary-related expenses are specified as follows:**

|  |         |         |
|--|---------|---------|
| Salaries .....   | 727.358 | 624.202 |
| Contributions to pension funds .....                                 | 83.717  | 68.405  |
| Other salary related expenses .....                                  | 123.760 | 90.015  |
| Total salaries and other salary related expenses .....               | 934.835 | 782.622 |
| Administrative expenses .....  | 631.512 | 518.423 |
| Operating expenses .....   | 303.322 | 264.199 |
| Total salaries and other salary related expenses .....               | 934.835 | 782.622 |
| Number of employees in full time equivalent units .....              | 7       | 7       |
| Salaries and salary-related expenses to the Board of Directors ..... | 66.264  | 56.231  |
| Salaries and salary-related expenses to the CEO .....                | 231.268 | 188.197 |

**11. Finance income and finance expenses**

Interest- and indexation expenses are specified as follows:

|   |           |           |
|---|-----------|-----------|
| Interest expenses and borrowing costs ..... | 3.092.741 | 2.812.233 |
| Indexation charge .....                     | 871.344   | 738.864   |
| Total finance expenses .....                | 3.964.085 | 3.551.097 |

## Notes, contd.:

### 12. Operating assets

Operating assets, their impairment and depreciation is specified as follows:

|                                    | PoP/<br>Backhaul/CS | Farice     | Danice     | Common<br>Items | Total       |
|------------------------------------|---------------------|------------|------------|-----------------|-------------|
| <b>Total value</b>                 |                     |            |            |                 |             |
| Total cost 1.1.2015 .....          | 18.450.959          | 46.878.987 | 82.368.038 | 4.427.583       | 152.125.567 |
| Additions during the year .....    |                     |            | 254.941    |                 | 254.941     |
| Total cost 31.12.2015 .....        | 18.450.959          | 46.878.987 | 82.622.979 | 4.427.583       | 152.380.508 |
| Additions during the year .....    | 0                   | 71.425     | 0          |                 | 71.425      |
| Total cost 31.12.2016 .....        | 18.450.959          | 46.950.412 | 82.622.979 | 4.427.583       | 152.451.933 |
| <b>Depreciation and impairment</b> |                     |            |            |                 |             |
| Depreciated 1.1.2015 .....         | 10.135.368          | 23.999.421 | 19.217.386 | 4.426.979       | 57.779.154  |
| Depreciation for the year .....    | 991.605             | 2.699.471  | 3.642.820  | 345             | 7.334.241   |
| Depreciated 31.12.2015 .....       | 11.126.973          | 26.698.892 | 22.860.206 | 4.427.324       | 65.113.395  |
| Depreciation for the year .....    | 645.761             | 2.699.471  | 3.840.407  | 259             | 7.185.898   |
| Depreciated 31.12.2016 .....       | 11.772.734          | 29.398.363 | 26.700.613 | 4.427.583       | 72.299.293  |
| <b>Carrying amount</b>             |                     |            |            |                 |             |
| Carrying amount 1.1.2015 .....     | 8.315.591           | 22.879.566 | 63.150.652 | 604             | 94.346.413  |
| Carrying amount 31.12.2015 .....   | 7.323.986           | 20.180.095 | 59.762.773 | 259             | 87.267.113  |
| Carrying amount 31.12.2016 .....   | 6.678.225           | 17.552.049 | 55.922.366 | 0               | 80.152.640  |

Insurance value of the Company's assets amounted to EUR 13,0 million.

At year end, the Company's operating assets were tested for impairment. The test was based on evaluation of the Company's operating value, based on management's assumptions, mainly with respect to future growth in revenue, operating margin and weighted average cost of capital. In the evaluation a five year forecast was used, but a fixed income increase and margin was assumed in the period thereafter. The conclusions of the impairment test did not lead to an impairment loss. Nevertheless if future operation will not be in line with budgets there is an indication that an impairment loss will be recognised.

The value of the operating assets was estimated to be significantly higher than their carrying amount and no impairment was required.

### 13. Prepaid expenses

The prepaid expenses are a state guarantee fee paid in 2010 for the secured bond issue.

