Íslandspóstur

ÁRSSKÝRSLA / ANNUAL REPORT 2014

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Advance and defence

In 1997, the Icelandic government made the formal decision to create a limited liability company for the operation of Íslandspóstur (Iceland Post). This was in accordance with the changes that had already been made, together with anticipated changes, to other mail companies in many parts of the world.

The main objective was to operate postal services on a privatised basis, as applies to the operation of other limited liability companies, with the aim of making postal services financially independent. The purpose was to ensure that the universal postal service would not have to be funded by tax payers.

Postal services are the responsibility of the state according to law. According to its operating license, Iceland Post has undertaken the responsibility of the state to ensure postal services for the entire country. The role of Iceland Post, according to its Articles of Association, is to provide reliable services for businesses and private persons in the field of mail distribution, communications and logistics solutions and any other related services. The main field of operation of the company, therefore, involves the distribution of mail and parcels as well as sale of goods. Iceland Post's business model is based on returning acceptable dividends to its owners based on annual profits of 10% of equity as well as increasing the value of the company by ensuring profitable growth.

Iceland Post's losses in 2014 amountsed to 43 million ISK. This is somewhat less than the losses in 2013, although there is still some way to go to ensure that the operation of the company returns the profits according to its business model. With the continued decline in the volume of letters, further losses in the operation of Iceland Post may be expected over the next few years if requirements in laws and regulations as regards universal services remain unchanged. The loss will increase year after year and will reduce the company's equity if necessary actions, that are dependent on changes to laws and regulations regarding delivery, are not taken.

The backbone of the operation of Iceland Post is its distribution network, which is based on reliability and speed. The distribution network is decreasingly supported by letters and increasingly by parcels. The number of letters has declined by 51% since 2000, while at the same time, the number of homes and businesses, and thereby mailboxes, has increased considerably. Thus, the cost of the distribution network increases at the same time as such cost is divided among ever fewer letters if account is not taken of the other aspects involved, such as the increase in the number of parcel deliveries and economisation in operations. Iceland Post has established and bought companies in related and value-adding operations and has become an agent for several sales and service companies. The objective is to achieve better utilisation of the operations that form the basis of the company. These operations are for the most part outside the defined universal services provision of Iceland Post and earned the company 1,700 million ISK and around 240 million ISK in profits in 2014.

The European Union has identified ecommerce as one of the key aspects of strengthening economic growth in Europe. At the end of 2012, the European Commission published two documents on parcel delivery services containing five goals for increased provision of such services to be attained before mid year 2015. Iceland Post has, in co-operation with its partners, been working toward adopting these goals. By this, the company aims to offer broader and better services in parcel delivery, which could considerably facilitate ecommerce here in Iceland, both domestically as well as crossborder.

Growth in logistics and retail, however, cannot be expected to cover Iceland Post's losses due to the decline in letters and increased cost of universal services. In addition to increases in postage prices, which are lowest in Iceland when compared to our neighbours, such as the other Nordic countries, the UK and Germany according to a study published by the Swedish Post and Telecom Authority (PTS) last year, the management of Iceland Post has repeatedly pointed out ways to reduce costs which must be implemented in the next few years to cover further decline in letters. These include a decision on the distribution of letters every other working day instead of on every working day, the requirement of situating letterboxes by the

street, as is the case in neighbouring countries, and continuing with increasing the use of mobile post offices rather than maintaining the operation of post offices in their current form.

Iceland Post adopted several changes to its strategy in 2014. These were formulated by key employees and were approved by the Board of Directors in late 2013. The strategy is set out in five main categories relating to (i) increasing the future value of the company, (ii) growing in domestic and overseas parcel transport and delivery, (iii) responding to changed communications needs with electronic services, (iv) adapting the distribution network to the reduced volume of letters and (v) increasing the sale of goods and services. In addition, it was assumed that in conjunction with declining letter volumes, efforts would be made to advance in other fields and thereby combat considerable income reduction.

There have been significant changes in the operation and operational environment of Iceland Post in recent years. Ahead are even more changes, new opportunities and great challenges. The company's strategy is intended to ensure maximum success and to be a guide for employees in the tasks ahead. The Board of Directors and employees of Iceland Post are determined to meet the needs of the company's customers by strengthening and increasing its services in various fields. Over the next few years, the focus will first and foremost be on basic operations and related service fields. In addition, changes will have to be made to the laws and regulations applicable to postal services, with the view of adapting the service to the needs of customers, further increasing economisation and keeping an eye out for new opportunities, for new partners and for synergies with other profitable operations. Thus, there are numerous opportunities to develop Iceland Post in accordance with the provisions of laws and the company's Articles of Association for the benefit of its customers, employees and owners.

Ingimundur Sigurpálsson,
Managing Director & CEO

There have been considerable changes in the operation and operational environment of Íslandspóstur in recent years. Ahead are even more changes, new opportunities and great challenges.

