

Farice ehf.  
Financial Statements 2013

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 economical 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 2013**

According to the Statement of Comprehensive Income the operating revenue amounted to EUR 12,3 million and the EBITDA EUR 6,7 million. According to the Statement of Financial Position the company's asset amounted to EUR 104,5 million and the equity amounted to EUR 47,0 million, an equity ratio of 45,0%. 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 EUR 7,2 million.

## **Share capital**

The three shareholders in Farice ehf. are Arion Bank (ID 581008-0150) with 39,3%, the Icelandic State (ID 540269-5459 with 30,2%), Landsvirkjun, The National Power Company (ID 420269-1299 with 28,9%) and 1,6% 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 system 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.

## **Risk management**

The board refers to note 16 in the financial statements, regarding information on the financial risk management.

## **Going concern**

In the year 2012 the company signed a Public Service Agreement with the Icelandic State, the contract period is five years, starting in the year 2012. The purpose of the Agreement is to secure continued international connectivity to and from Iceland in the public interest. The Agreement supports the sustainability and the continuing operations of the company. The public telecommunication sector is a vital customer and the company has high expectations to the growing data industry in Iceland and expects increased revenue from that source in the coming years.

## **Performance**

Protected service on Farice network delivered 100% availability in year 2013 as in previous years. Backhaul in Iceland showed 99,89 to 99,97% availability depending on routes. Backhaul in UK to London showed 99,14 and 99,48% availability on each route, backhaul in Denmark to Copenhagen showed 99,68 and 99,71% availability and backhaul to Amsterdam showed 99,83 and 100% availability on each route. Reported availability is based on faults and planned outages.

## 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 Director's 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 2013, operating performance and the cash flow for the year ended 31 December 2013 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.

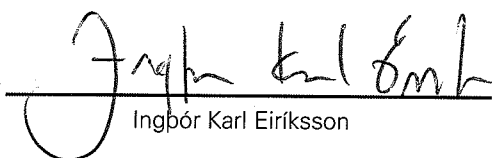
The Board of Directors and CEO of Farice ehf., hereby confirm the Financial Statements of Farice ehf., for the year 2013 with their signatures.

Kópavogur, 27 February 2014

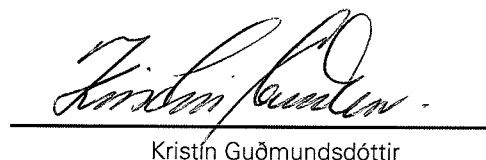
The Board of Directors of Farice ehf.



Martha Eiríksdóttir, Chairman



Ingþór Karl Eiríksson



Kristín Guðmundsdóttir



Pétur Richter



Ríkarður Ríkarðsson

Chief Executive Officer



Ómar Benediktsson

# Independent Auditors' Report

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To the Board of Directors and Shareholders of Farice ehf.

We have audited the accompanying financial statements of Farice ehf, which comprise the statement of financial position as at 31 December 2013, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

## **Management's Responsibility for the financial statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## **Auditors' responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**



In our opinion, the financial statements give a true and fair view of the financial position of Farice ehf. as at 31 December 2013, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

## **Report on the Report of the Board of Directors and the CEO**

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.

Reykjavík, 27 February 2014

**KPMG ehf.**

# Statement of Comprehensive Income for the year ended 31 December 2013

	Notes	2013	2012
Sale of bandwidth .....	5	9.646.534	7.998.793
Income from Public Service Contract .....	6	2.619.779	2.163.888
		<u>12.266.313</u>	<u>10.162.681</u>
Operating expenses .....	7	4.799.195	5.327.009
Administrative expenses .....	8	746.039	937.031
		<u>5.545.234</u>	<u>6.264.040</u>
<b>Profit before depreciation and finance items</b> .....		6.721.079	3.898.641
Depreciation .....	10	( 7.631.006)	( 7.843.297)
<b>Operating loss</b> .....		( 909.927)	( 3.944.656)
Finance income .....		2.368	2.573
Interest and indexation expenses .....	9	( 3.971.451)	( 4.629.550)
Exchange rate differences .....		( 2.319.527)	2.443.785
<b>Net finance cost</b> .....		<u>( 6.288.610)</u>	<u>( 2.183.192)</u>
<b>Total comprehensive loss for the year</b> .....		<u>( 7.198.537)</u>	<u>( 6.127.848)</u>

Notes on pages 10 to 25 are an integral part of these financial statements.