## Notes, contd.:

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### 14. Deferred tax asset

A deferred tax asset is not recognised in the balance sheet due to the uncertainty of utilisation of the deferred carryforward tax loss. Carry forward losses may be utilised for 10 years from when it is incurred.

| Deferred tax asset is as follows at the year end: | 31.12.2016   | 31.12.2015   |
|---|--------------|--------------|
| Property and equipment.....                       | (3.537.476)  | (2.936.546)  |
| Trade receivables.....                            | (2.396)      | (3.581)      |
| Deferred foreign exchange difference.....         | 911.239      | 539.641      |
| Tax loss carryforward.....                        | 24.146.191   | 17.882.552   |
| Impairment of tax asset.....                      | (21.517.558) | (15.482.066) |
|   | <u>0</u>     | <u>0</u>     |

At year-end 2017 the Company has unused tax losses available for offset against future profits as follows:

|                                    |                    |
|------------------------------------|--------------------|
| Available until the year 2018..... | 3.077.258          |
| Available until the year 2019..... | 28.600.659         |
| Available until the year 2020..... | 26.913.767         |
| Available until the year 2021..... | 14.733.000         |
| Available until the year 2022..... | 15.237.434         |
| Available until the year 2023..... | 7.369.618          |
| Available until the year 2024..... | 8.625.380          |
| Available until the year 2025..... | 1.298.686          |
| Available until the year 2026..... | 14.875.153         |
| Unused tax losses total.....       | <u>120.730.955</u> |

### 15. Equity

#### *Share capital*

In December 2016 the share capital of the Company was increased by converting subordinated loans, previously classified as other-paid in capital, to share capital. The total amount of subordinated loans converted to equity amounted to EUR 6,2 million of which the principal amounted to EUR 5 million and accrued interest of EUR 1,2 million. The accrued interests were recognized directly to accumulated deficit as the settlement of the interest was with equity. The increase in share capital therefore did not have any impact on net equity or the financial position of the company. The new shares form a new class of shares B-class, shares with entitlement to 45% of dividend payments and 6 votes per share at general meetings of the company. Owners of the ordinary A-class shares are entitled to 55% of dividend payments and one vote per share at general meetings.

After this increase in share capital the nominal value of the A-class shares is EUR 54,3 million and B-class shares 6,2 million, and total capital is EUR 60,5 million. The nominal value of A-class treasury shares is EUR 862.335, the nominal value of outstanding shares therefore amounts to EUR 59,6 million on December 31st. 2016.

## Notes, contd.:

### 16. Loans and borrowings

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings, which are measured at amortized cost. For more information about the Company's exposure to interest rate, foreign currency and liquidity risk, see note 17.

|                                  | Curr. | Year of maturity | 2016             |                   | 2015             |                   |
|----------------------------------|-------|------------------|------------------|-------------------|------------------|-------------------|
|                                  |       |                  | Interest rate    | Carrying amount   | Interest rate    | Carrying amount   |
| Secured bond issue.....          | ISK   | 2034             | 5,5% + indexed   | 46.335.608        | 5,5% + indexed   | 39.419.515        |
| Secured bank loans.....          | EUR   | 2018             | Euribor+0,8-1,7% | 0                 | Euribor+0,8-1,7% | 8.434.276         |
| Secured loan.....                | EUR   | 2018             | Euribor + 4,5%   | 995.407           | Euribor + 4,5%   | 1.449.975         |
| Finance lease liabilities.....   | EUR   | 2018             | Libor + 4,12%    | 891.358           | Libor + 4,12%    | 1.740.983         |
| Finance lease liabilities.....   | CHF   | 2018             | Libor + 4,12%    | 195.365           | Libor + 4,12%    | 379.775           |
| Finance lease liabilities.....   | JPY   | 2018             | Libor + 4,12%    | 199.242           | Libor + 4,12%    | 366.572           |
| Finance lease liabilities.....   | USD   | 2018             | Libor + 4,12%    | 42.042            | Libor + 4,12%    | 79.610            |
|                                  |       |                  |                  | <u>48.659.021</u> |                  | <u>51.870.706</u> |
| Current maturities.....          |       |                  |                  | (3.329.225)       |                  | (9.473.101)       |
| Total long term liabilities..... |       |                  |                  | <u>45.329.796</u> |                  | <u>42.397.605</u> |