Consolidated Financial Statements

Endorsement and statement by the Board of Directors and the Managing Director

Operations in 2014

The financial statements include the consolidated financial statements of Íslandspóstur ohf. and its subsidiaries, Trönur ehf., Samskipti ehf., Frakt flutningsmiðlun ehf., ePóstur ehf. and Gagnageymslan ehf. which was acquired at end of June 2014.

The Group's loss for the year amounted to ISK 43 million according to the income statement. Equity as at December 31, 2014 amounted to ISK 2.314 million according to the balance sheet. The Company's share capital as at December 31, 2014 amounted to ISK 1.448 million and is entirely owned by the State.

The Company's operating result for the year 2014 was unsatisfactory. In recent years it has become evident that the managements limited scope for pricing decisions and streamlining the Company's operation has significantly prevented efficient and necessary response to changes in the operational environment. Decisions regarding the pricing of letters within the exclusive right and rationalisation of the universal service have prevented the company from reaching an acceptable operating result, see note 23. In a declining letter market, it is of vital importance that administrative decisions regarding pricing and scope of the postal service, be taken in a more timely manner than until now, so that the company be able to react in a timely and appropriate way to changes in the operational environment.

Corporate governance

The Board of Directors of Íslandspóstur endeavours to maintain good corporate governance in line with the Guidelines on Corporate Governance issued by the Icelandic Chamber of Commerce in collaboration with the Confederation of Icelandic Employers and Nasdaq OMX Iceland. The Board of Directors operates on the basis of the Company's Articles of Association and the Board of Directors operating procedures. The procedures include among other things definition of the competences and division of tasks between the Directors of the Board, provisions on the qualification of the Directors of the Board, confidentiality rules.

Statement by the Board of Directors and the Managing Director

The annual consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

According to the best of our knowledge, it is our opinion that the consolidated financial statements give a true and fair view of the consolidated financial performance of the Group for the financial year 2014, its assets, liabilities and consolidated financial position as at December 31, 2014 and its consolidated cash flows for the financial year 2014.

Further, in our opinion the consolidated financial statements and the Endorsement of the Board of Directors and the Managing Director gives a fair view of the development and performance of the Group's operations and its position and describes the principal risks and uncertainties faced by the Group.

The Board of Directors and the Managing Director of Íslandspóstur ohf. have today discussed the Company's consolidated financial statements for the year 2014 and confirm them by means of their signatures. The Board of Directors and the Managing Director recommend that the consolidated financial statements be approved at the annual general meeting of Íslandspóstur ohf.

Reykjavik, 19th of February, 2015.

The Board of Directors:

Eiríkur Haukur Hauksson, Svanhildur Hólm Valsdóttir

Jón Ingi Cæsarsson, Ólöf Kristín Sveinsdóttir, Preben Jón Pétursson

Managing Director:

Ingimundur Sigurpálsson

Auditor´s report

To the Board of Directors and Shareholders of Íslandspóstur ohf.

We have audited the accompanying consolidated financial statements of Íslandspóstur ohf., and its subsidiaries, (the Group), which comprise the balance sheet as at December 31, 2014 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the financial statements

The Board of Directors and CEO are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of 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 judgement, 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 consolidated financial statements give a true and fair view of the consolidated financial position of Íslandspóstur ohf. as at December 31, 2014 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Report on the Board of Directors report

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 consolidated financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the consolidated financial statements.

Reykjavik, 19th of February, 2015.

The National Audit Office of Iceland:

Sveinn Arason

Auditor General CPA

Óskar Sverrisson

Auditor CPA

Income statement for the year 2014

	Notes	2014	2013
OPERATING REVENUES			
Postal services		6.237.375	5.934.931
Other revenues		1.041.125	851.890
		7.278.500	6.786.821
OPERATING EXPENSES			
Salaries and salary related expenses	5	3.994.529	3.751.412
Direct cost of postal distribution		1.538.269	1.607.110
Other operating expenses		1.266.424	1.078.780
		6.799.222	6.437.302
EBITDA		479.278	349.519
Depreciation	8	(410.291)	(349.862)
EBIT		68.987	(343)
Financial income		20.360	15.770
Financial expenses		(131.058)	(157.303)
Net financial expenses	7	(110.698)	(141.533)
Loss before income tax		(41.711)	(141.876)
Income tax	16	(1.266)	23.100
Comprehensive loss for the year		(42.977)	(118.776)
TOTAL COMPREHENSIVE INCOME ATTRIBUTABLE TO:			
Owners of the Company		(50.560)	(117.612)
Non-controlling interests		7.583	(1.164)
Total comprehensive income (loss) for the year		(42.977)	(118.776)
EARNINGS PER SHARE AND DILUTED EARNINGS PER SHARE			
Earnings and diluted earnings per share on each ISK 1 share	3.l	(0,03)	(0,08)