# Statement of Financial Position 31 December 2013

	Notes	31.12.2013	31.12.2012
<b>Assets</b>			
Operating assets .....	10	101.487.558	107.944.314
Prepaid expenses .....	11	1.814.826	1.904.080
Prepaid lease .....		45.063	90.039
Non-current assets		<u>103.347.447</u>	<u>109.938.433</u>
Trade receivables .....		284.934	465.866
Other receivables .....		199.207	216.500
Cash and cash equivalents .....		626.172	300.839
Current assets		<u>1.110.313</u>	<u>983.205</u>
<b>Total assets</b>		<u><u>104.457.760</u></u>	<u><u>110.921.638</u></u>
<b>Equity</b>			
Share capital .....	13	53.372.575	53.372.575
Other paid in capital .....	13	2.549.061	0
Accumulated deficit .....		( 8.892.064)	( 1.693.527)
Total equity		<u>47.029.572</u>	<u>51.679.048</u>
<b>Liabilities</b>			
Loans and borrowings .....	14	52.991.618	37.238.036
Loans and borrowings .....	14	3.463.970	20.873.712
Trade payables .....		192.675	394.415
Other liabilities .....		779.925	736.427
Current liabilities		<u>4.436.570</u>	<u>22.004.554</u>
Total liabilities		<u>57.428.188</u>	<u>59.242.590</u>
<b>Total equity and liabilities</b>		<u><u>104.457.760</u></u>	<u><u>110.921.638</u></u>

Notes on pages 10 to 25 are an integral part of these financial statements.

# Statement of Changes in Equity for the year ended 31 December 2013

	Notes	Share capital	Other paid in capital	Accumulated deficit	Total equity
<b>2012</b>					
Equity as at 1 January 2012 .....		83.492.512	0	( 25.666.933)	57.825.579
Total comprehensive loss for the year .....				( 6.127.848)	( 6.127.848)
Own shares acquired .....		( 1.331.351)		1.312.668	( 18.683)
Write down of shares .....		( 28.788.586)		28.788.586	0
Equity as at 31 December 2012 .....		<u>53.372.575</u>	<u>0</u>	<u>( 1.693.527)</u>	<u>51.679.048</u>
<b>2013</b>					
Equity as at 1 January 2013 .....		53.372.575	0	( 1.693.527)	51.679.048
Total comprehensive loss for the year .....				( 7.198.537)	( 7.198.537)
Other paid in capital .....	13		2.549.061		2.549.061
Equity as at 31 December 2013 .....		<u>53.372.575</u>	<u>2.549.061</u>	<u>( 8.892.064)</u>	<u>47.029.572</u>

Notes on pages 10 to 25 are an integral part of these financial statements.



# Statement of Cash Flows for the year ended 31 December 2013

	Notes	2013	2012
<b>Cash flow from operating activities</b>			
Loss for the year .....		( 7.198.537)	( 6.127.848)
Adjustments for:			
Depreciation .....	10	7.631.006	7.843.297
Net finance cost .....		6.288.610	2.198.610
		<u>6.721.079</u>	<u>3.914.059</u>
Changes in current assets and liabilities .....		265.801	225.018
Cash generated from operating activities before interest		<u>6.986.880</u>	<u>4.139.077</u>
Interest received .....		2.368	2.573
Interest paid .....		( 2.717.339)	( 2.781.734)
Net cash from operating activities		<u>4.271.909</u>	<u>1.359.916</u>
<b>Cash flows from investing activities</b>			
Acquisition of property and equipment .....	10	( 1.174.250)	( 127.576)
Net cash used in investing activities		<u>( 1.174.250)</u>	<u>( 127.576)</u>
<b>Cash flows from financing activities</b>			
Other paid in capital .....		650.000	0
Own shares acquired .....		0	( 18.683)
New short-term loans .....		0	2.000.000
Repayment of long-term loans .....		( 3.422.147)	( 3.305.682)
Net cash (used in) from financing activities		<u>( 2.772.147)</u>	<u>( 1.324.365)</u>
<b>Net increase (decrease) in cash and cash equivalents</b> .....		325.512	( 92.025)
<b>Cash and cash equivalents at 1 January</b> .....		300.839	408.282
<b>Effect of exchange rate fluctuations on cash held</b> .....		( 179)	( 15.418)
<b>Cash and cash equivalents at 31 December</b> .....		<u>626.172</u>	<u>300.839</u>
<b>Investing and financing activities not affecting cash flow</b>			
Repayment of long-term loans .....		( 1.899.061)	0
Additional paid in capital .....		1.899.061	0

Notes on pages 10 to 25 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.