Maturities are specified as follows over the next years:

|                       | 31.12.2016        | 31.12.2015        |
|-----------------------|-------------------|-------------------|
| Year 2017 / 2016..... | 3.329.225         | 9.473.101         |
| Year 2018 / 2017..... | 2.321.904         | 3.068.382         |
| Year 2019 / 2018..... | 1.807.001         | 3.904.311         |
| Year 2020 / 2019..... | 1.909.556         | 1.486.373         |
| Year 2021 / 2020..... | 2.017.828         | 1.571.051         |
| Subsequent.....       | 37.273.507        | 32.367.488        |
|                       | <u>48.659.021</u> | <u>51.870.706</u> |

Guarantees on long-term liabilities:

|                                  | 31.12.2016        | Guarantor/Guarantee |
|----------------------------------|-------------------|---------------------|
| Secured bond issue, indexed..... | 46.335.608        | Icelandic State     |
| Secured loan.....                | 995.407           | Landing equipment   |
| Finance lease liabilities.....   | 1.328.006         | Leased equipment    |
|                                  | <u>48.659.021</u> |                     |

The Icelandic State has a 1st ranking security in the Danice cable system as collateral against its guarantee of the secured bond.

The company complies with all covenants in loan agreements at year-end.

## Notes, contd.:

### 17. Financial assets and financial liabilities

According to the International Accounting Standard IAS 39 *Financial Instruments: Recognition and Measurement*, financial assets and financial liabilities are classified into certain categories. The classification of financial assets and financial liabilities affects how the respective financial instruments are measured after initial recognition. The classification of financial assets and financial liabilities and their measurement basis is specified as follows:

- \* Loans and receivables - are recognised at amortised cost
- \* Other financial liabilities - are recognised at amortised cost

The following table shows the classification of the Company's financial assets and liabilities:

#### 31 December 2016

|   | Cash and<br>receivables | Other financial<br>liabilities | Carrying<br>amount |
|---|-------------------------|--------------------------------|--------------------|
| <b>Assets:</b>  |                         |                                |                    |
| Cash and cash equivalents.....                        | 599.365                 | 0                              | 599.365            |
| Trade receivables.....                                | 239.615                 | 0                              | 239.615            |
| Other short-term receivables.....                     | 418.778                 | 0                              | 418.778            |
|   | 1.257.758               | 0                              | 1.257.758          |
| <b>Liabilities:</b>                                   |                         |                                |                    |
| Loans and borrowings.....                             |                         | 48.659.021                     | 48.659.021         |
| Trade payables.....                                   |                         | 465.880                        | 465.880            |
| Deferred income and other short-term liabilities..... |                         | 5.276.068                      | 5.276.068          |
|   |                         | 54.400.969                     | 54.400.969         |

#### 31 December 2015

|                                   | Cash and<br>receivables | Other financial<br>liabilities | Carrying<br>amount |
|-----------------------------------|-------------------------|--------------------------------|--------------------|
| <b>Assets:</b>                    |                         |                                |                    |
| Cash and cash equivalents.....    | 802.938                 | 0                              | 802.938            |
| Trade receivables.....            | 358.142                 | 0                              | 358.142            |
| Other short-term receivables..... | 268.891                 | 0                              | 268.891            |
|                                   | 1.429.971               | 0                              | 1.429.971          |
| <b>Liabilities:</b>               |                         |                                |                    |
| Loans and borrowings.....         |                         | 51.870.706                     | 51.870.706         |
| Trade payables.....               |                         | 438.463                        | 438.463            |
| Other short-term liabilities..... |                         | 928.670                        | 928.670            |
|                                   |                         | 53.237.839                     | 53.237.839         |

## Notes, contd.:

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### 18. Financial risk management

#### Overview

The following risks arise from the Company's financial instruments.

