Farice ehf.

Financial Statements 2017

Farice ehf.
Smáratorgi 3
201 Kópavogur

Reg. no. 511203-2950

Contents

Report of the Board of Directors and the CEO

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 2017

The Company is delivering Operating Profit for the fourth year in a row. According to the Statement of Comprehensive Income the operating revenue amounted to EUR 15 million and the EBITDA EUR 8 million. Depreciation was EUR 7,1 million and operating profit EUR 933 thousand. According to the Statement of Financial Position the Company´s assets amounted to EUR 76 million and the equity amounted to EUR 28,2 million, an equity ratio of 37,2%. 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 347 thousand.

The present Public Service Agreement with the Icelandic State is valid until end of 2018. The purpose of the Agreement is to secure Iceland´s continued international connectivity and sustainability of the Company. Present environment does not require the Agreement to be extended.

Share capital

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 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.

Environmental responsibility

Farice supports environmental protection and supports initiatives made to increase environmental responsibility. An example is that when the submarine cables FARICE-1 and DANICE were laid extensive seabed researches were performed with regard to environment and fishing ground.

Social responsibility

Farice has few employees and taken into account the importance of the company for the Icelandic society it is of great importance to employ competent employees. We provide safe and healthy work environment and allow employees to develop themselves through team work and training courses with equal opportunities.The company encourages open communication and healthy balance between work and personal life. Human rights violations or harassments are not tolerated.

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 2017 as in previous years. Backhaul in Iceland showed 99,72% to 100% availability depending on routes. Backhaul in UK connecting Farice-1 submarine cable to London showed 99,22% to 99,36% availability on each route. Backhaul on continental Europe connecting Danice submarine cable to Amsterdam and Copenhagen showed 99,54% to 100% availability depending on route. Reported availability is based on faults and planned outages. Submarine cables availability was 100% on both cables.

Statement by the Board of Directors and the CEO

To the best of our knowledge the financial statements give a true and fair view of the Company´s assets and liabilities, financial position as at 31 December 2017, operating performance and the cash flow for the year ended 31 December 2017 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 2017 with their signatures.

Kópavogur, 7 February 2018

The Board of Directors of Farice ehf.

Martha Eiríksdóttir, Chairman

Jón Gunnar Vilhelmsson

Kristín Guðmundsdóttir

Sölvi Sölvason

Ríkarður Ríkarðsson

Chief Executive Officer

Ómar Benediktsson

Independent Auditors´ Report

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 December 31, 20X1, 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 December 31, 2017, 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.

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 determine 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 intend to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

The Board of Directors and CEO are responsible for overseeing the Company's financial reporting process.

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.:

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.

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, 7 February 2018

KPMG ehf.

Árni Claessen

Statement of Comprehensive Income for the year ended 31 December 2017

	Notes	2017	2016
Sale of bandwidth	5	11.238.988	10.920.225
Income from Public Service Contract	6	3.811.744	2.948.168
		15.050.732	13.868.393
Operating expenses	7	6.113.298	5.742.122
Administrative expenses	8	950.710	914.810
		7.064.008	6.656.932
Profit before depreciation and finance items		7.986.724	7.211.460
Depreciation	12	(7.052.929)	(7.185.898)
Operating profit		933.795	25.562
Finance income		20.706	25.441
Interest and indexation expenses	11	(3.381.065)	(3.964.085)
Exchange rate differences		2.079.720	(7.076.925)
Net finance cost		(1.280.639)	(11.015.569)
Total comprehensive loss for the year		(346.844)	(10.990.007)

Notes on pages 12 to 26 are an integral part of these financial statements.

Statement of Financial Position 31 December 2017

	Notes	31.12.2017	31.12.2016
Assets			
Operating assets	12	73.099.711	80.152.640
Prepaid expenses	13	1.457.811	1.547.063
Non-current assets		74.557.522	81.699.703
Trade receivables		458.278	239.615
Other receivables		689.963	418.778
Cash and cash equivalents		143.289	599.365
Current assets		1.291.530	1.257.758
Total assets		75.849.052	82.957.462
Equity			
Share capital	15	59.615.031	59.615.031
Accumulated deficit		(31.405.382)	(31.058.538)
Total equity		28.209.649	28.556.493
Liabilities			
Loans and borrowings	16	41.665.718	45.329.796
Deferred income	3f	1.500.000	3.000.000
Non-current liabilities		43.165.718	48.329.796
Loans and borrowings	16	1.869.687	3.329.225
Trade payables		348.913	465.880
Deferred income and other liabilities	3f	2.255.085	2.276.068
Current liabilities		4.473.685	6.071.173
Total liabilities		47.639.403	54.400.969
Total equity and liabilities		75.849.052	82.957.462

Notes on pages 12 to 26 are an integral part of these financial statements.