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 27 February 2014.

### 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 10 - 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 10 - key assumptions used in discounted cash flow projections

- Note 12 - recoverability of deferred tax asset

## 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 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.

##### ***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.

Shares are ordinary shares with all normal voting rights and shall be entitled to the payment of dividend and can only be converted into shares in other share classes by a resolution of shareholder's meeting. The Company has the right to take a shareholders loan of up to EUR 5 million that can be converted into a new class of shares.

Upon purchase of treasury shares the acquisition price, including direct costs, is recognised as reduction from equity. When treasury shares are sold the sale is recognised as increase in equity.

## Notes, contd.:

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

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

##### (iii) Other paid in capital

The Company classifies a financial instrument as an equity instrument rather than a financial liability when the instrument includes no contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Company, and the instrument will or may be settled with a fixed number of shares in the Company.

Interest on such instruments is not expensed as the financial instrument will not be settled with cash or other financial assets.

#### 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

## 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.

##### **(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.:

### 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 2013, 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 76,8% of the revenues from sale of bandwidth of the Company (2012: 82,1%). 67,8% of the revenue from sold bandwidth comes from the domestic market.

### 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 possessions 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 period is five years, starting on 1 January 2012.

### 7. Operating expenses

	2013	2012
Backhaul .....	2.929.846	3.073.478
Cable stations and submarine cable maintenance support .....	860.589	800.816
Other operating expenses .....	1.008.760	1.452.715
Total operating expenses .....	<u>4.799.195</u>	<u>5.327.009</u>

Notes, contd.:

<b>8. Administrative expenses</b>	<b>2013</b>	<b>2012</b>
Salaries and salary-related expenses .....	440.712	455.114
Office rent .....	68.625	65.861
Auditing and accounting support .....	49.347	42.897
Other administrative expenses .....	187.355	373.159
Total administrative expenses .....	<u>746.039</u>	<u>937.031</u>
Salaries and salary-related expenses are specified as follows:		
Salaries .....	343.991	342.461
Contributions to pension funds .....	31.146	31.331
Other salary related expenses .....	65.575	81.322
Total salaries and other salary related expenses .....	<u>440.712</u>	<u>455.114</u>
Number of employees in full time equivalent units .....	4	4
Salaries and salary-related expenses to the Board of Directors .....	41.890	28.631
Salaries and salary-related expenses to the CEO .....	173.405	145.030
<b>9. Finance income and finance expenses</b>		
Interest- and indexation expenses are specified as follows:		
Interest expenses and borrowing costs .....	2.685.848	3.106.396
Indexation charge .....	1.285.603	1.523.154
Total finance expenses .....	<u>3.971.451</u>	<u>4.629.550</u>



## Notes, contd.:

### 10. Operating assets

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

	PoP/			Common	
	Backhaul/CS	Farice	Danice	Items	Total
<b>Total value</b>					
Total cost 1.1.2012 .....	18.323.383	46.878.987	90.697.604	4.427.583	160.327.557
Additions during the year .....	127.576			0	127.576
Disposals .....			( 9.729.500)	0	( 9.729.500)
Total cost 31.12.2012 .....	18.450.959	46.878.987	80.968.104	4.427.583	150.725.633
Additions during the year .....	0		1.174.250		1.174.250
Total cost 31.12.2013 .....	18.450.959	46.878.987	82.142.354	4.427.583	151.899.883
<b>Depreciation and impairment</b>					
Depreciated 1.1.2012 .....	6.478.425	15.901.008	17.943.008	4.345.081	44.667.522
Depreciation for the year .....	1.412.170	2.699.471	3.650.448	81.208	7.843.297
Disposals .....			( 9.729.500)	0	( 9.729.500)
Total depreciation 31.12.2012 .....	7.890.595	18.600.479	11.863.956	4.426.289	42.781.319
Depreciation for the year .....	1.220.580	2.699.471	3.710.610	345	7.631.006
Total depreciation 31.12.2013 .....	9.111.175	21.299.950	15.574.566	4.426.634	50.412.325
<b>Carrying amount</b>					
Carrying amount 1.1.2012 .....	11.844.958	30.977.979	72.754.596	82.502	115.660.035
Carrying amount 31.12.2012 .....	10.560.364	28.278.508	69.104.148	1.294	107.944.314
Carrying amount 31.12.2013 .....	9.339.784	25.579.037	66.567.788	949	101.487.558

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 a strong indication that an impairment loss will be recognised.