- \* Credit risk
- \* Liquidity risk
- \* Market risk

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the management of capital.

#### Financial risk management objectives

The Company's management monitors and manages the financial risks relating to the operations of the Company. These risks primarily include credit risks and liquidity risk and is being closely followed by the management. The Company does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

#### Credit risk

Credit risk is the risk of financial loss to the Company if a customer fails to meet its contractual obligations. Over 85% of the revenue is coming from long standing customers and the company has never had to write off considerable receivables.

The Company's maximum possible loss due to financial assets with inherent credit risk is their carrying amount, which is specified as follows at year end:

|                                   | 2016             | 2015             |
|-----------------------------------|------------------|------------------|
| Trade receivables.....            | 239.615          | 358.142          |
| Other short term receivables..... | 418.778          | 268.891          |
| Cash and cash equivalents.....    | 599.365          | 802.938          |
|                                   | <u>1.257.758</u> | <u>1.429.971</u> |

#### Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company's objective is to always have sufficient liquidity to meet its payment obligations as they become due.

## Notes, contd.:

### 18. Financial instruments, contd.:

The following table shows the remaining contractual maturities at the end of the reporting period of financial liabilities and financial assets, including estimated interest payments:

| <b>Year end 2016</b>           | <b>Carrying amount</b> | <b>Contractual cash flows</b> | <b>0 - 12 months</b> | <b>1 - 2 years</b> | <b>More than 2 years</b> |
|--------------------------------|------------------------|-------------------------------|----------------------|--------------------|--------------------------|
| Trade and other payables.....  | 5.741.948              | 5.741.980                     | 5.741.980            |                    |                          |
| Long-term loans.....           | 48.659.021             | 94.686.587                    | 5.957.838            | 4.917.705          | 83.811.044               |
|                                | <u>54.400.969</u>      | <u>100.428.567</u>            | <u>11.699.818</u>    | <u>4.917.705</u>   | <u>83.811.044</u>        |
| Trade receivables.....         | 239.615                | 239.615                       | 239.615              |                    |                          |
| Other receivables.....         | 418.778                | 418.778                       | 418.778              |                    |                          |
| Cash and cash equivalents..... | 599.365                | 599.365                       | 599.365              |                    |                          |
|                                | <u>1.257.758</u>       | <u>1.257.758</u>              | <u>1.257.758</u>     | <u>0</u>           | <u>0</u>                 |
| Net balance 31.12.2016.....    | 53.143.211             | 99.170.809                    | 10.442.060           | 4.917.705          | 83.811.044               |
| <b>Year end 2015</b>           |                        |                               |                      |                    |                          |
| Trade and other payables.....  | 1.367.133              | 1.367.133                     | 1.367.133            |                    |                          |
| Long-term loans.....           | 51.870.706             | 93.960.207                    | 11.787.097           | 5.328.569          | 76.844.541               |
|                                | <u>53.237.839</u>      | <u>95.327.340</u>             | <u>13.154.230</u>    | <u>5.328.569</u>   | <u>76.844.541</u>        |
| Trade receivables.....         | 358.142                | 358.142                       | 358.142              |                    |                          |
| Other receivables.....         | 268.891                | 278.778                       | 278.778              |                    |                          |
| Cash and cash equivalents..... | 802.938                | 802.938                       | 802.938              |                    |                          |
|                                | <u>1.429.971</u>       | <u>1.439.858</u>              | <u>1.439.858</u>     | <u>0</u>           | <u>0</u>                 |
| Net balance 31.12.2015.....    | 51.807.868             | 93.887.482                    | 11.714.372           | 5.328.569          | 76.844.541               |

### Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the income of the Company or the value of its holdings of financial instruments.

### Currency risk

Currency risk exposure does arise when there is a difference between assets and liabilities denominated in foreign currency. The majority of the Company's assets and liabilities are denominated in EUR and ISK.