Balance sheet December 31, 2014

ASSETS	Notes	2014	2013
Property, plant and equipment	8	3.307.642	3.243.710
Shares in other companies	9	80.372	80.372
Bonds	10	16.171	20.973
NON-CURRENT ASSETS		3.404.185	3.345.055
Inventories	11	196.896	200.390
Accounts receivable and other receivables	12	1.134.836	981.146
Cash and cash equivalents	13	86.725	276.175
Assets held for sale	14	50.140	27.140
CURRENT ASSETS		1.468.597	1.484.851
TOTAL ASSETS		4.872.782	4.829.906
EQUITY			
Share capital	15	1.447.500	1.447.500
Statutory reserve		351.378	351.378
Retained earnings		506.577	557.137
EQUITY ATTRIBUTABLE TO OWNERS OF THE COMPANY		2.305.455	2.356.015
Non-controlling interests		8.137	554
EQUITY		2.313.592	2.356.569
LIABILITIES			
Debenture loans	19	1.385.540	1.484.459
Income tax liability	17	21.970	20.704
LONG TERM LIABILITIES		1.407.510	1.505.163
Accounts payable and other short term liabilities	18	1.151.680	968.174
SHORT TERM LIABILITIES		1.151.680	968.174
LIABILITIES		2.559.190	2.473.337
TOTAL EQUITY AND LIABILITIES		4.872.782	4.829.906

Statement of changes in equity for the year 2014

	Share capital	Statutory reserve	Retained earnings	Total	Non-controlling interests	Total equity
YEAR 2014						
Equity 1.1.2014	1.447.500	351.378	557.137	2.356.015	554	2.356.569
Net (loss) income for the year			(50.560)	(50.560)	7.583	(42.977)
Equity 31.12.2014	1.447.500	351.378	506.577	2.305.455	8.137	2.313.592
YEAR 2013						
Equity 1.1.2013	1.447.500	351.378	689.749	2.488.627	(2.032)	2.486.595
Dividends to shareholders ..			(15.000)	(15.000)		(15.000)
Contribution from non-controlling shareholders				0	3.750	3.750
Net loss for the year			(117.612)	(117.612)	(1.164)	(118.776)
Equity 31.12.2013	1.447.500	351.378	557.137	2.356.015	554	2.356.569

Statement of cash flows for the year 2014

CASH FLOWS FROM OPERATING ACTIVITIES	Notes	2014	2013
Loss for the year		(42.977)	(118.776)
Operating items not affecting cash flow:			
Gain on sale of assets		(4.377)	(12.180)
Depreciation	8	410.291	349.862
Net financial expenses	7	110.698	141.533
Income tax	16	1.266	(23.100)
WORKING CAPITAL FROM OPERATING ACTIVITIES		474.901	337.339
Changes in operating assets and liabilities:			
Inventories, decrease (increase)		5.494	(5.920)
Short term receivables, (increase)		(186.699)	(172.150)
Short term liabilities, increase		140.382	8.220
CASH GENERATED FROM OPERATING ACTIVITIES		(40.823)	(169.850)
Interest received		11.158	14.858
Interest paid		(76.691)	(78.600)
NET CASH FROM OPERATING ACTIVITIES		368.545	103.747
CASH FLOWS FROM INVESTING ACTIVITIES			
Real estates and land	8	(82.289)	(31.788)
Machinery, equipment and vehicles	8	(361.590)	(262.019)
Proceeds from the sales of fixed assets		14.895	36.591
Other changes		(25.420)	6.189
NET CASH USED IN INVESTING ACTIVITIES		(454.404)	(251.027)
CASH FLOWS FROM FINANCING ACTIVITIES			
New loans		0	250.000
Dividends paid		0	(15.000)
Contribution from non-controlling shareholders		0	3.750
Repayment on long-term loans		(103.591)	(98.251)
NET CASH USED IN FINANCING ACTIVITIES		(103.591)	140.499
DECREASE IN CASH AND CASH EQUIVALENTS		(189.450)	(6.781)
CASH AND CASH EQUIVALENTS AT YEAR BEGINNING		276.175	282.956
CASH AND CASH EQUIVALENTS AT YEAR END	13	86.725	276.175

Notes

1. REPORTING ENTITY

Íslandspóstur ohf. ("the Company") is a company domiciled in Iceland. The address of the Company's registered office and headquarters is Stórhöfði 29, Reykjavík. The consolidated financial statements of the Company as at and for the year ended December 31, 2014 comprise the Company and its subsidiaries, together referred to as the "Group".

2. BASIS OF PREPARATION

a. Statement of compliance

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRSs) as approved by EU.