A minor decrease in the budget for revenues will result in an impairment loss. According to a sensitivity analysis within the impairment test a permanent 10% decrease in EBITDA will result in EUR 2,3 million impairment of assets. A 100 basis points increase in the discount rate will result in an impairment loss of EUR 8,8 million.

The PSA contract with the Icelandic Telecommunication Fund on behalf of the Icelandic State, described in note 5, has substantial effect on the income in the next 3 years.

### 11. Prepaid expenses

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

## Notes, contd.:

### 12. 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.

Deferred tax asset is as follows at the year end:	31.12.2013	31.12.2012
Property and equipment.....	(2.292.751)	(2.269.676)
Trade receivables.....	815	2.056
Deferred foreign exchange difference.....	(1.002.342)	(427.321)
Tax loss carryforward.....	14.203.267	10.933.539
Impairment of tax asset.....	(10.908.989)	(8.238.598)
	<u>0</u>	<u>0</u>

At year-end 2013 the Company has unused tax losses available for offset against future profits as follows:

Available until the year 2014 .....	121.425
Available until the year 2015.....	182.796
Available until the year 2018.....	2.129.532
Available until the year 2019.....	15.229.638
Available until the year 2020.....	20.284.936
Available until the year 2021.....	11.057.361
Available until the year 2022.....	11.531.389
Available until the year 2023.....	10.479.259
Unused tax losses total.....	<u>71.016.336</u>

### 13. Equity

#### a. Share capital

Total share capital is EUR 54.234.910. The nominal value of treasury shares is EUR 862.335, the nominal value of outstanding shares therefore amounts to EUR 53.372.575 at 31 December 2013. One vote is attached to each share of one EUR.

No dividend has been paid in 2013.

#### b. Other paid in capital

Two shareholders provided additional paid in capital to the company in January 2013, in the form of subordinated loans. According to the terms of the loan agreements the loans will be repaid by issuing new share capital in Farice ehf., at 31 December 2016, unless Farice decides to pay the loans with cash or other financial assets. The loan agreements therefore fulfill the conditions in IAS 32 to be presented as equity in the statement of financial position.

The total outstanding amount of the loans at 31 December 2013 is EUR 2.549.061, but it can go up to EUR 5.000.000. The total amount, as well as 10% interest per annum, will be converted to new shares in Farice in a new class B. The conversion rate will be one share in class B for each one EUR of the loans.

## Notes, contd.:

### 14. 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 15.

	2013			2012		
	Curr.	Year of maturity	Interest rate	Carrying amount	Interest rate	Carrying amount
Secured bond issue.....	ISK	2034	5,5% + indexed	36.021.961	5,5%	33.195.835
Secured bank loans.....	EUR	2017-2019	Euribor+0,8-2,12%	13.384.704	Euribor+0,8-2,12%	14.372.311
Secured loan.....	EUR	2018	Euribor + 4,5%	2.304.038	Euribor + 4,5%	2.685.886
Finance lease liabilities...	EUR	2018	Libor + 4,12%	3.337.485	Libor + 4,12%	4.024.588
Finance lease liabilities...	CHF	2018	Libor + 4,12%	645.522	Libor + 4,12%	792.403
Finance lease liabilities...	JPY	2018	Libor + 4,12%	640.682	Libor + 4,12%	986.269
Finance lease liabilities...	USD	2018	Libor + 4,12%	121.196	Libor + 4,12%	152.799
Convertible notes.....	ISK	2013		0	10,00%	1.901.657
				56.455.588		58.111.748
Current and due maturities.....				(3.463.970)		(20.873.712)
Total long term liabilities.....				52.991.618		37.238.036

Maturities are specified as follows over the next years:

	31.12.2013	31.12.2012
Year 2014 / 2013.....	3.463.970	20.873.712
Year 2015 / 2014.....	3.586.470	2.009.142
Year 2016 / 2015.....	3.715.039	2.109.164
Year 2017 / 2016.....	7.623.684	2.214.157
Year 2018 / 2017.....	5.595.562	2.324.379
Subsequent.....	32.470.863	28.581.194
	56.455.588	58.111.748