The Company's exposure to currency risk is specified as follows at year end:

| <b>Year 2016</b>  | <b>Assets</b>  | <b>Liabilities</b>  | <b>Net exposure</b> |
|-------------------|----------------|---------------------|---------------------|
| JPY.....          | 0              | 199.242 (           | 199.242)            |
| USD.....          | 83.517         | 164.912 (           | 81.395)             |
| CHF.....          | 0              | 195.365 (           | 195.365)            |
| DKK.....          | 0              | 20.725 (            | 20.725)             |
| ISK.....          | 43.420         | 51.767.339 (        | 51.723.919)         |
| GBP.....          | 90.578         | 1.531               | 89.047              |
| Net exposure..... | <u>217.515</u> | <u>52.349.114 (</u> | <u>52.131.599)</u>  |



## Notes, contd.:

### 18. Financial instruments, contd.:

| Year 2015         | Assets  | Liabilities  | Net exposure |
|-------------------|---------|--------------|--------------|
| JPY.....          | 0       | 366.572 (    | 366.572)     |
| USD.....          | 10      | 79.610 (     | 79.600)      |
| CHF.....          | 0       | 379.775 (    | 379.775)     |
| DKK.....          | 0       | 104.850 (    | 104.850)     |
| ISK.....          | 24.966  | 40.414.954 ( | 40.389.988)  |
| GBP.....          | 102.505 | 0            | 102.505)     |
| Net exposure..... | 127.481 | 41.345.761 ( | 41.218.280)  |

The following exchange rates applied during the year:

|          | Average exchange rate |        | End of year exchange rate |        |
|----------|-----------------------|--------|---------------------------|--------|
|          | 2016                  | 2015   | 2016                      | 2015   |
| JPY..... | 120,08                | 134,31 | 123,36                    | 131,27 |
| USD..... | 1,11                  | 1,11   | 1,06                      | 1,09   |
| CHF..... | 1,09                  | 1,07   | 1,08                      | 1,08   |
| ISK..... | 133,96                | 146,30 | 119,46                    | 141,71 |
| GBP..... | 0,82                  | 0,73   | 0,86                      | 0,74   |
| DKK..... | 7,44                  | 7,44   | 7,43                      | 7,46   |

#### Market risk

##### Sensitivity analysis

The table below shows what effects 5% and 10% strengthening of the relevant foreign currency rates against the EUR would have on P/L and equity. The foreign currency assets and liabilities in the sensitivity analysis are mainly foreign currency borrowings and foreign currency bank balances. The analysis is prepared assuming the amount outstanding at the balance sheet date was outstanding for the whole year. The analysis assumes that all variables other than the relevant foreign currency rate are held constant. The sensitivity analysis does not take into account tax effects. A positive number below indicates an increase in profit and other equity. A decrease of the relevant foreign currency rate against the EUR would have an opposite impact on P/L and equity.

|            | 31.12.2016 |            | 31.12.2015 |            |
|------------|------------|------------|------------|------------|
|            | 5%         | 10%        | 5%         | 10%        |
| JPY..... ( | 7.970)     | 15.939)    | 14.663)    | 29.326)    |
| USD..... ( | 3.256)     | 6.512)     | 3.184)     | 6.368)     |
| CHF..... ( | 7.815)     | 15.629)    | 15.191)    | 30.382)    |
| ISK..... ( | 2.068.957) | 4.137.914) | 1.615.600) | 3.231.199) |
| DKK..... ( | 829)       | 1.658)     | 4.194)     | 8.388)     |
| GBP.....   | 3.562      | 7.124      | 4.100      | 8.200      |

##### Interest rate risk

The Company is exposed to cash flow interest rate risk due to changes in interest rates of floating rate financial liabilities. As stated before, the Company endeavours to ensure it always has sufficient liquidity to meet its liabilities as they become due.

Interest rate risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company has both fixed and floating rate interest bearing financial instruments.