Statement of Changes in Equity for the year ended 31 December 2017

	Notes	Share capital	Other paid in capital	Accumulated deficit	Total equity
2016					
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	59.615.031	0	(31.058.538)	28.556.493
2017					
Equity as at 1 January 2017		59.615.031	0	(31.058.538)	28.556.493
Total comprehensive loss for the year				(346.844)	(346.844)
Equity as at 31 December 2017	15	59.615.031	0	(31.405.382)	28.209.649

Notes on pages 12 to 26 are an integral part of these financial statements.

Statement of Cash Flows for the year ended 31 December 2017

	Notes	2017	2016
Cash flow from operating activities			
Loss for the year		(346.844)	(10.990.007)
Adjustments for:			
Depreciation	12	7.052.929	7.185.898
Net finance cost		1.280.639	11.015.569
		7.986.724	7.211.460
Changes in current assets and liabilities		(2.079.034)	4.877.561
Cash generated from operating activities before interest		5.907.690	12.089.021
Interest received		20.706	25.441
Interest paid		(2.631.875)	(3.060.907)
Net cash from operating activities		3.296.521	9.053.555
Cash flows from investing activities			
Acquisition of property and equipment	12	0	(71.425)
Net cash used in investing activities		0	(71.425)
Cash flows from financing activities			
Other paid in capital	15	0	2.450.927
Repayment of long-term loans		(3.733.611)	(11.556.342)
Net cash used in financing activities		(3.733.611)	(9.105.415)
Net decrease in cash and cash equivalents		(437.090)	(123.285)
Cash and cash equivalents at 1 January		599.365	802.938
Effect of exchange rate fluctuations on cash held		(18.986)	(80.288)
Cash and cash equivalents at 31 December		143.289	599.365

Notes on pages 12 to 26 are an integral part of these financial statements.

Notes

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 7 February 2018.

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.

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, cash and cash equivalents 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 affects.

3. Significant accounting policies, 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.

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 the income statement 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.

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.

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 2018, 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 bandwith

Four customers account for 57,1% of the revenues from sale of bandwidth of the Company (2016: 63,3%). 54,4% of the revenue from sold bandwith comes from the domestic market (2016: 51,5%).

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 extented in December 2015 and the extented expiration date is 31 December 2018.

7. Operating expenses

	2017	2016
Backhaul	2.979.026	2.972.015
Cable stations and submarine cable maintenance support	1.445.283	1.392.205
Other operating expenses	1.688.989	1.377.903
Total operating expenses	6.113.298	5.742.122

8. Administrative expenses

	2017	2016
Salaries and salary-related expenses	667.408	631.512
Office rent	100.510	85.554
Auditing and accounting support	44.271	71.169
Other administrative expenses	138.521	126.575
Total administrative expenses	950.710	914.810

9. Fee to auditors

	2017	2016
Audit of financial statements	25.324	25.030
Review of interim financial statements	8.250	8.718
Other services	10.266	5.695
	43.840	39.443

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

Salaries	842.350	727.358
Contributions to pension funds	101.521	83.717
Other salary related expenses	110.194	123.760
Total salaries and other salary related expenses	1.054.065	934.835
Administrative expenses	667.408	631.512
Operating expenses	386.657	303.322
Total salaries and other salary related expenses	1.054.065	934.835
Number of employees in full time equivalent units	7	7
Salaries and salary-related expenses to the Board of Directors	78.566	66.264
Salaries and salary-related expenses to the CEO	219.411	231.268

11. Finance income and finance expenses

Interest- and indexation expenses are specified as follows:

Interest expenses and borrowing costs	2.592.882	3.092.741
Indexation charge	788.183	871.344
Total finance expenses	3.381.065	3.964.085