Current and due maturity is specified as follows:

Contractual repayments.....	3.463.970	3.296.566
Short term convertible notes.....	0	1.901.657
Classified as current due to breach in covenants.....	0	15.675.489
	3.463.970	20.873.712

Guarantees on longterm liabilities:

	31.12.2013	Guarantor/Guarantee
Secured bond issue, indexed.....	36.021.962	Icelandic State
Secured bank loans A-term.....	9.434.276	Icelandic State
Secured bank loans B1-term.....	1.794.691	Icelandic State
Secured bank loans B2-term.....	1.785.353	Skipti hf.
Secured bank loans.....	370.384	Trade receivables
Secured loan.....	2.304.038	Landing equipment
Finance lease liabilities.....	4.744.885	Leased equipment
	56.455.589	

## Notes, contd.:

### 14. Loans and borrowings contd.:

The bank loans are also guaranteed with 1st ranking securities in the subsea cables, landing stations and trade receivables. The Icelandic State has a 1st ranking security in the Danice cable system as collateral against its guarantee of the secured bond.

The terms of loan facilities include various provisions that limit certain actions by the company without prior consulting with the lender. In addition the loan facilities include certain financial covenants.

The terms of loan facilities include various provisions that limit certain actions by the company without prior consulting with the lender. In addition the loan facilities include certain financial covenants. At the reporting date the company does not fulfill covenants in loan agreements amounting to EUR 13,4 million. The company had waivers from those creditors at year end 2013 and has received extensions of the waivers for the next 12 months.

### 15. 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:

<b>31 December 2013</b>	<b>Loans and receivables</b>	<b>Financial liabilities</b>	<b>Carrying amount</b>
<b>Assets:</b>			
Cash and cash equivalents.....	626.172	0	626.172
Trade receivables.....	284.934	0	284.934
Other short-term receivables.....	199.207	0	199.207
	1.110.313	0	1.110.313
<b>Liabilities:</b>			
Loans and borrowings.....		56.455.588	56.455.588
Trade payables.....		192.675	192.675
Other short-term liabilities.....		779.925	779.925
		57.428.188	57.428.188
<b>31 December 2012</b>			
	<b>Cash and receivables</b>	<b>Financial liabilities</b>	<b>Carrying amount</b>
<b>Assets:</b>			
Cash and cash equivalents.....	300.839		300.839
Trade receivables.....	465.866		465.866
Other short-term receivables.....	216.500		216.500
	983.205	0	983.205
<b>Liabilities:</b>			
Loans and borrowings.....		58.111.748	58.111.748
Trade payables.....		394.415	394.415
Other short-term liabilities.....		736.427	736.427
		59.242.590	59.242.590

## Notes, contd.:

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### 16. 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:

	<b>2013</b>	<b>2012</b>
Trade receivables.....	284.934	465.866
Other short term receivables.....	199.207	216.500
Cash and cash equivalents.....	626.172	300.839
	<u>1.110.313</u>	<u>983.205</u>

The Company establishes an allowance for estimated impairment on trade receivables and other receivables. At year-end 2013 the allowance amounts to EUR 19.288 and has decreased by EUR 36.355 during the year 2013.

#### **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.

The total outstanding amount of the loans from shareholders, as disclosed in note 12, is EUR 2.549.061 as at 31 December 2013. According to the loan agreements the shareholders have agreed to provide Farice with EUR 5.000.000.

## Notes, contd.:

### 16. 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 2013</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.....	972.600	972.675	972.601		
Long-term loans.....	56.455.588	104.517.379	7.707.100	7.730.663	89.079.616
	<u>57.428.188</u>	<u>105.490.054</u>	<u>8.679.701</u>	<u>7.730.663</u>	<u>89.079.616</u>
Trade receivables.....	284.934	284.934	284.934		
Other receivables.....	199.207	199.207	199.207		
Cash and cash equivalents.....	626.172	626.172	626.172		
	<u>1.110.313</u>	<u>1.110.313</u>	<u>1.110.313</u>	<u>0</u>	<u>0</u>
Net balance 31.12.2013.....	56.317.875	104.379.741	7.569.388	7.730.663	89.079.616
<b>Year end 2012</b>					
Trade and other payables.....	1.130.842	1.130.842	1.130.842		
Long-term loans.....	58.111.748	104.164.899	4.936.512	4.582.603	110.330.415
	<u>59.242.590</u>	<u>105.295.741</u>	<u>6.067.354</u>	<u>4.582.603</u>	<u>110.330.415</u>
Trade receivables.....	465.866	465.866	465.866	0	0
Other receivables.....	216.500	216.500	216.500	0	0
Cash and cash equivalents.....	300.839	300.839	300.839	0	0
	<u>983.205</u>	<u>983.205</u>	<u>983.205</u>	<u>0</u>	<u>0</u>
Net balance 31.12.2012.....	58.259.385	104.312.536	5.084.149	4.582.603	110.330.415