The Company's Board of Directors approved the consolidated financial statements on February 19, 2015.

b. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for shares in other companies, which are stated at fair value.

c. Functional and presentation currency

These consolidated financial statements are presented in Icelandic kronas, which is the Company's functional currency. All financial information presented in Icelandic kronas has been rounded to the nearest thousand.

d. Use of estimates and judgements

The preparation of financial statements in conformity with IFRSs 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 recognised in the period in which the estimates are revised and in any future periods affected.

3. SIGNIFICANT ACCOUNTING POLICIES

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

a. Basis of consolidation

(i) *Business combinations*

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment. Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if related to the issue of debt or equity securities.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Any contingent consideration is measured at fair value at the date of acquisition. If an obligation to pay contingent consideration that meets the definition of a financial instrument is classified as equity, then it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

If share-based payment awards (replacement awards) are required to be exchanged for awards held by the acquiree's employees (acquiree's awards), then all or a portion of the amount of the acquirer's replacement awards is included in measuring the consideration transferred in the business combination. This determination is based on the market-based measure of the replacement awards compared with the market-based measure of the acquiree's awards and the extent to which the replacement awards relate to pre-combination service.

Notes cont.

3. SIGNIFICANT ACCOUNTING POLICIES, CONT.

a. Basis of consolidation, cont.

(ii) *Subsidiaries*

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

(iii) *Non-controlling interests*

NCI are measured at their proportionate share of the acquiree's identifiable net assets at the date of acquisition.

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

(iv) *Loss of control*

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related NCI and other components of equity. Any resulting gain or loss is recognised in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

(v) *Transactions eliminated on consolidation*

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated.

b. Foreign currency

Transactions in foreign currencies are translated to the functional currency at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss arising is recognised in the income statement.

c. Financial instruments

Financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Cash and cash equivalents comprise cash balances and call deposits.

(i) *Available-for-sale financial assets*

The Group's investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein are recognised directly in equity. When investments in equity securities do not have a quoted market price in an active market and whose fair value cannot be reliably measured they are measured at cost less any impairment recognised. Fair value changes recognised in equity are transferred to the income statement when the recognition of the available-for-sale financial asset in the financial statements is discontinued.

Notes cont.

3. SIGNIFICANT ACCOUNTING POLICIES, CONT.

d. Property, plant and equipment

(i) *Recognition and measurement*

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognised net within “other income” in the income statement.

(ii) *Subsequent costs*

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. All other cost is recognised in the income statement as incurred.

(iii) *Depreciation*

Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated. The estimated useful lives are specified as follows:

Buildings	20-25 years
Machines, equipment and vehicles	3-10 years

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

e. Inventories

Inventories are measured at the lower of cost and net realisable value. The net realisable value is the estimated sales value in transactions between unrelated parties less estimated cost of selling the goods. The cost of inventories is based on the average cost principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

f. Impairment

(i) *Financial assets*

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in the income statement. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to the income statement.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost the reversal is recognised in the income statement.

Notes cont.

3. SIGNIFICANT ACCOUNTING POLICIES, CONT.

f. Impairment, cont.

(ii) *Other assets*

The carrying amounts of the Group's non-financial assets, other than inventories (see accounting method e) 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. For goodwill, the recoverable amount is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement.

The recoverable amount of an asset or cash-generating unit 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 in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. 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 amortisation, if no impairment loss had been recognised.

g. Fixed assets held for sale

Fixed assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets (or components of a disposal group) are remeasured in accordance with the Group's accounting policies. Thereafter generally the assets (or disposal group) are measured at the lower of their carrying amount and net fair value.

Any impairment loss on a disposal group first is allocated to goodwill, and then to remaining assets and liabilities on pro rata basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, investment property and biological assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in the income statement. Gains are not recognised in excess of any cumulative impairment loss.

h. Obligations

An obligation is recognised in the financial statements if the Group has a present legal or constructive obligation due to past events, it is likely that payment will take place and it can be measured reliably.

The Company has engaged in paying a pension fund contribution to the Pension Fund of State Employees amounting to 6% of the difference betweeen total salaries and standard salaries of those employees exploiting their right to payment of pension fund premiums while working for the Company.

i. Revenue

The Group's revenues on service are recognised in the income statement in the month, in which the service is rendered without regard for when settlement therefore is received. Revenue on sale of goods is recognised in the income statements when the ownership is transferred to the buyer.

j. Financial income and expenses

Finance income comprises interest income on funds invested, foreign exchange gain on foreign currencies and dividends received. Interest income is recognised as it accrues in the income statement. Finance expenses comprise interest expense on borrowings and foreign exchange loss on foreign currencies.

Notes cont.