12. Operating assets

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

	PoP/ Backhaul/CS	Farice	Danice	Common Items	Total
Total value					
Total cost 1.1.2016	18.450.959	46.878.987	82.622.979	4.427.583	152.380.508
Additions during the year		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
Total cost 31.12.2017	18.450.959	46.950.412	82.622.979	4.427.583	152.451.933
Depreciation and impairment					
Depreciated 1.1.2016	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
Depreciation for the year	513.053	2.699.471	3.840.405	0	7.052.929
Depreciated 31.12.2017	12.285.787	32.097.834	30.541.018	4.427.583	79.352.222
Carrying amount					
Carrying amount 1.1.2016	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
Carrying amount 31.12.2017	6.165.172	14.852.578	52.081.961	0	73.099.711

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 recoverable amount of operating assets was estimated using discounted cash flows. The cash flow projections included specific estimates from management for five years and a growth rate of 4% until 2030 and a 2,5% growth rate thereafter . The discount rate was determined 8,3% and is based on a post-tax measure and a equity ratio of 40%. The estimated recoverable amount of the operating assets exceeds its carrying amount by EUR 2,0 million and did therefore not lead to impairment loss. However, if future operation will not be in line with budgets there is an indication that an impairment loss will be recognised. According to a sensitivity analysis a 5% decrease in EBITDA will result in EUR 1,7 million impairment of assets and a 50 basis points increase in the discount rate will result in an impairment loss of EUR 1,5 million.

13. Prepaid expenses

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

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:	**31.12.2017**	**31.12.2016**
Property and equipment	(3.740.187)	(3.537.476)
Trade receivables	(4.583)	(2.396)
Deferred foreign exhange difference	(232.204)	911.239
Tax loss carryforward	23.866.932	24.146.191
Impairment of tax asset	(19.889.958)	(21.517.558)
	0	0

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

Available until the year 2018	2.931.578
Available until the year 2019	19.249.872
Available until the year 2020	25.639.641
Available until the year 2021	14.035.524
Available until the year 2022	14.516.078
Available until the year 2023	7.020.732
Available until the year 2024	8.217.045
Available until the year 2025	9.242.861
Available until the year 2026	11.476.806
Available until the year 2027	7.004.521
Unsused tax losses total	119.334.658

15. Equity

Share capital

Total share capital is EUR 60,5 million where nominal value of A-class shares is EUR 54,3 million and B-class shares 6,2 million. The nominal value of A-class treasury shares is EUR 862.335 and the nominal value of outstanding shares therefore amounts to EUR 59,6 million. Owners of the ordinary A-class shares are entitled to 55% of dividend payments and one vote per share at general meetings. Owners of the B-class shares are entitled to 45% of dividend payments and 6 votes per share at general meetings of the company.

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.

			2017		2016	
	Curr.	Year of maturity	Interest rate	Carrying amount	Interest rate	Carrying amount
Secured bond issue.............	ISK	2034	5,5% + indexed	43.321.827	5,5% + indexed	46.335.608
Secured loan........................	EUR	2018	Euribor + 4,5%	213.578	Euribor + 4,5%	995.407
Finance lease liabilities........	EUR	2018	Libor + 4,12%	0	Libor + 4,12%	891.358
Finance lease liabilities........	CHF	2018	Libor + 4,12%	0	Libor + 4,12%	195.365
Finance lease liabilities........	JPY	2018	Libor + 4,12%	0	Libor + 4,12%	199.242
Finance lease liabilities........	USD	2018	Libor + 4,12%	0	Libor + 4,12%	42.042
				43.535.405		48.659.021
Current maturities..				(1.869.687)		(3.329.225)
Total long term liabilities..				41.665.718		45.329.796

Maturities are specified as follows over the next years:	31.12.2017	31.12.2016
Year 2018/2017..	1.869.687	3.329.225
Year 2019/2018..	1.750.250	2.321.904
Year 2020/2019..	1.849.641	1.807.001
Year 2021/2020..	1.954.573	1.909.556
Year 2022/2012..	2.065.356	2.017.828
Year 2023/2022..	2.182.315	2.132.138
Subsequent..	31.863.583	35.141.369
	43.535.405	48.659.021

Guarantees on long-term liabilities:	Guarantor/Guarantee	31.12.2017
Secured bond issue, indexed..	Icelandic State	43.321.827
Secured loan..	Leased equipment	213.578
		43.535.405

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.