#### 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 2013</b>	<b>Assets</b>	<b>Liabilities</b>	<b>Net exposure</b>
JPY.....		640.682 (	640.682)
USD.....		121.196 (	121.196)
CHF.....		645.522 (	645.522)
ISK.....	129.789	36.513.273 (	36.383.484)
GBP.....	84.923		84.923
Net exposure.....	<u>214.712</u>	<u>37.920.673 (</u>	<u>37.705.961)</u>

## Notes, contd.:

### 16. Financial instruments, contd.:

Year 2012	Assets	Liabilities	Net exposure
JPY.....	0	986.269 (	986.269)
USD.....	20	152.799 (	152.779)
CHF.....	0	792.403 (	792.403)
ISK.....	49.414	35.513.840 (	35.464.426)
GBP.....	92.079	50.349	41.730
DKK.....	0	269.730 (	269.730)
Net exposure.....	141.513	37.765.390 (	37.623.877)

The following exchange rates applied during the year:

	Average exchange rate		End of year exchange rate	
	2013	2012	2013	2012
JPY.....	129,26	102,39	144,66	113,54
USD.....	1,33	1,29	1,38	1,32
CHF.....	1,23	1,21	1,23	1,21
ISK.....	162,38	161,18	158,94	170,27
GBP.....	0,85	0,81	0,83	0,82
DKK.....	7,46	7,44	7,46	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.

	31.12.2013		31.12.2012	
	5%	10%	5%	10%
JPY.....	( 25.628)	( 51.255)	( 39.451)	( 78.902)
USD.....	( 4.848)	( 9.696)	( 6.111)	( 12.222)
CHF.....	( 25.821)	( 51.642)	( 31.696)	( 63.392)
DKK.....	0	0	( 10.789)	( 21.578)
ISK.....	( 1.455.340)	( 2.910.679)	( 1.418.577)	( 2.837.154)
GBP.....	3.397	6.794	( 1.669)	( 3.338)

##### 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.:

### 16. Financial instruments, contd.:

#### Exposure to interest rate risk

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

	2013	2012
<b>Financial instruments with fixed interest rate</b>		
Financial liabilities.....	0	(1.901.657)
	<u>0</u>	<u>(1.901.657)</u>
<b>Financial instruments with floating interest rate</b>		
Financial assets.....	626.172	300.839
Financial liabilities.....	(56.455.588)	(56.210.091)
	<u>(55.829.416)</u>	<u>(55.909.252)</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) the return by the 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 2012.

	Effect on profit or loss	
	100 bp increase	100 bp decrease
<b>2013.</b>		
Financial instruments with floating interest rates.....	5.009	(5.009)
Cash flow sensitivity analysis, net.....	(163.469)	163.469
	<u>(158.460)</u>	<u>158.460</u>
<b>2012</b>		
Financial instruments with floating interest rates.....	24	(24)
Cash flow sensitivity analysis, net.....	(449.681)	449.681
	<u>(449.657)</u>	<u>449.657</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:

	2013		2012	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest bearing liabilities.....	56.455.588	59.062.254	58.111.748	64.299.504
	<u>56.455.588</u>	<u>59.062.254</u>	<u>58.111.748</u>	<u>64.299.504</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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### **17. 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 2013 and 2012 and Farice did not buy any goods or service from related parties in 2013 and 2012.

As discussed in note 12 two shareholders provided the company with additional capital in the form of subordinated loans during the year 2013. The total outstanding amount of the loans at 31 December 2013 is EUR 2.549.061. The subordinated loans were used to pay convertible notes from the same shareholders.

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 5.

### **18. 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 45,0% at year end 2013 (2012: 46,6%).

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.