3. SIGNIFICANT ACCOUNTING POLICIES, CONT.

k. Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the income statement loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised 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 not recognised for the temporary differences due to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future and that the parent company can manage when differences are reversed. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. 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 realised.

l. Earnings per share

The Group presents basic and diluted earnings per share data for its ordinary shares, which are calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. The Company has neither concluded option agreements nor acquired new loans convertible into share capital so diluted earnings per share equals basic earnings per share.

m. New standards and interpretations

All new standards and amendments to standards effective for annual periods beginning after January 1, 2014, have been applied in preparing these consolidated financial statements. The effect on the consolidated financial statements of the Group is immaterial.

4. FINANCIAL RISK MANAGEMENT

Overview

The Group has exposure to the following risks:

* credit risk
* liquidity risk
* market risk

This note presents information about the Group’s exposure to each of the above risks, the Group’s objectives, policies and processes for measuring and managing risk, and the Group’s management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Group’s risk management framework. The Board has assigned to the Director of the parent company the task of monitoring the Group's daily risk management.

The Group’s risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group’s activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

Notes cont.

4. FINANCIAL RISK MANAGEMENT, CONT.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers.

Trade and other receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The demographics of the Group's customer base, including the default risk of the industry and country in which customers operate, has less of an influence on credit risk.

The Group has established a credit policy under which all new customers are measured before the Group's standard payment and delivery terms and conditions are offered. Each new customer is analysed individually for creditworthiness and credit limits are set. When managements feel it is needed a guarantee is requested.

Most of the Group's customers have been its customer for many years and there have been insubstantial losses on receivables in proportion to turnover. Credit risk management due to customers mainly involves age of receivables and financial standing of single customers. The Group's accounts receivable and other receivables both regard individuals and companies. Customers classified as "high risk" may not have further credit transactions with the Group unless their debt is settled.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables and investments. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

The allowance for impairment of accounts receivables at year end amounts to ISK 146 million (2013: ISK 112 million) and the allowance for impairment of notes receivables at year end amount to ISK 3 million (2013: ISK 3 million).

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due.

Residual contractual maturities of financial liabilities are specified as follows at year-end:

2014	Book value	Within 1 year	2-3 years	4-5 years	More than 5 years
Debenture loans	1.518.003	213.543	421.749	406.774	1.623.603
Accounts payable and short term payables	1.151.680	1.151.680			
	2.669.683	1.365.223	421.749	406.774	1.623.603
2013					
Debenture loans	1.612.505	224.796	437.207	417.241	1.782.365
Accounts payable and short term payables	968.174	968.174			
	2.580.679	1.192.970	437.207	417.241	1.782.365

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Notes cont.

4. FINANCIAL RISK MANAGEMENT, CONT.

Market risk, cont.

Currency risk

Of the Group's borrowing which totals 4% in foreign currency, a curve of EUR, CHF and JPY, proposes currency risk which is not hedged. Intrest rates on these borrowings are much lower than on borrowings by the Parent Company denominated in ISK.

The Group is exposed to currency risk on receivables from foreign postal managements and customers denominated in a currency other than the respective functional currencies of Group entities. Those currencies mainly creating foreign exchange risk are SDR and EUR. The Group does not, in general hedge against currency risk but foreign exchange rate changes would have insignificant effect on the Group's return.

Interest rate risk

The Group's borrowings in ISK are bound by consumer price index and carry both fixed and variable interests. Borrowings in foreign currencies carry fixed interests. If the interest rate would have been 1% higher the Group's return would have been ISK 15 million lower in the year 2014 but ISK 15 million higher had the interest rate been 1% lower. If interest rates in the year 2013 had been 1% higher the return for the year 2013 would have been ISK 16 million lower and at the same time ISK 16 million higher had the interest rate for the year 2013 been 1% lower.

Other market price risk

Other market price risk is limited, as investments in bonds and shares are an insubstantial part of the Group's operation.

Capital management

The Board's policy is to maintain a strong capital base to sustain future development 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 Company is not obliged to comply with external rules on minimum equity.

5. SALARIES AND SALARY RELATED EXPENSES

Salaries, salary related expenses and other personnel expenses are specified as follows:	2014	2013
Salaries	3.178.386	2.988.652
Contribution to defined contribution fund	308.569	288.316
Salary related expenses	306.389	290.109
Other personnel expenses	201.185	184.335
Total salaries and salary related expenses	3.994.529	3.751.412
Full-time equivalent units	790	786

Salaries and perquisite of the Board of Directors and executive management amounted to ISK 100 million (2013: ISK 95 million) during the year, whereof the salaries of the President amounted to ISK 14 million (2013: ISK 14 million) and the salaries of Directors of the Board amounted to ISK 7 million (2013: ISK 7 million). Salaries of the Chairman of the Board are the double of the salaries of a Director of the Board. Agreements with the Company's management neither include provisions on option rights to shares in the Company nor special employment termination payments.

The remaining balance of employment termination agreements amounted to ISK 18 million (2013: ISK 18 million), which is accounted for in the financial statements.

Notes cont.