## Notes, contd.:

### 18. Financial instruments, contd.:

#### Exposure to interest rate risk

Interest-bearing financial assets and liabilities are as follows at the year end:

|  | 2016                | 2015                |
|--|---------------------|---------------------|
| <b>Financial instruments with floating interest rate</b> |                     |                     |
| Financial assets.....                                    | 599.365             | 802.938             |
| Financial liabilities.....                               | (48.659.021)        | (51.870.706)        |
|  | <u>(48.059.656)</u> | <u>(51.067.768)</u> |

#### Fair value sensitivity analysis for fixed interest rate instruments

Financial instruments with fixed interest rates are not measured at fair value. Therefore, a change in interest rates at the reporting date would not affect profit and loss or equity.

#### Cash flow sensitivity analysis for floating interest rate instruments

An increase or decrease in interest rates of 100 basis points at the reporting date would have increased (decreased) profit or loss after tax by following amounts. This analysis is based on that all other variables, in particular foreign currency rates, remain constant. The analysis was performed on the same basis for the year 2015.

|                            | Effect on profit or loss |                 |
|----------------------------|--------------------------|-----------------|
|                            | 100 bp increase          | 100 bp decrease |
| <b>2016</b>                |                          |                 |
| Financial assets.....      | 4.795                    | (4.795)         |
| Financial liabilities..... | (18.587)                 | 18.587          |
|                            | <u>(13.792)</u>          | <u>13.792</u>   |
| <b>2015</b>                |                          |                 |
| Financial assets.....      | 6.424                    | (6.424)         |
| Financial liabilities..... | (99.610)                 | 99.610          |
|                            | <u>(93.186)</u>          | <u>93.186</u>   |

#### Fair value

##### Fair value versus carrying amounts

The carrying amount of financial assets and non interest bearing liabilities is equal to their fair value. Comparison of fair value of interest bearing liabilities, together with the carrying amounts shown in the statement of financial position, is as follows:

|                                   | 2016              |                   | 2015              |                   |
|-----------------------------------|-------------------|-------------------|-------------------|-------------------|
|                                   | Carrying amount   | Fair value        | Carrying amount   | Fair value        |
| Interest bearing liabilities..... | 48.659.021        | 50.202.703        | 51.870.706        | 53.673.808        |
|                                   | <u>48.659.021</u> | <u>50.202.703</u> | <u>51.870.706</u> | <u>53.673.808</u> |

#### Interest rates used for determining fair value

The interest rates used to discount estimated cash flows, where applicable, are based on the government yield curve at the reporting date in the case of ISK denominated debt. For other debt the discount rates are based on interbank rates. All discount rates include an adequate credit spread.

## Notes, contd.:

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### **19. Related parties**

The Company's related parties are shareholders, Board members, the CEO, and close family members of the aforementioned parties. No related parties purchased service from the company in 2016 and 2015 and the company did not buy any goods or service from related parties in 2016 and 2015.

The Company has a public service agreement with the Telecommunication Fund that belongs to one shareholder. Further information on the public service agreement can be found in note 6.

### **20. Capital management**

The Board's policy is to maintain a strong capital base to sustain future developments of the business.

The Company's Board of Directors seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position. The equity ratio was 34,4% at year end 2016 (2015: 41,0%).

There were no changes in the Company's approach to capital management during the year and the Company is not obliged to comply with external rules on minimum equity other than those related to covenants in its loan agreements.

### **21. Non-financial information**

In June 2016 the Parliament of Iceland approved extensive changes to the Financial Statements Act. These changes are retroactive as of 1 January 2016. Among the changes to the Act is a requirement that the management report of certain entities shall include a non-financial statement containing information necessary for an understanding of the development, performance, position and impact of its activity, relating to environmental, social and employee matters. Furthermore, it shall include the entities' policy regarding human rights and how the entities counteracts corruption and bribery matters. The statement shall also contain a brief description of the entity's business model, non-financial key performance indicators etc. Where the entity does not pursue policies with respect to one or more of those matters, the non-financial statement shall provide a clear and reasoned explanation for not doing so. The Company is a public interest entity and thus must comply with these requirements. It should be noted that for entities within the European Union, the provision applies as of the year 2017. Due to the short time which has elapsed from the change of the Act to the end of the financial year, the Company has not been able to implement this requirement. Implementation will take place in the year 2017 and the aforementioned information will be included in the financial statements of the company for next year.