Reconciliation between the opening balance and closing balance for liabilities arising from financing activities:

	Loans and borrowings
Balance 1. January 2017...	48.659.021
Repayment of long-term loans..	(3.733.611)
Currency fluctations and indexations..	(1.390.005)
Balance 31. December 2017..	43.535.405

17. 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:

	2017	2016
Trade receivables	458.278	239.615
Other short term receivables	689.963	418.778
Cash and cash equivalents	143.289	599.365
	1.291.530	1.257.758

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.

17. Financial risk management, 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:

Year end 2017	Carrying amount	Contractual cash flows	0 - 12 months	1 - 2 years	More than 2 years
Trade and other payables	1.103.998	1.103.998	1.103.998		
Long-term loans	43.535.405	83.491.970	4.269.063	4.155.145	75.067.762
	44.639.403	84.595.968	5.373.061	4.155.145	75.067.762
Trade receivables	458.278	458.278	458.278		
Other receivables	689.963	689.963	689.963		
Cash and cash equivalents	143.289	143.289	143.289		
	1.291.530	1.291.530	1.291.530	0	0
Net balance 31.12.2017	43.347.873	83.304.438	4.081.531	4.155.145	75.067.762

Year end 2016					
Trade and other payables	1.241.948	1.241.948	1.241.948		
Long-term loans	48.659.021	94.686.587	5.957.838	4.917.705	83.811.044
	49.900.969	95.928.535	7.199.786	4.917.705	83.811.044
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		
	1.257.758	1.257.758	1.257.758	0	0
Net balance 31.12.2016	48.643.211	94.670.777	5.942.028	4.917.705	83.811.044

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:

Year 2017	Assets	Liabilities	Net exposure
USD	74.300	0	74.300
DKK	6.405	73.882	(67.477)
ISK	567.905	44.234.436	(43.666.531)
GBP	85.044	52.707	32.337
Net exposure	733.654	44.361.025	(43.627.371)

17. Financial risk management, contd.:

Year 2016	Assets	Liabilities	Net exposure
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	47.267.339	(47.223.919)
GBP	90.578	1.531	89.047
Net exposure	217.515	47.849.114	(47.631.599)

The following exchange rates applied during the year:

	Average exchange rate		End of year exchange rate	
	2017	2016	2017	2016
JPY	126,7	120,1	134,8	123,4
USD	1,13	1,11	1,20	1,06
CHF	1,11	1,09	1,17	1,08
ISK	120,9	134,0	125,4	119,5
GBP	0,88	0,82	0,89	0,86
DKK	7,44	7,44	7,44	7,43

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. 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.

	31.12.2017		31.12.2016	
	5%	10%	5%	10%
JPY	0	0	(7.970)	(15.939)
USD	2.972	5.944	(3.256)	(6.512)
CHF	0	0	(7.815)	(15.629)
ISK	(1.746.661)	(3.493.322)	(2.068.957)	(4.137.914)
DKK	(2.699)	(5.398)	(829)	(1.658)
GBP	1.294	2.587	3.562	7.124

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.

17. Financial risk management, contd.:

Exposure to interest rate risk

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

Financial instruments with floating interest rate	2017	2016
Financial assets	143.289	599.365
Financial liabilities	(43.535.405)	(48.659.021)
	(43.392.116)	(48.059.656)

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 2016.

	Effect on profit or loss	
	100 bp increase	100 bp decrease
2017		
Financial assets	1.146	(1.146)
Financial liabilities	(348.283)	348.283
	(347.137)	347.137
2016		
Financial assets	4.795	(4.795)
Financial liabilities	(389.272)	389.272
	(384.477)	384.477

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:

	2017		2016	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest bearing liabilites	43.535.405	44.596.158	48.659.021	50.202.703
	43.535.405	44.596.158	48.659.021	50.202.703

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 a 2,5% credit spread which is based on last transaction of Farice Bond (EFAR 09 1) in November 2013.

18. 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 2017 and 2016 and the company did not buy any goods or service from related parties in 2017 and 2016.

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.

19. 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 37% at year end 2017 (2016: 34%).

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.