6. AUDITOR'S FEE

Payments to the Icelandic National Audit Office are specified as follows:

	2014	2013
Audit of financial statements	6.381	5.785
Interim financial statements review	4.138	4.488
Total	10.519	10.273

7. FINANCIAL INCOME AND EXPENSES

Financial income and expenses are specified as follows:

	2014	2013
Interest earned and indexation	11.698	8.488
Dividend	8.662	7.282
Total financial income	20.360	15.770
Interest expenses and indexation	(121.915)	(129.524)
Foreign exchange difference	(9.143)	(27.779)
Total financial expense	(131.058)	(157.303)
Total net financial expense	(110.698)	(141.533)

8. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment and depreciation are specified as follows:

	Real estates and land	Machinery, equipment and vehicles	Total
Cost price			
Balance at 1.1.2013	3.128.074	2.720.997	5.849.071
Additions during the year	31.788	262.019	293.807
Disposals	(25.226)	(72.174)	(97.400)
Balance at 31.12.2013	3.134.636	2.910.842	6.045.478
Balance at 1.1.2014	3.134.636	2.910.842	6.045.478
Additions do to merger	0	5.005	5.005
Additions during the year	82.289	361.590	443.879
Disposals	(804)	(173.888)	(174.692)
Balance at 31.12.2014	3.216.121	3.103.549	6.319.670
Depreciation			
Balance at 1.1.2013	1.097.136	1.427.780	2.524.916
Depreciation for the year	127.042	222.820	349.862
Disposals	(14.715)	(58.295)	(73.010)
Balance at 31.12.2013	1.209.463	1.592.305	2.801.768
Balance at 1.1.2014	1.209.463	1.592.305	2.801.768
Additions do to merger	0	1.460	1.460
Depreciation for the year	125.821	284.470	410.291
Disposals	(805)	(200.686)	(201.491)
Balance at 31.12.2014	1.334.479	1.677.549	3.012.028

Notes cont.

8. PROPERTY, PLANT AND EQUIPMENT, CONT.

	Real estates and land	Machinery, equipment and vehicles	Total
Book value			
1.1.2013	2.030.938	1.293.217	3.324.155
31.12.2013 and 1.1.2014	1.925.173	1.318.537	3.243.710
31.12.2014	1.881.642	1.426.000	3.307.642
Depreciation rates	0-5%	10-33%	

Insurance and evaluation of assets

Insurance value, rateable value and book value of real estates and land at year end were as follows:

	2014	2013
Insurance value of real estates	3.638.743	3.597.731
Rateable value of real estates and land	1.994.303	1.871.729
Book value of real estates and land	1.881.642	1.925.173

Mortgages

The Group's operating assets are pledged for an insurance bill and bonds to secure liabilities amounting to ISK 828 million at year end (2013: ISK 864 million.)

9. SHARES IN OTHER COMPANIES

Shares in other companies are specified as follows:	2014		2013	
	Nominal value	Book value	Nominal value	Book value
Internet á Íslandi hf.	3.781	45.352	3.781	45.352
Vörusjá ehf.	27.500	27.500	27.500	27.500
Sendill is Unimaze ehf.	25	5.000	25	5.000
Eurogiro, nominal value 100 thousand DKK		2.520		2.520
Total shares in other companies		80.372		80.372

10. BONDS

Bonds are specified as follows:	2014	2013
Balance at 1.1	27.870	32.889
Indexation	679	1.168
Maturities	(6.969)	(6.921)
Change in allowance	789	734
Next year's maturities	(6.198)	(6.897)
Bonds at 31.12	16.171	20.973

11. INVENTORIES

Inventories at year end are specified as follows:	2014	2013
Inventories, consumables	104.332	96.867
Inventories, postage stamps	92.564	103.523
Total inventories	196.896	200.390

Inventories recognised as cost of sales amounted to ISK 155 million. (2013: ISK 130 million.)

Notes cont.

12. ACCOUNTS RECEIVABLE AND OTHER RECEIVABLES

Accounts receivable and other receivables are specified as follows:	2014	2013
Nominal value of accounts receivable	904.975	776.327
Write down of probable loss on accounts receivable	(145.864)	(112.286)
Next year's payment on bonds	6.198	6.897
Various short term receivables	369.527	310.208
Total accounts receivable and other receivables	1.134.836	981.146

13. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are specified as follows:	2014	2013
Market securities	23.286	22.523
Current bank deposits	59.155	248.984
Funds	4.284	4.668
Total cash and cash equivalents	86.725	276.175

14. ASSETS HELD FOR SALE

Fixed assets held for sale are specified as follows:	2014	2013
Balance at 1.1	27.140	27.140
Addition	23.000	0
Total fixed assets held for sale	50.140	27.140

15. EQUITY

Share capital

The Company's total share capital according to its Articles of Association amounts to ISK 1.448 million and have all been paid for. One vote is attached to each ISK 1 share in the Company.

Dividends

No dividends paid in the year 2014 (2013: ISK 15 million).

Statutory reserve

The Company has the obligation to allocate at least 10% of its profit, which is not used to meet possible losses of previous years and is not allocated into other statutory reserves, into a legal reserve until reaching 10% of share capital. When that target has been reached, contributions must be at least 5% until the reserve amounts to 25% of share capital. The Company has received payments exceeding the nominal value for shares when share capital was increased, and the paid amount in excess of the nominal value has been allocated to the premium account. The Company may use the legal reserve to settle against a loss that can not be settled with other reserves. When the reserve amounts to more than 25% of share capital, the amount in excess may be used to increase share capital or, in accordance with provisions of Article 53 of the Act on Limited Companies, no. 2/1995, for other concerns.

Notes cont.

16. INCOME TAX EXPENSE

Income tax in the income statement is specified as follows:	2014	2013
Deferred taxes		
Temporary differences	1.266	(23.100)
Income tax recognised in the income statement	1.266	(23.100)

Effective income tax is specified as follows:		2014		2013
Profit (loss) for the year		(42.977)		(118.776)
Income tax		1.266		(23.100)
Loss before income tax		(41.711)		(141.876)
Income tax according to current income tax rate	20,0%	(8.342)	20,0%	(28.375)
Effects of taxable losses	(23,0%)	9.608	(3,7%)	5.302
Other	0,0%	0	0,0%	(27)
Effective tax rate	(3,0%)	1.266	16,3%	(23.100)

17. INCOME TAX LIABILITY

The Company's income tax liability is specified as follows:	2014	2013
Income tax liability at 1.1	20.704	43.804
Calculated income tax for the year	1.266	(23.100)
Income tax liability at 31.12	21.970	20.704

Income tax liability is specified as follows at year end:		
Property, plant and equipment	45.762	38.071
Accounts receivable	(18.409)	(13.460)
Deferred foreign exchange difference	(187)	(3.631)
Tax loss carry-forwards	(22.065)	0
Valuation allowance	16.765	0
Inventories	104	64
Other items	0	(340)
Total	21.970	20.704

18. ACCOUNTS PAYABLE AND OTHERS SHORT-TERM PAYABLES

Accounts payable and other short-term payables are specified as follows:	2014	2013
Accounts payable	516.895	415.930
Other short-term payables	634.785	552.244
Total accounts payable and other short-term payables	1.151.680	968.174

19. INTEREST BEARING LIABILITIES

Interest bearing liabilities are specified as follows:	2014	2013
Loans bound by consumer price index	1.436.833	1.520.955
Loans in ISK, non-indexed	14.675	19.288
Loans in EUR	30.975	33.976
Loans in CHF	26.829	28.736
Loans in JPY	8.691	9.550
Next year's mortgages	(132.463)	(128.046)
Long term liabilities at 31.12	1.385.540	1.484.459

Notes cont.

19. INTEREST BEARING LIABILITIES, CONT.

Payments on long-term liabilities at year end are specified as follows over the coming years:

	2014	2013
Year 2014		128.046
Year 2015	132.463	131.817
Year 2016	136.014	135.164
Year 2017	140.011	137.450
Year 2018	144.248	141.941
Year 2019	148.739	146.701
Later	816.528	791.386
Total long-term liabilities	1.518.003	1.612.505

20. RELATED PARTIES

The Groups related parties is the State and companies and institution that are part of the State, Board of Directors, key management and their close family members. The Group has transactions with its related parties on an arm‘s length basis.

21. GROUP ENTITIES

Subsidiaries:	Ownership interest	
	2014	2013
Samskipti ehf.	100%	100%
Trönur ehf.	100%	100%
Frakt flutningsmiðlun ehf.	62,5%	62,5%
ePóstur ehf.	100%	100%
Gagnageymslan ehf.	100%	-

At end of June the Company acquired all shares in Gagnageymslan ehf. The operation of Gagnageymslan includes a lease of data storage rooms in Reykjavik. Gagnageymslan ehf. is included in the consolidated financial statements from 30 June 2014.

22. REVENUES AND EXPENSES BY OPERATING SEGMENTS

Regulation 313/2005 includes requirements on accounting and financial separation of postal operators. The regulation includes provisions on implementation of such separation and on disclosure requirements to the Post and Telecom Administration (PTA).

Until the year 2012 information on revenue and expenses by operating segments was disclosed in the financial statements. The separation is based on the regulation. In ruling 18/2013 made by the PTA the accounting separation and cost accounting was assessed. Their main conclusion was that cost accounting and separation was in all material respect in line with the requirements of the Postal Services Act no 19/2002 and regulation 313/2005. It was also the opinion of PTA that certain improvements regarding assumptions used and application needed improvement.

In accordance to the conclusion of PTA, Íslandspóstur has completed necessary improvements on the cost accounting applied and the results are being reviewd by the PTA.

Notes cont.

23. ADDITIONAL INFORMATION

The Icelandic Government has the exclusive rights to distribute letters up to 50 grams but has entrusted Íslandspóstur to execute these rights. Associated with these rights is the universal service obligation which ensures all citizens equal access to certain aspects of the postal service with specific quality and at affordable prices. The universal service obligation of Íslandspóstur requires the company to distribute shipments up to 20 kilograms. The service obligation requires the Company to provide certain types of services that are not profitable but revenue from the exclusive rights is intended to compensate for those losses.

Over the past years the volume of letters within the exclusive right has decreased significantly. This development is expected to continue in coming years. This decrease in revenue from letters within the exclusive right has resulted in the revenue not being sufficient to cover the cost that relates to the universal service obligation and therefore the Company’s operating result has not been satisfactory. The Company’s financial position is still strong with an equity ratio of 47% at year end. The Company’s cash and cash equivalents at year end was however only ISK 87 million which is inadequate and management expects that further borrowing of funds will be needed to enable the Company to provide its service obligations and meet commitments.

Management is of the opinion that it is of the upmost importance that the Company can under these exceptional circumstances react quickly to new market conditions. In recent years it has become evident that the current process regarding pricing has significantly limited the Company’s abilities to increase efficiency. The universal service obligation also limits possibilities to streamline the Company’s operation. Management believes that the process for price changes and other necessary actions needed to improve operating results needs to be accelerated to enable the Company to react timely and appropriately to changes.

24. KEY RATIOS

The Company's key ratios are as follows:	2014	2013
Current ratio - current assets / short term liabilities	1,28	1,53
Equity ratio - equity / total capital	0,47	0,49
Internal value of share capital - equity / share capital	1,59	1,63
EBITDA ratio on total earnings	6,6%	5,1%
EBIT ratio on total earnings	0,9%	0,0%
Return on equity	-1,8%	-4,8%

Notes cont.

Unaudited information

25. INTERIM FINANCIAL STATEMENTS

The Group's operation is divided as follow by quarters:

Year 2014	Q4	Q3	Q2	Q1	Total
Postal services	1.850.248	1.493.093	1.454.561	1.439.473	6.237.375
Other revenues	311.714	300.890	189.582	238.939	1.041.125
	2.161.962	1.793.983	1.644.143	1.678.412	7.278.500
Salaries and salary related expenses	1.149.789	944.150	948.623	951.967	3.994.529
Direct cost of postal distribution	401.184	377.432	366.979	392.674	1.538.269
Other operating cost	464.635	305.823	242.910	253.056	1.266.424
	2.015.608	1.627.405	1.558.512	1.597.697	6.799.222
EBITDA	146.354	166.578	85.631	80.715	479.278
Depreciation	(95.236)	(97.620)	(116.131)	(101.304)	(410.291)
EBIT	51.118	68.958	(30.500)	(20.589)	68.987
Financial expenses	(12.790)	(30.981)	(30.284)	(36.643)	(110.698)
Profit (loss) before income tax	38.328	37.977	(60.784)	(57.232)	(41.711)
Income tax	(6.077)	(9.181)	3.980	10.012	(1.266)
Profit (loss)	32.251	28.796	(56.804)	(47.220)	(42.977)

Year 2013	Q4	Q3	Q2	Q1	Total
Postal services	1.724.811	1.387.957	1.380.565	1.441.598	5.934.931
Other revenues	284.075	186.333	202.204	179.278	851.890
	2.008.886	1.574.290	1.582.769	1.620.876	6.786.821
Salaries and salary related expenses	1.051.630	856.730	937.589	905.463	3.751.412
Direct cost of postal distribution	453.432	384.404	377.144	392.130	1.607.110
Other operating cost	341.777	244.342	259.360	233.301	1.078.780
	1.846.839	1.485.476	1.574.093	1.530.894	6.437.302
EBITDA	162.047	88.814	8.676	89.982	349.519
Depreciation	(75.749)	(92.336)	(90.408)	(91.369)	(349.862)
EBIT	86.298	(3.522)	(81.732)	(1.387)	(343)
Financial expenses	(44.069)	(25.516)	(22.268)	(49.680)	(141.533)
Profit (loss) before income tax	42.229	(29.038)	(104.000)	(51.067)	(141.876)
Income tax	1.410	28	16.178	5.484	23.100
Profit (loss)	43.639	(29.010)	(87.822)	(45.583)	(118.776)

Hönnun og umbrot: Markaðsdeild Íslandspósts / Elías Jóhann Jónsson
Prentun: Ísafoldarprentsmiðja umhverfisvottuð
Ljósmyndir: Hörður Ásbjörnsson og Torfi Agnarsson